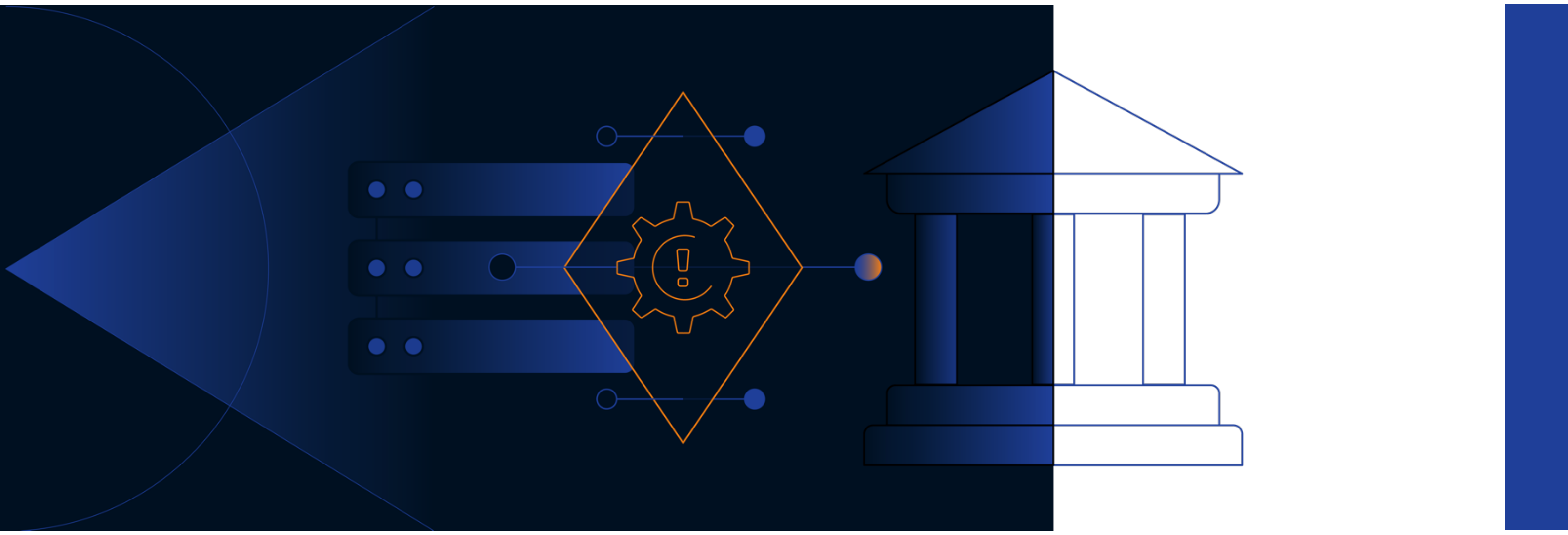
How leveraging data leads to more effective risk management in correspondent banking



One of the major challenges faced by financial institutions with extensive correspondent banking relationships is managing the financial crime risks they are exposed to through their networks.

Among the approaches used by banks to manage these risks is 'de-risking': terminating or restricting their business relationships with categories of clients and in some cases whole markets. De-risking can severely affect access to financial markets and has a wide range of societal costs such as the impact on remittances.

Paradoxically, de-risking often simply reallocates risks to less transparent channels, be they overburdened local banks or the informal market.[1]

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This case study shows how the quantification of financial crime risk allows for a more nuanced and productive approach to the management of correspondent banking relationships.

[1] https://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector

Baseline situation

Bank A operates in Eastern and Central Europe, providing smaller banks in the region with services including access to currency from European and American clearance markets. Bank A's correspondent banking activity links various regions with different legal standards and regulatory frameworks, some of which are considered high risk.

Commercial relations with US institutions supplying Bank A with US dollars were positive, however, Bank A’s upstream banks perceived Bank A’s markets as being of high risk.

Bank A’s approach to due diligence and sanctions screening processes was manual, which was not producing satisfactory results, in addition to being labour intensive and largely subjective. When combined with rapidly changing regulatory details and restrictions (EU AML directives, evolving sanction regimes), and the increasing risk of enforcement and fines by key regulatory bodies across the industry, the result was that Bank A was under pressure to improve its compliance framework.

Solution: Regular quantification of financial crime risk via the Elucidate Financial Crime Index (EFI)

Bank A started using the Elucidate Financial Crime Index (EFI) to strengthen their approach to financial crime risk. The EFI leverages a bank’s own data combined with publicly available sources and Elucidate’s proprietary dataset to generate a monthly overall financial crime risk score, in addition to scores and reports across nine financial crime risk themes.

Elucidate deployed a two-fold solution within Bank A. First, data was leveraged through the EFI platform to automate Bank A’s client risk assessment and enhance due diligence. Second, Bank A can visualize their data and increase transparency in their correspondent network.

Benefits to this solution have included:

- The EFI was deployed in Bank A within 10 to 12 weeks, replacing a multi-annual project to create a risk management framework. The automation of labour-intensive and subjective analysis of counterparty risk gives Bank A’s managers more time to focus on managing substantiated risk. Regular monthly assessments allow Bank A to take a risk-based approach to due diligence.

- Bank A assessed the added value of the EFI tool in a joint exercise between first and second lines of defense. This illustrates how the introduction of a new approach to data through the EFI helps implement better risk management. Delivering an objective scoring mechanism also helped increase internal alignment between Bank A's functions, in particular business and compliance. Pressures generated by financial crime risk are better balanced with client and commercial needs.

- Applying the EFI enables Bank A to manage risk appetite by providing portfolio assessments and further insight on nesting activity, potential sanctions violation and transaction exposure. This is achieved without additional workload or costs for Bank A's respondent partners.

- The EFI produces an in-depth report for Bank A, setting KPIs and providing information about governance policy, geographic footprint, customer portfolio, and organisational reputation. These reports facilitate long-term analysis and decision-making, and are used at Bank A board level.

- Respondent banks for which there were existing concerns about financial crime risk were requested by Bank A to also implement the EFI.

Applying a data-driven process has facilitated discussions about expectations in terms of remedial action, with de-risking being avoided. For banks in the network, quantifying financial crime risk has led to internal improvement in risk management processes. In addition, it has led to partner banks having a shared framework to discuss areas for improvement and establish baselines.

Next steps

Bank A has not yet fully exploited the potential of scoring financial crime risk, for example it could be using scores for price risk externally by implementing differential pricing for counterparties based on risk tolerance.

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The EFI allows banks to score their financial crime risk against a standard benchmark. It draws on the bank's own data, and complements them with publicly available sources, and Elucidate's proprietary data. On a monthly basis, EFI platform users receive an automated report with their updated overall financial crime risk score, scores for each of nine risk themes, and underlying findings and key risk indicators.

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