

Correspondent Banking, Prescribed Transaction Reporting and Transaction Monitoring Survey.

AML/CFT Supervision

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Executive summary

Following the allegations made by the Australian Transaction Reports and Analysis Centre (AUSTRAC) against Westpac Banking Corporation ('WESTPAC Australia') in November 2019, the Reserve Bank of New Zealand ('Reserve Bank') – Te Pūtea Matua issued a survey in March 2020 to all New Zealand registered banks¹. The purpose of the survey was to understand the extent the systemic failings may be present within the banking sector in New Zealand. The majority of survey responses submitted by registered banks were comprehensive and provided a detailed account of their relevant procedures and controls. Based on the responses, all registered banks surveyed appear to have adequate processes and controls² in relation to correspondent banking due diligence, prescribed transaction reporting and transaction monitoring regarding potential child exploitation.

A key focus of the survey was to firstly determine if and to what extent registered banks provided international payment services to customers (including correspondent banks) outside of the SWIFT international payment network. This was considered one of the causal factors behind the transactions WESTPAC Australia failed to report. We also sought to ascertain whether such transactions were being captured for prescribed transaction reporting purposes. A small number of banks acknowledged that they do provide international payment services outside of the traditional SWIFT network. However, it was evident that all registered banks who provided this type of service do so within their prescribed transaction reporting solutions.

Some registered banks also acknowledged the existence of other alternative international payment services outside of SWIFT, including cross-border transactions between credit card holders. This is a new and emerging technology and it is unclear if this type of transaction would constitute an international wire transfer as defined under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('AML/CFT Act'). We recommend that this is considered further and clarified in the context of the upcoming statutory review of the AML/CFT Act.

In relation to detecting transactions involving potential child exploitation, such as low value transactions to countries in South East Asia, all of the major retail banks have implemented some type of monitoring scenario to detect this type of activity. These banks have all submitted suspicious activity reports to the New Zealand Police Financial Intelligence Unit ('New Zealand Police FIU') where potential child exploitation was suspected. Wholesale and institutional type banks have not implemented this type of transaction monitoring scenario. However, this was expected because their customer bases are corporate and institutional customers and not individuals.

In relation to correspondent banking, money laundering and terrorism financing risk is fairly concentrated. Only 13 registered banks have established correspondent banking relationships. This is further limited by some registered banks only allowing relationships to be established with other banks or branches within their wider banking group. For those registered banks that established correspondent banking relationships, initial money laundering and terrorism financing risk assessments are completed prior to establishment of the relationship and various checks or due diligence is conducted. Ongoing due diligence is also conducted on a risk basis.

Some banks do allow nested accounts via correspondent banking relationships. This practice is fairly common, and presents an inherently higher level of money laundering and terrorism financing risk. However, the banks that did allow nested accounts had additional controls in place and applied adequate enhanced due diligence measures. Two banks indicated they did not prohibit a correspondent bank having a relationship with a high risk or 'sanctioned' country, however, both appeared to have additional controls to ensure adequate compliance.

¹ Two New Zealand registered banks Westpac New Zealand Limited and Westpac Banking Corporation (New Zealand branch) were not included in the survey due to the decision made to assess their AML/CFT systems through to a face-to-face on-site inspection which was already scheduled for them later in the year.

² This survey did not assess the effectiveness of registered banks' processes and controls. Rather, this is covered via our regular on-site inspections of reporting entities.

Background and Purpose

Background

On 20 November 2019, AUSTRAC applied to the Federal Court of Australia for civil penalty orders against WESTPAC Australia.³ The civil penalty orders related to serious and systemic non-compliance with Australia's Anti-Money Laundering and Counter-Terrorism Financing Act 2006.

The alleged serious and systemic failings included three main areas:⁴

- Failure to report 19.5 million international funds transfer instructions to AUSTRAC;
- Failure to appropriately assess and monitor the ongoing money laundering and terrorism financing risks associated with correspondent banking relationships and with the movement of money into and out of Australia; and
- Failure to carry out appropriate due diligence on customers sending money to the Philippines and South East Asia – jurisdictions known for child exploitation risks.

Purpose

In March 2020, the Reserve Bank's AML/CFT Supervision team issued a survey to all New Zealand registered banks with the exception of Westpac New Zealand Limited and Westpac Banking Corporation (New Zealand branch). These two registered banks were assessed separately as part of a scheduled statutory on-site inspection by the Reserve Bank's AML/CFT Supervision team.

