ASSESSMENT OF CORRESPONDENT BANKING RELATIONSHIP: THE CASE OF COMMERCIAL BANKS IN ETHIOPIA.

LISSAN GETACHEW

A THESIS SUBMITTED TO ADDIS ABABA UNIVERSITY IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF THE DEGREE OF EXECUTIVE MASTER OF BUSINESS ADMINSTRATION

JULY 2024

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ADVISOR: LAKEW ALEMU (Ph.D)

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DECLARATION

Under the direction and recommendation of the research adviser, I, the undersigned, hereby certify that this thesis is my original work and that all basis resources used for the study have been officially acknowledged. It is available for the partially satisfied Executive master of business administration post. Not a single degree from this university or any other affiliation has been submitted with this study.

Declared by

Name: Lissan Getachew

Signature

Department Management

Date: 07/04/2024

ACRONYMS

ANOVA	Analysis of Variance
SD	Standard Deviation
SPSS	Statistical Packages for Social Science
VIF	Variance Inflation Factor
OFAC	Office of Foreign Assets and Control
SWIFT	Society for Worldwide Inter-bank Financial Telecommunication
AML	Anti-Money Laundering
KYC	Know Your Customer
CBR	Correspondent Banking Relation
NBE	National Bank of Ethiopia
IMF	International Monetary Fund
USD	United State Dollar
MTO	Money Transfer Organization
CDD	Customer Due Diligence
KYCC	Known as Know Your Customer's Customer
FATF	Financial Action Task Force
GDP	Gross Domestic Product
LC	Letter of Credit
CFT	Combating the Financing of Terrorism Trafficking
FATCA	Foreign Account Tax Compliance Act
PEPs	Politically Exposed Persons
FCC	Financial Crime Controls
UNCTAD	United Nations Conference on Trade and Development
NPOs	Non-Profit Organizations
EU	European Union
KYCCC	Know your customer’s customer’s customer

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STATEMENT OF CERTIFICATE

This is to certify that, in terms of originality and quality, Lissan Getachew thesis, " Assessment of correspondent banking relationship: The case of commercial banks in Ethiopia” which was submitted in partial fulfillment of the requirements for the executive master of business administration degree, satisfies accepted standards.

Approved By

Signature
07/06/24
Signature

Lakew Alemu (Ph.D.)
Advisor

03 Jun 2024
Signature

Tenkir Seifu (Ph.D.)
External Examiner

Hailemariam G/Michael (Ph.D.)
Internal Examiner

ABSTRACT

The study aimed to assess the assessment of correspondent banking relationships of Ethiopian commercial banks with their foreign correspondents. A purposive sampling method was used to select four representatives from each commercial bank, resulting in a total of 120 respondents. Additionally, two national bank experts were interviewed. The study employed both qualitative and quantitative data and applied descriptive and inferential analysis.

The findings revealed that Ethiopian commercial banks face significant challenges in establishing and maintaining correspondent banking relationships, which impacts their ability to provide comprehensive international banking services and efficiently meet customer demands. Addressing these challenges requires proactive measures from both Ethiopian banks and regulatory authorities like the National Bank of Ethiopia (NBE) to enhance trust, compliance, and efficiency in correspondent banking operations. The NBE's approach to correspondent banking relationships appears to be passive and lacking in proactive measures to support local banks. The absence of clear directives, limited involvement, and lack of supportive mechanisms highlight areas where the NBE could enhance its role in facilitating and regulating correspondent banking activities for the benefit of Ethiopian banks and the broader financial system.

To resolve the identified problems, the researcher recommends the following:

Strengthen relationships with existing African correspondent banks while exploring new opportunities within the continent to enhance transaction efficiency, Proactively seek to establish more correspondent banking relationships in North America and Europe to diversify the network and reduce reliance on intermediary banks, Enhance compliance with international regulations to mitigate the risk of relationship terminations by foreign banks, Establish regular communication channels with foreign banks to understand their concerns and demonstrate proactive measures taken to address them, Negotiate for more favorable terms and reduced fees with correspondent banks to lower transaction costs, Implement automated systems for compliance to ensure continuous and accurate adherence to international regulations, The NBE should take a more active role in supporting local banks in establishing and maintaining correspondent banking relationships, Foster trust and confidence among foreign banks through transparency, reliability, and consistent performance and Advocate for sound policy solutions that address the consequences of de-risking and support sustainable correspondent banking relationships.

