

CPMI Secretariat
Bank for International Settlements
Centralbahnplatz
4002 Basel
Switzerland

Submitted via email to cpmi@bis.org

London, December 7th 2015

Consultative Report on *Correspondent Banking*

Dear Sirs,

Markit is pleased to submit the following comments to CPMI in response to its Consultative Report on *Correspondent Banking* (the “**Consultative Report**”).

Markit¹ is a leading global diversified provider of financial information services.² Founded in 2003, we employ over 4,000 people in 11 countries and our shares are listed on Nasdaq (ticker: MRKT). Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 130 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Introduction

Markit Counterparty Manager³ (“**MCPM**”) was set up as an online document repository to create a secure environment for trading counterparties to manage and share relevant documentation and make regulatory representations.⁴ The platform has since onboarded a large number of firms⁵ that maintain a range of relevant documents on the platform and permission their trading partners to view them.

Our experience in operating MCPM showed that, in the absence of KYC standards, the data available on the platform was often insufficient on its own to rely upon for the purposes of KYC compliance. In 2013, Markit therefore partnered with Genpact⁶ and worked with several design partner banks to agree a common standard and global framework for KYC data and document management for certain firm types, initially focussed on the US and UK.⁷ After a year of discussions and workshops with the design partners, the final standards agreed

¹ See www.markit.com for more details.

² We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants' compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

³ Initially called Markit Document Exchange.

⁴ Such as the ISDA Cross-Border Swaps representation Letter and the EMIR counterparty classification.

⁵ Specifically, MCPM is currently used by more than 6,000 corporate clients, more than 900 buy-side firms and over 80 dealers.

⁶ See www.genpact.com for more details.

⁷ For AML/CFT compliance in the US and the UK.

were adopted by the Markit / Genpact Know Your Customer (KYC) Service ("**kyc.com**")⁸ when it launched in 2014. Subsequent to this several additional design partner banks have agreed to the policy and joined the service.

In our discussions with firms we often find that the processes that they have established to conduct customer due diligence to comply with their KYC/AML obligations are inefficient, non-standardised and time consuming. Today, kyc.com is widely recognised by financial market participants and corporates⁹ for providing standardised and repeatable processes designed to facilitate client onboarding. Our centralised platform helps our subscribers to upload, disseminate and maintain over 200 types of documents across 45 categories, thus assisting firms ("subscribers") in performing due diligence on their customers ("contributors") to facilitate their compliance with KYC/AML requirements effectively and efficiently. By removing the need to perform duplicative, non-standardised processes the service significantly lowers the compliance costs incurred by individual firms and their clients, while also allowing them to more quickly establish new counterparty relationships. Kyc.com forms part of a suite of Markit's services that help market participants to perform due diligence on parties they transact with, including also third party vendors¹⁰ and trading algorithms.¹¹

Markit welcomes the publication of CPMI's Consultative Report as well as the FSB's initiative¹² to address certain issues related to correspondent banking. The Consultative Report suggested a number of solutions to counter the general decline in correspondent banking activity, including measures to strengthen "the tools for due diligence by correspondent banks"¹³ central to which are "KYC utilities to assist in the identification of banks". It also endorsed the role that KYC Utilities play in facilitating due diligence as "an essential element of banking, including correspondent banking" while stating that "the implementation of KYC Utilities is a positive development".¹⁴ We appreciate that the FSB and CPMI recognise the importance of KYC Utilities in this context and we welcome their comments that, to leverage some of the capabilities of KYC Utilities in resolving the aforementioned issues, "authorities may wish to promote the use of KYC utilities".¹⁵

Comments

CPMI surveyed the landscape of third party vendors that provide KYC compliance services ("**KYC Utilities**").¹⁶ It is worth highlighting that the services of the KYC Utilities mentioned in the Consultative Report are targeted at different user groups and/or address different aspects of customer due diligence. Furthermore, firms' KYC due diligence obligations apply not just in the context of correspondent banking, but also on all firms with which they intend to establish direct relationships.¹⁷ Given the breadth of required KYC due diligence obligations some KYC Utilities have specialized in certain market segments,¹⁸ with many large firms that are active in several of these market segments employing the service of multiple KYC Utilities.

⁸ See www.kyc.com for more details.

⁹ As of today, ten of the largest global banks have signed up for the service or are in the process of contractual negotiations and more than 1,400 buy-side and corporate clients are on the platform.