The purpose of the survey was to assess the extent to which the allegations made by AUSTRAC against WESTPAC Australia, may or may not be present within the banking sector in New Zealand. The survey included questions regarding registered banks' policies, procedures and controls in relation to the following:

- Correspondent banking relationships;
- Prescribed Transaction Reporting ('PTR'); and
- Transaction monitoring scenarios to detect potential child exploitation.

Please refer to '**Appendix A**' for the survey questions and '**Appendix B**' for the list of New Zealand registered banks who completed the survey.

Survey preparation and analysis was completed by the following members of the Reserve Bank's AML/CFT Supervision team; Damian Henry (Adviser) and Sigita Wilson (Senior Analyst).

³ <https://www.austrac.gov.au/about-us/media-release/civil-penalty-orders-against-westpac>

⁴ <https://www.austrac.gov.au/sites/default/files/2019-11/20191120%20Westpac%20Concise%20Statement%20FILED%2019008953.pdf>

Key findings

Correspondent banking

Thirteen out of 24 registered banks have a correspondent banking relationship with a respondent financial institution⁵. However, six of the 13 have limited their money laundering and terrorism financing exposure via correspondent banking by only establishing relationships with other banks or branches within their related group of companies.

For those registered banks that established correspondent banking relationships, initial money laundering and terrorism financing risk assessments are completed prior to establishment. Common checks and procedures conducted include the following:

- Completion of a Wolfsberg questionnaire⁶;
- Approval of the relationship by senior management and/or relevant Committee;
- Checks to confirm a relationship is not being established with a shell bank;
- Checks to understand the ownership and control structure of the correspondent bank;
- Adverse media searches;
- Checks to determine if any regulatory or enforcement action has been taken against the correspondent bank;
- A relationship manager is assigned to the correspondent banking relationship; and
- Physical on-site visit of the correspondent bank.

Some banks that did not directly establish correspondent banking relationships did facilitate international wire transfers for their customers via other New Zealand registered banks or third party providers.

Five registered banks allowed nested accounts or downstream activity on an exemption basis. However, additional controls and sign-offs were implemented where this type of activity was permitted.

All respondents indicated ongoing correspondent banking due diligence was conducted and a risk based approach was adopted (i.e. higher risk relationships were reviewed more regularly than lower risk relationships). A common response was that high risk correspondent banking relationships were reviewed on an annual basis which we consider adequate.

A number of Australian subsidiary banks placed reliance on their parent bank to conduct the relevant correspondent banking due diligence, including ongoing correspondent banking due diligence.

Two registered banks indicated they did not prohibit a correspondent bank having a relationship with a high risk or 'sanctioned' country.⁷ However, both banks performed ongoing enhanced due diligence and had additional controls in place which appeared to be adequate. In particular, both banks ensured their activity was ring-fenced from those high-risk and 'sanctioned' countries.

⁵ Correspondent banking relationships are defined in [Section 29 of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009](#)

⁶ Society for Worldwide Interbank Financial Telecommunications. It provides a network that enables financial institutions around the world to send and receive information about financial transactions in a secure and standardised format. See: <https://www.wolfsberg-principles.com/wolfsbergcb>

⁷ The rules covering sanctions are complex, broad and constantly changing. Sanctions are not always imposed on an entire country, they can also be imposed on companies, organisations and individuals. The potential risk with not prohibiting a correspondent bank having a relationship with a high risk or 'sanctioned' country is that, should a New Zealand registered bank have no or inadequate controls in place, this high risk or 'sanctioned' country may be able to access the New Zealand payment system through these nested arrangements, unbeknown to the bank.

Prescribed transaction reporting

Five registered banks offer a type of international payment service platform for customers (including correspondent banks) that is outside of the traditional SWIFT network. However, relevant prescribed transactions conducted via these services were still reported to the New Zealand Police FIU.

For those services offered outside of the SWIFT network, all registered banks conducted some form of monitoring and assurance across PTR controls (e.g. reconciliation reports).

Two registered banks acknowledged the existence of further alternative international payment services outside of SWIFT, including cross-border transactions between credit card holders. It was unclear if this type of transaction would constitute an international wire transfer as defined under the AML/CFT Act, specifically due to the exclusion of credit and debit card transactions. We recommend that this is considered further and clarified as part of the upcoming statutory review of the AML/CFT Act to determine if PTRs should be required.

Seven registered banks did not conduct cash transactions and therefore only had PTR obligations relating to international wire transfers.

Transaction monitoring

Sixteen registered banks appeared to have adequate transaction monitoring controls in place to detect suspicious transactions that might involve potential child exploitation. These included one or, a combination of manual controls; a related detection scenario; or a specific transaction monitoring scenario to detect potential child exploitation activity.