Keywords: - NBE, Correspondent bank relationship, de-risking

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CHAPTER ONE

1. INTRODUCTION

1.1 Background of the Study

The expansion of financial services and financial education across international borders is one effect of globalization. Since 1980, gaps in geography and even culture have decreased because to technical advancements like computer networks and worldwide telephony. Because of this, businesses are now able to get materials, manufacture products, and market goods and services in distant nations. Goods and services that were developed in one nation are now produced and offered in several countries (Mehta and Fung, 2004).

Since the end of World War II, the development of global banking activity has coincided with growth in the global economy. Banks accompanied their clients abroad. Businesses of many different nationalities are increasing their overseas investments, exporting, setting up foreign facilities, and some of the biggest firms are turning into global corporations in the integrated technology with worldwide brands of goods and services. In almost all of these cases, these businesses and organizations are looking for chances in attractive transition economies where global markets promise faster expansion of free trade. International financial institutions will be more necessary as a result of these changes as they will have to operate in increasingly intricate, global networks (Saunders and Cornett, 2007).

The significance of international commerce has increased throughout time. The rising globalization of economies throughout the world and the accessibility of trade financing from the global financial community are responsible for this development (Madura, 2011).

Without the involvement of international banking institutions, the global commerce and financial system would not be complete. International banks provide their clients with a comprehensive array of international financial services, such as accepting deposits, buying and selling foreign currencies, issuing L/Cs, and making loans (Madura, 2009).

In order to speed up different transactions and processes, one bank (the correspondent bank) will offer financial services to another (the responder bank). This arrangement is known as correspondent banking. These services are vital for supporting liquidity, enabling cross-border transactions, and gaining access to financial markets. They are often provided by banks situated in various regions or nations (CPMI, 2016).

Global trade and economic activities depend heavily on correspondent banking. Correspondent banking supports economic growth through international trade and cross-border financial transactions, while also facilitating the movement of goods and services across borders in today's highly integrated global economy. Through its ability to facilitate cross-border aid and remittance flows, correspondent banking services are a contributing factor to financial inclusion in many low-income and developing nations. Around 7,000 institutions use the SWIFT network for correspondent banking, and there are more than one million distinct correspondent banking relationships (CBRs), according to the Society for Worldwide Interbank Financial Telecommunications (SWIFT) (Alleyne et al., 2017).

The volume of items sold worldwide has increased dramatically over the past 15 years, notwithstanding the financial crisis of 2009. Combined, emerging nations have nearly doubled this volume of trade since 2009. In 2019, the value of goods and services traded globally exceeded US$ 25 trillion. In 2020, the value of global trade in goods and services decreased by over US$ 2.5 trillion, or roughly 10%. In 2021, global trade increased by over US$ 6 trillion, reaching a record high of over US$ 28 trillion (UNCTAD, 2021).

Global trade rebounded in 2021, global banks have reportedly cut back on their correspondent banking services in a number of emerging countries and developing economies in recent years. Although some client groups and business lines have always had less access to financial services, the most recent example of this decrease is the widespread termination of correspondent banking relationships (CBRs). Certain jurisdictions and areas were notably impacted by the withdrawal of CBRs during the global financial crisis, according to survey data and information acquired as part of IMF monitoring (Artingstall et al., 2016).

According to Belize (2017c), officially recorded remittances to developing countries are expected to surpass USD 450 billion in 2017, up from USD 429 billion in 2016 and rebounding from a two-year decline. It is anticipated that global remittances, which include payments to high-income countries, will reach $596 billion, a 3.9% rise. The World Bank reports that the average cost of moving money overseas is currently 7.32%, while the International MTO Index is 8.2% (IMF and UAB, 2015).

Banks continue to be the most costly type of service provider, charging 11% on average. Remittance companies and local banks in some areas are at risk of losing access to the global financial system due to de-risking practices used by global financial institutions (US Department of the Treasury, 2016).