¹⁰ Markit's Know your third party (KY3P) service is a centralised, cloud-based data hub that standardises third party risk management processes focusing on vendor due diligence and ongoing monitoring.

¹¹ Markit's Counterparty Manager provides an electronic questionnaire designed by industry associations to help buy-side firms and brokers comply with due diligence requirements around electronic trading.

¹² In addition to the CPMI consultative report on Correspondent Banking, the FSB in its report refers to efforts made by Basel Committee for Banking supervision (BCBS), Financial Action Task Force (FATF), International Monetary Fund (IMF), Legal Entity Identifier Regulatory Oversight Committee (LEI ROC) and World Bank to address the issues faced by correspondent banking.

¹³ The FSB proposed a 4-point action plan that includes "Strengthening tools for due diligence by correspondent banks". See Pg. 2 of the FSB report: <http://www.financialstabilityboard.org/wp-content/uploads/Correspondent-banking-report-to-G20-Summit.pdf>

¹⁴ See CR, Pg. 11

¹⁵ See CR, Pg. 12

¹⁶ CPMI states that "several providers have developed or are developing KYC utilities, with the aim of storing in a single repository relevant due diligence information".

¹⁷ These include asset managers, hedge funds, corporates and natural persons.

¹⁸ For example, the Markit-Genpact KYC service focusses mainly on providing banks with the tools to perform due diligence on their trading customers such as asset managers and corporates. In contrast, SWIFT's KYC registry focuses on facilitating due diligence for correspondent banking relationships.

Please find below our comments in relation to CPMI's recommendations for KYC Utilities, a list of factors that, we believe, might currently prevent their broader adoption, and our recommendations on how those hurdles could be addressed. Specifically, we recommend that CPMI:

1. Encourage the greater use of KYC Utilities while also recognizing their broader relevance
2. Agree commitments with banks to empower them to require their clients to provide the relevant documentation to the chosen KYC Utilities in a timely manner;
3. Provide a safe harbour for data privacy requirements when firms and contributors provide personal information to KYC Utilities;
4. Leave it to firms to ensure that KYC Utilities they use operate to certain operational standards;
5. Not impose any changes to distribution of liabilities between KYC Utilities and firms but let these be set through their contractual/commercial agreements;
6. Not attempt to set a standard for common data fields across jurisdictions and entities but rather establish some general standards including the frequency of updates and the reflection of corporate actions; and
7. Encourage the broader use of LEIs.

1. Encouraging greater use of KYC Utilities while recognizing their broader relevance

CPMI lists a number of advantages that accrue to banks using the services of KYC Utilities. Specifically, it highlights that "(i) the number of times a bank must send the same information could be greatly reduced; (ii) the accuracy and consistency of the information could improve, as banks would only maintain one set of updated information; (iii) the use of a single template might promote the standardisation of the information that banks provide to other institutions as a starting point for KYC obligations; (iv) the use of a central KYC utility might speed up the process; and (v) costs could be reduced thanks to a lesser amount of documentation being exchanged".¹⁹

We agree with CPMI's analysis of the benefits that banks reap from using KYC Utilities and believe that there is significant potential to be unlocked for all types of financial institutions if they were to increase their use of and reliance on them.

We note that the Consultative Report does not generally focus on the challenges correspondent banks face when performing due diligence on the respondent banks' clients, also referred to as Know Your Client's Client (or "**KYCC**"). However, CPMI should note that KYC Utilities are already facilitating KYCC due diligence in other market segments. Specifically, before the emergence of KYC Utilities, sellside firms with trading relationships with asset managers ("buyside firms"), found it challenging to gather sufficient documentation about the clients of those buyside firms.²⁰ To address such challenges, some firms made use of "reliance letters".²¹ While this was a pragmatic approach it resulted in creating a significant risk of sell side firms' non-compliance with their KYC obligations. KYC Utilities have since provided buyside firms with a central location for storage and maintenance of relevant documents which has in turn been perused by the permissioned sell side firms to perform the necessary KYCC checks.

2. Provision of KYC information by banks' clients / contributors

One of the most significant hurdles reducing the effectiveness and preventing the broad-based use of KYC Utilities are the difficulties they face in sourcing the relevant documentation from the banks' clients. Our experience has shown that even banks that are fully supportive of the use of KYC Utilities have only limited

¹⁹ See CR, Pg.12

²⁰ This is relevant in the context of sell side interaction with buyside clients who manage funds for investors.