There were 11 registered banks which did not have a control or transaction monitoring scenario to detect potential child exploitation activity. However, seven of the 11 registered banks had customer bases that were restricted to corporate and institutional type customers and not individuals. Therefore, the typology of low value payments by individuals was not applicable to these banks.

Of the remaining four registered banks, two banks did not have any correspondent banking relationships in the relevant high risk countries. The third bank only conducted international payments to remit funds from customers to overseas family members. The remaining bank had some relevant transaction monitoring in place and was in the process of developing a specific transaction monitoring scenario which was subsequently implemented in mid-2020.

The majority of registered banks (six of 11) that had implemented a transaction monitoring scenario to detect potential child exploitation activity also submitted suspicious activity reports in the 12 months preceding the survey being issued. The effectiveness of transaction monitoring and suspicious activity reporting is assessed during the Reserve Bank on-site inspections.

One bank had contacted the New Zealand Police's Online Child Exploitation team for guidance and insights. Some registered banks also referenced the guidance issued by AUSTRAC in relation to child exploitation risks.

Conclusion

Based on the survey responses provided, the vast majority of registered banks appear to have adequate processes and controls in relation to correspondent banking due diligence, PTR and transaction monitoring regarding potential child exploitation. However, an assessment of the effectiveness of these procedures and controls could not be determined from the survey and going forward this will be covered as part of the Reserve Bank on-site inspection programme.

A number of registered banks provide international payment services outside of the traditional SWIFT network. However, it was reassuring that those banks had included the international payment services within the scope of their PTR obligations and some level of assurance activities were conducted across these services.

By the end of 2020 all registered banks, appeared to have adequate controls relating to detecting and reporting potential child exploitation through the suspicious activity reporting channel.

For those banks that establish correspondent banking relationships, their procedures and controls appeared to be adequate, including initial risk assessments and the various checks completed before establishing each relationship.

The Reserve Bank has drawn the conclusion based on the survey responses provided in March 2020 and further follow-up enquiries that the failures exhibited by WESTPAC Australia do not appear to be present within the surveyed banks.

Next steps

As part of the statutory review of the AML/CFT Act in 2021, the Reserve Bank will submit a request to consider alternative international payment services outside of SWIFT, including cross-border transactions between credit card holders. This will help to determine if this type of transaction should be covered by PTR and whether changes are needed to the AML/CFT Act to make this clear.

Verification of survey responses and work to assess the effectiveness of relevant processes and controls is still required. This assessment will be conducted via the Reserve Bank's AML/CFT on-site inspection programme with registered banks.

Glossary

AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism.
AML/CFT Act	New Zealand's Anti-Money Laundering and Countering the Financing of Terrorism Act 2009.
AML/CFT Supervisors	There are three AML/CFT supervisors in New Zealand, the Reserve Bank of New Zealand, the Financial Markets Authority and the Department of Internal Affairs.
AUSTRAC	Australian Transaction Reports and Analysis Centre. AUSTRAC is the Australian Government agency responsible for detecting, deterring and disrupting criminal abuse of the financial system to protect the community from serious and organised crime. It operates as both the AML/CFT supervisor of reporting entities and as the FIU.
New Zealand Police FIU	Financial Intelligence Unit. This Unit is part of the New Zealand Police and receives and analyses both suspicious activity reports and prescribed transaction reports submitted by reporting entities.
Nesting or nested accounts	Refers to the use of a bank's correspondent relationship by a number of respondent banks through their relationships with the bank's direct respondent bank to conduct transactions and obtain access to other financial services.
Prescribed transaction	<p>A prescribed transaction includes an international wire of NZ\$1,000 or more, or a cash transaction of NZ\$10,000 or more. A reporting entity is required to report all prescribed transactions to the Commissioner of Police as soon as practicable, but no later than 10 working days after the transaction was conducted. The compliance date for large reporting entities was 1 July 2018.</p> <p>This is New Zealand's equivalent to Australia's Threshold Transaction Report or TTR.</p>
SWIFT	Society for Worldwide Interbank Financial Telecommunications. It provides a network that enables financial institutions around the world to send and receive information about financial transactions in a secure and standardised format.
Wolfsberg questionnaire	The Wolfsberg Questionnaire is issued by the Wolfsberg Group which is an association of thirteen global banks. It aims to develop frameworks and guidance for the management of financial crime risks, particularly with respect to Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies. The Wolfsberg questionnaire is used globally by banks when establishing and maintaining correspondent banking relationships.