There are several concurrently operating possible reasons that might be the cause of the CBR withdrawal. In general, banks' cost-benefit analyses inform their business decisions, which are reflected in the withdrawal of CBRs. Therefore, analyzing the changing regulatory expectations and enforcement landscape, recognizing banks' evolving business models against the backdrop of macroeconomic developments and the overall decline in cross-border lending since the global financial crisis, and differentiating between "wholesale" CBR withdrawals and a case-by-case termination in services are all necessary to understand trends in CBRs (IMF, 2015).

1.2 Statement of the Problem

Over time, the significance of international commercial activity has increased. The availability of trade financing from the global financial community and the growing globalization of world economies are the reasons for this trend (Madura, 2011).

International trade and financial systems would not be complete without the role of international banking institutions and corresponding banking in developing local banks operations in the field of trade and to provide and deliver better goods and services. Banks and their relationships with their correspondents play a critical role in facilitating international trade by guaranteeing international payments and thereby reducing the risk of trade transactions. The majority of banks have expanded their operations and banking services internationally since international commerce is increasingly becoming the backbone of the global economy. Developed nations are unable to exist alone and be self-sufficient (Al Abbadi and others, 2011).

According to the FATF, "de-risking" refers to the practice of financial institutions ending or limiting their business dealings with certain customers or client groups in order to prevent risk rather than manage it in accordance with the FATF's risk-based strategy. De-risking strips financial institutions of CBRs, which are essential to the efficient completion of international transaction settlement.

Over time, and because of various economic and financial issues, managing the related connection between local banks and international and foreign correspondents can be difficult (Fouad, 2016).

The islands in the Pacific seem to have been the most affected in Asia and the Pacific, and the reduction in CBRs may hinder efforts to promote financial inclusion. Africa has seen the disappearance of CBR in certain countries, like as Liberia and issues with the availability of banknotes in Angola. Concerns over AML/CFT compliance in Botswana have resulted in some correspondent banks closing their accounts with the central bank, which has reduced the pool of counterparties accessible for investment and foreign currency activities. Certain bigger economies in Asia and Latin America, like, as Mexico and the Philippines, are seeing pressure on CBRs, albeit to a lower degree. The Middle East and North Africa's sanctioned nations are the ones most impacted by the CBRs' withdrawal: those under trade and economic sanctions (IMF and UAB 2015).

The main reasons that researcher to conduct this research are the ever growing and recent problems for international banking services. Now, its core services, such as MTO, Import, Export, foreign account are all in the state of critical positions due to the sole factor of weak home banks relationship with correspondent banks. This in turn, puts strains on both making outflow and inflow payments using hard currency and fund delay in reaching destinations on time. Moreover, Ethiopian commercial banks have suffered in general from these correspondent banks because they are threatened by the potential loss of their connection to the global financial system as large international banks terminate long- standing relationships/withdrawal of correspondent banking relationship and close correspondent accounts, restrictions to access some correspondent bank services by certain categories of customers, business lines, jurisdictions, or regions and establishing the corresponding relationship are coming difficult with time due to many economic, political , financial and policy concerns.

In Ethiopia there is no empirical study about correspondent banking relationship and how the relationship terminates. Therefore, this study proposed to assess the correspondent banking relationships in the case of private commercial banks in Ethiopia.

1.3 Research Question

The research was proposed to address the following fundamental questions:

1. What kind of relationship do respondent banks and correspondent banks have?
2. What kind of approach or methodologies followed by local banks in managing the corresponding relationship?
3. What kind of polices or governing rules followed by National Bank of Ethiopia to monitor the commercial banks of Ethiopia in dealing with their correspondent relationship?

1.4 Objective of the Study

1.4.1 General Objective

The general objective of the study was to evaluate correspondent banking relationships of Ethiopian commercial banks with their correspondents.

1.4.2 Specific Objectives

i. To assess how well local banks and their foreign correspondent get along.
ii. Evaluating the methods and strategies used by neighborhood banks to manage the related relationship.
iii. Realizing the NBE's responsibility for creating and overseeing the relevant financial connections between regional banks and their foreign correspondents.