²¹ A statement by the sellside firm that it would rely on the KYC checks being performed by the buyside firm on its clients.

ability to impose sufficient pressure on their clients to provide such documentation in a timely manner. As a consequence, both banks and KYC Utilities will often need to spend significant amounts of time and effort to remind banks' clients, which slows down the adoption of KYC Utilities in general.

We encourage CPMI to address this issue. Specifically, CPMI could consider employing an approach that has already been used by banking regulators to improve practices for confirmations and central clearing for OTC derivatives.²² Similar commitments in relation to AML/KYC could contain specific, agreed targets for banks in relation to the percentage of their relevant clients that have provided the relevant documentation to the chosen KYC Utility (or Utilities). In the event that clients have not furnished the required documentation to the relevant KYC Utility by an agreed date banks could decide to discontinue trading with them. We believe that such approach will empower banks to impose greater discipline on their clients, enabling them to increase their reliance on the services provided KYC Utilities sooner.

3. Data privacy laws

CPMI states that "The privacy laws of some jurisdictions may prohibit sharing, storing or mining of basic information in KYC utilities, such as other correspondent relationships and details of geographical areas served".²³

We agree with CPMI that, in many jurisdictions, data privacy laws represent a significant hurdle preventing the timely provision of data by contributors and consequently slowing down the broader adoption of KYC Utilities. This is because such data privacy laws can create a significant degree of uncertainty for firms and contributors about whether and under what conditions they can share documentation and data with KYC Utilities. We therefore urge CPMI to further investigate and consider taking steps to address issues related to data privacy. One possible approach would be for legislation and/or regulatory authorities to provide firms and contributors with a safe harbour pursuant to which they may provide non-public personal information (NPPI) solely to a KYC Utility for KYC purposes without needing to obtain individual client consent (or a consent of the relevant subject e.g. the director or officer). We believe that such approach could significantly speed up the sourcing of relevant documentation from contributors and firms and hence the broader adoption of KYC Utilities.

A further barrier to the broader adoption of KYC Utilities is firms' reluctance to share the names and the details of contacts at contributors because of perceived data privacy and confidentiality issues. This is crucial as it is these individual contacts that the Utilities will contact to obtain the relevant documents to complete the relevant KYC Profiles. If firms believe that they cannot share those contact details then KYC Utilities are either unable to obtain the requisite information or are required to spend a significant amount of time sourcing those details in the public domain. To alleviate this issue, again, one possible approach would be for legislation and/or regulatory authorities to provide firms with a safe harbour for providing client contact details to a KYC Utility for KYC purposes without needing to obtain individual client consent. An alternative would be to establish a legal requirement for a "KYC officer" to be designated at each contributor, which is a matter of public record, for KYC Utilities to contact.

4. Operational standards

CPMI states that, to allow banks to rely on KYC Utilities to a greater extent, it might be useful to establish "some form of independent standard to set out what systems and controls such utilities should have to ensure

²² The OTC derivatives regulators forum ("ODRF"), a body of national OTC derivatives regulators have previously co-operated to create standards that would enable the OTC derivatives markets to operate efficiently. For example, the ODRF created trade repository subgroups that would "develop expectations regarding the data that authorities would like to see registered in the respective repositories". See "Trade Repository Subgroups": <http://www.otcdrf.org/work/index.htm>. CPMI could consider proposing a similar subgroup of national KYC regulators that expect regulated firms to maintain data quality standards with their chosen KYC utilities.

²³ See CR, Pg.14

that the data they hold are accurate and to facilitate some sort of external accreditation process to test compliance with this standard”.²⁴

Our experience has shown that banks already demand, via their contractual agreements with KYC Utilities, consistent data quality and operational resiliency standards. To achieve these objectives the KYC Utilities are required to establish Service Level Agreements (“**SLAs**”) and to adhere to certain standards whilst, in addition, the firms themselves will perform extensive Quality Assurance on the data they receive. Also, some KYC Utilities are subject to regular external audits to assess the quality of their processes and systems.²⁵ We believe that such client-driven approach to setting operational standards for KYC Utilities is best suited to ensure that KYC Utilities maintain high standards for their operations. It will also help forge a competitive market place where banks will choose between competing KYC Utilities depending on the operational standards and data quality that they deliver.