Appendix A – Survey questions

Correspondent banking relationships and payments services

1. Does the reporting entity have a correspondent banking relationship with a respondent financial institution, as per section 29 of the AML/CFT Act 2009?
2. What type of services does the reporting entity provide to those correspondent banks?
3. Please describe what risk management and monitoring compliance activities are undertaken to give the reporting entity comfort that these correspondent banking services are sound.
4. Has the reporting entity's overall strategy and risk appetite in relation to correspondent banking changed since the allegations against Westpac Banking Corporation?
5. Please describe what type of due diligence and key controls the reporting entity currently have in place when establishing a new correspondent banking relationship.
6. Please describe what type of ongoing customer due diligence and oversight the reporting entity currently has in place for correspondent banking relationships, including the products and customer base, the types of transactions carried out as part of those relationships and any changes to the relationships.
7. Does the reporting entity offer any low cost international payment service to customers (including correspondent banks) outside of the SWIFT network? If "Yes", please name countries the low cost international payment service platform/s facilitate transactions to.
8. Does the reporting entity offer any off-system payment (virtual account) arrangements to correspondent banks? This payment service allows the correspondent banks to open an account with the reporting entity through which offshore and domestic customers operate virtual accounts. This enables the correspondent bank to process payments through the New Zealand payments system relying on the reporting entity's infrastructure.
9. Does the reporting entity prohibit business relationships with another financial institution with nested correspondent relationships?
10. Does the reporting entity prohibit business relationships with another financial institution with payable-through accounts?
11. Does the reporting entity prohibit business relationships with another correspondent bank having relationships with sanctioned countries?

Prescribed transaction reporting

- 12.** Does the reporting entity report certain prescribed transactions to the Commissioner (as defined in section 48 in the AML/CFT Act)? International Funds Transfers (IFTs) over the prescribed threshold Large Cash Transactions (LCTs) over the prescribed threshold.
- 13.** Does the reporting entity's prescribed transaction reporting include both inward and outward IFTs over the prescribed threshold?
- 14.** If the reporting entity conducts or receives IFTs outside of the SWIFT network e.g. a low cost international payment service platform does the reporting entity report all these IFTs over the prescribed threshold? If "Yes", please describe monitoring and managing compliance controls in this regard.

Transaction monitoring detection scenarios

- 15.** Does the reporting entity have controls (preventative or detective) in place to cover the 12 key vulnerabilities that are listed in RBNZ's Sector Risk Assessment (2017)? If "Yes", how does the reporting entity ensure the adequacy and effectiveness of the set controls?
- 16.** Does the reporting entity's transaction monitoring specifically cover detection scenarios related to potential child exploitation risks? If "Yes", when were the scenarios first implemented and last updated? If "No", please explain why not.
- 17.** Please describe the process the RE has in place for processing of alerts triggered from scenarios related to potential child exploitation risks, including timeframes and rationales for escalation and closure of alerts.
- 18.** Has the reporting entity ever submitted a suspicious activity report in relation to potential child exploitation? If "Yes", how many suspicious activity reports were filed in the last 12 months?

Appendix B – Survey participants

1. ANZ Bank New Zealand Limited
2. ASB Bank Limited
3. Australia and New Zealand Banking Group Limited (B)
4. Bank of Baroda (New Zealand) Limited
5. Bank of China Limited (B)
6. Bank of China (New Zealand) Limited
7. Bank of India (New Zealand) Limited
8. Bank of New Zealand
9. China Construction Bank Corporation (B)
10. China Construction Bank (New Zealand) Limited
11. Citibank NA (B)
12. Commonwealth Bank of Australia (B)
13. Heartland Bank Limited
14. Industrial and Commercial Bank of China (New Zealand) Limited
15. JP Morgan Chase Bank N A (B)
16. Kiwibank Limited
17. Kookmin Bank (B)
18. MUFG Bank, Ltd (B)
19. Cooperatieve Rabobank U.A. trading as Rabobank Nederland (B)
20. Rabobank New Zealand Limited
21. Southland Building Society
22. The Co-operative Bank Limited
23. The Hongkong and Shanghai Banking Corporation Limited (B)
24. TSB Bank Limited

Banks marked (B) operate in New Zealand as branches of overseas-incorporated banks. All other banks are incorporated in New Zealand.

Note: Industrial and Commercial Bank of China Limited (B) became a registered bank in New Zealand on 18 May 2020 and was not a registered bank at the time the survey was issued.