

# PROS & CONS OF CORRESPONDENT BANKING

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Banking transactions require connection between different banks, due to the nature of this business. When a bank needs to provide or use banking services in another country, they may engage a correspondent bank in that jurisdiction to work on their behalf. As most jurisdictions require overseas banks to open a branch if they want to operate within its borders. Doing this can be costly, especially if the bank does little business in that country.

Correspondent banks are authorized by their regulator (central banks) to carry out the services and charge fees. There are advantageous to engage a local bank, to do your banking, because they have better access to capital markets and this enables the sourcing of loans and other financial instruments. They also, have better understanding of local laws and relationships as required.

Services carried by correspondent banks are cross-border business transactions that require foreign exchange, to enable customers to purchase stock or equipment from an overseas supplier. Such banks can also facilitate wire transfers of cash for banks and their customers and handle straightforward currency exchanges. They can even take and hold deposits for overseas customers of a bank with which they have corresponding arrangements. This activity, is an essential component of the global payment system, because it helps in keeping the wheels of cross-border business in motion. This is highly required for banking business transactions.

Normally, correspondent banks hold “nostro” accounts into which they will accept foreign currency from a respondent lender, and a “vostro” account in which they will hold funds for their foreign counterpart. Transfers and payments are usually conducted using the SWIFT network. Correspondent

banks can also provide services as an agent for a respondent bank's customer that has an office or residence in their country.

Irrespective of the importance of correspondent banking, however there is dark side, as they can give rise to various risks. They may have no pre-existing relationships with parties with which the respondent transacts, making them vulnerable to corruption and money laundering. Without visibility into the governance of a respondent bank's clients for whom it does business, correspondent banks are prone to abuse. The repercussions can be severe and include large regulatory or criminal, sanctions, reputational and financial damage. There are many big litigation cases before Courts.

You must undertake a due diligence assessment prior to entering into a correspondent banking relationship and conduct ongoing due diligence assessments throughout the period of the relationship.

The correspondent bank often has no direct relationship with the underlying parties to a transaction and is therefore not able to verify their identities. When these services are offered to a respondent that is itself a downstream correspondent clearer, you should use a risk-based approach, take reasonable steps to understand the types and risks of financial institutions to whom the respondent offers such services, take special care to ensure there are no shell bank customers, and consider the degree to which the respondent examines the legal controls of those transactions. By all means, more care is required.