5. Reliance on KYC Utilities and liabilities of the parties

CPMI states that the costs incurred by banks to perform KYC due diligence “could be further reduced if they were able to place more reliance on KYC utilities so that they could undertake fewer checks of the quality of data held in utilities”²⁶. At the same time, CPMI acknowledges that “Correspondent banks cannot simply delegate their responsibility as KYC utilities cannot perform due diligence on behalf of third parties and the ultimate responsibility always lies with the correspondent banks”.²⁷

We are generally supportive of CPMI’s intention to take steps that encourage broader adoption of KYC Utilities. However, we recommend CPMI carefully consider the following issues in the context of banks’ reliance on KYC Utilities and the liabilities borne by them:

- Most banks are only in the early stages of signing up to and actively using KYC Utilities²⁸ and, given the significant risks arising from potential non-compliance with their KYC obligations, it is natural for them to only progressively increase their reliance on them. In this context we regard banks’ quality assurance tests on the data they receive from KYC Utilities²⁹ simply as good business practice. We would expect banks’ willingness to rely on KYC Utilities to naturally increase over time as they become more comfortable with the reliability of the data that they receive.
- As regulators have previously highlighted,³⁰ customer due diligence should not merely be regarded as a “paper-gathering exercise” but as a real assessment of money laundering risk. Banks’ ability to rely on KYC Utilities is limited to ensuring that such utilities assist in gathering the requisite information to facilitate banks’ KYC due diligence on their clients, with the ultimate liability for properly performing risk-based assessments remaining with the banks. The delegation of banks’ KYC obligations to KYC Utilities will neither be possible nor desirable given the stringent legal AML/CFT frameworks that are in place in most countries placing the ultimate liability solely with the banks.³¹
- Standards of contractual liability have been successfully established between the banks and the KYC Utilities that service them. These impose contractual liabilities on the KYC Utilities in the event they fail to

²⁴ See CR, Pg.12

²⁵ CPMI should note that external auditors are already performing regular audits for certain KYC utilities. For example, KPMG conducts an annual audit of processes, controls and contractual obligations of the Markit/Genpact KYC service.

²⁶ See CR, Pg.12

²⁷ See CR, Pg.13

²⁸ For example, the Markit/Genpact KYC service was one of the first providers when it launched in May 2014.

²⁹ Banks using the Markit/Genpact KYC service currently perform Quality Assurance check on up to 100% of the data held in the utility.

³⁰ See BCBS consultative document on *Sound management of risks related to money laundering and financing of terrorism* (<http://www.bis.org/publ/bcbs252.pdf>)

³¹ Violations of AML/CFT requirements have led to enforcement actions on banks. See for example:

<http://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations>

deliver the service to the agreed standards. We believe that such liability frameworks fairly and effectively apportion risk and allow the firms to “rely” on the KYC Utilities; the frameworks have been widely accepted by all relevant stakeholders, including banking supervisors. We are concerned that CPMI’s suggestion of increasing reliance on KYC Utilities could be interpreted as encouraging or requiring changes to established liability agreements. Forcing such changes would be costly to implement and could even disrupt the provision of the service. It would almost certainly make the provision of KYC services more costly for banks and would hence be counterproductive to CPMI’s aims of *reducing* their compliance costs. In the extreme, the increased liabilities that KYC Utilities could be exposed to might even make the service prohibitively expensive or risky. We therefore urge CPMI to leave it to the industry to establish liability arrangements as part of their commercial agreements that they regard as appropriate and not require them to be designed in a certain manner.

We recommend that CPMI continue to encourage banks to employ the services of and increase their reliance on KYC Utilities. However, it should not take any specific action to effect a change in the division of responsibility (or liability) between banks and KYC Utilities.

6. Data standards

CPMI states that it might be beneficial if industry bodies³² were to “review the templates and procedures used by different utilities and identify the most appropriate data fields to compile a data set that all utilities should collect as best practice”.³³

We believe that it might be useful for CPMI to recommend some *general* standards in relation to the accuracy of the data that is provided by KYC Utilities. For example, CPMI might consider advising that KYC Utilities used by banks update the relevant documents and data fields on a regular basis while also reflecting corporate actions on an ad hoc basis.³⁴ In this context market participants might benefit from CPMI agreeing, in dialogue with relevant stakeholders, and recommending:

- A standard to determine the frequency of updates of the relevant KYC information. Specifically, an annual refresh seems to be a standard that has been adopted by some firms and regulators.³⁵
- A defined set of corporate action events that would trigger an update of the relevant KYC information. Such events could include, for example, changes in the hierarchy of the legal entity, its address, its ownership or its key controllers.

In contrast, we strongly believe that any attempt to agree on a specific standard set of datafields to be gathered and provided by KYC Utilities would not only be time consuming and costly but also provide little value. This is for the following reasons:

- Depending on the jurisdiction and the type of counterparty, different information and documentation is relevant for KYC checks.³⁶ Any standard dataset, to be relevant across jurisdictions and counterparties, would therefore be small leaving banks with a large number of “non-standard” datafields they would need to acquire bilaterally. This would reduce the role that KYC Utilities can play in this context contrary to CPMI’s stated objective.

³² For example the Wolfsberg Group.

³³ See CR, Pg.14

³⁴ Events such as stock splits, dividends, rights issues, mergers and acquisitions, spin offs that affects the securities of a firm is commonly referred to as corporate actions.

³⁵ See, for example, Ireland Criminal Justice Act 2013: “(c) measures to be taken to keep documents and information relating to the customers of that designated person up to date.”

³⁶ For example, KYC regulations in Hong Kong require authorised signatories to be identified in all cases while UK/US requirements do not.

- Forcing an agreement on a minimum data set that could be used across jurisdictions is likely to only be achievable if it was based on the lowest common denominator. As such it would result in lowering standards, contrary to CPMI's objectives.
- The various KYC Utilities cater to different market segments and users which are required to comply with different AML/KYC requirements.³⁷ To be effective, any attempt to agree on a standard of datafields would therefore result in creating a multitude of standards. However, given that only a few KYC utilities are active across market segments an agreed standard would only ever be relevant to a limited number of KYC Utilities.
- Forging an agreement on a data standard for KYC due diligence is a very complex and time consuming process.³⁸ Based on our experience we believe that any attempt to create a standard that could apply across a multitude of jurisdictions and counterparty types will take several years to agree, and it might not be achievable at all.

We therefore believe that any effort to create a standard for KYC datafields is likely to reduce, not increase the effectiveness of KYC Utilities. CPMI should recognize that the KYC Utilities themselves, in consultation with their users, are in the best position to identify the most appropriate data fields, templates and procedures. Competing KYC Utilities will tailor such standards to the relevant jurisdiction and type of counterparty, the underlying objective of the service and the preferences of their subscribers. We strongly believe that individual KYC Utilities benefit from performing an iterative process that allows them to understand the compliance needs of firms and create the most appropriate standards for their specific use cases and users.

However, there would be benefits from banking regulators taking a more consistent approach to scrutinizing and approving the standards that individual KYC Utilities provide to banks. This is because banks will typically spend significant amounts of time discussing data and documentation standards with their individual supervisors in different jurisdictions, and feedback from these supervisors might not be clear or consistent. We therefore recommend that CPMI members discuss and agree between themselves whether the data standards that are put forward by individual KYC Utilities satisfy their regulatory expectations. If they are, they should approve those standards. Such approval by a regulator would allow banks in a particular jurisdiction to rely upon these standards. We believe that providing banks with clarity around the supervisory expectations for the required data fields will encourage the broader use of KYC Utilities, in particular by smaller banks for which the benefits will be most pronounced, in addition to increased transparency and higher standards.

7. The use of LEIs

CPMI recognized “the importance and benefit” of the consistent use of LEIs in the context of KYC due diligence and correspondent banking. It also stated that “although the LEI system has not been designed to facilitate AML/CFT compliance in correspondent banking, its use may bring some benefits in this area.”³⁹

We are very supportive of regulatory efforts to encourage the broader and more consistent use of LEIs in financial markets as we believe that it will increase legal certainty and reduce compliance burdens of firms. To achieve this objective we recommend that regulators mandate the use of LEIs for covered entities and their branches. CPMI should be aware that currently no consistent approach exists yet for branches. However, regulatory initiatives have been launched in this respect and we encourage CPMI to take those into account when recommending the broader use of LEIs.

³⁷ For example, the Markit Genpact KYC service focuses on the relationships between banks and asset managers, corporates, and hedge funds. In contrast, the SWIFT KYC registry is most relevant for correspondent and respondent bank relationships.

³⁸ For example, it took Markit more than 1 year to agree with a handful of major banks on a data standard to be used for just two major jurisdictions.

³⁹ See CR, Pg.16

We hope that our above comments are helpful to CPMI. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Schüler', with a stylized flourish at the end.

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