1.5 Significance of the Study

It is crucial to research the region in which the bank and its correspondent bank operate in order to minimize risks such as the possibility of money laundering and to stay clear of any issues or legal entanglements with correspondent banks. Additionally, this research significant in the following ways:

Based on the research, local banks may use their successful relationships with their correspondents to understand the value of correspondent banking and contribute to their own realization of the viability and profitability of their international commerce.

In Ethiopia, no research has been done specifically on the subject of comparable banking. Researchers and other interested parties may use this study as a springboard for further research in the area.

1.6 Scope of the Study

This study exclusively emphasized that the National Bank of Ethiopia' regulatory framework governing correspondent banking relationship, with the aim of ensuring adherence to international policies and standards. The research cover the existing and licensed thirty/30/ Ethiopian private banks practice in managing their correspondent banking relationship. It is also limited to the management strategies-such as actions taken to minimize reputational, financial, and regulatory risks-that these institutions employ in their correspondent banking arrangements.

1.7 Organization of the Study

The study organized in five chapters. The first chapter covers the research's preliminary concerns, which are divided into several categories such as the study's history, problem description, aims, significance, structure, and definition of essential terminology. The study's evaluation of the literature, which includes a theoretical analysis and a summary of earlier research in the field, is covered in the second chapter. The design and methods of the study, including the choice, evaluation, and presentation of data sources using various techniques covered in the third chapter. The data and statistics data sources were supplied, examined, and evaluated in the fourth chapter. The facts in the fourth chapter served as the basis for the conclusion and recommendation in the fifth chapter.

1.7 Definition of Key Terms

Correspondent Banking: - is the relationship between two financial institutions, where one (the correspondent bank) provides services to the other (the respondent bank).

Anti-Money Laundering: - refers to a set of laws, regulations and procedures aimed at preventing criminals from distinguishing illegally obtained funds as legitimate income.

Know Your Customer: - is a regulatory requirement in the financial industry that mandates businesses to verify and understand the identity of their clients and customers.

International Trade: - refers to the exchange of goods, services and capital across national borders between countries or regions. It involves the buying and selling of products and service between entities located in different countries often facilitated by trade agreements, tariffs and international regulations.

CHAPTER TWO

2. LITERATURE REVIEW

2.1 Introduction

Correspondent banking is an essential part of the global financial system that facilitates cross-border transactions, financing trade, and financial services access for millions of individuals. A complex network of relationships between financial organizations allows for the seamless flow of funds across borders. Politicians, regulators, and academics have taken notice of correspondent banking despite its important role, due to its inherent challenges, which include concerns about financial crime, regulatory compliance, and access to banking services (Alleyne et al., 2017).

For many institutions, the expense of creating and sustaining new relationships has gone up. With a few previously mentioned instances, creating new accounts has not proven to be particularly difficult. However, banks have admitted that the establishment and maintenance of correspondent accounts, including new ones, is more expensive. Typically, a 90-page questionnaire is used to create a new CBR or to keep track of an already-existing CBR. Correspondents are asking more information that is specific on banks' activities and customers, paying particular attention to the person who initiated the payment and the recipient. Additionally, correspondent banks are requesting regular updates and are paying closer attention to the customer due diligence (CDD) of their responders. Furthermore, it is customary for correspondents to visit the locations to confirm that their responders are adhering to their AML/CFT obligations-22. Respondent banks also voiced dissatisfaction with their correspondents' inquiries concerning the customers of their customers (also known as know your customer's customer, or KYCC) or, in one instance, the customers of their customers (KYCCC). The fact that KYCC and KYCCC extend beyond the Financial Action Task Force (FATF, 2019) should not be understated.

This literature review aims to provide a comprehensive overview of the scholarly discourse around correspondent banking. By integrating earlier research and elucidating its historical evolution, structural dynamics, regulatory frameworks, and contemporary challenges of the correspondent banking service in connection with international trade, the study seeks to understand the intricate nature of correspondent banking.

2.2 What is Correspondent Bank?

Every bank has a distinct definition of correspondent banking depending on their business and rules. Correspondent banking generally refers to banks providing services to their own customers via another bank functioning as an agent (Palmer, 1990).

According to the FATF (2016), a correspondent bank is a financial entity that provides services, whether equally or unequally, on behalf of another financial institution (bank). "An arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks".

Similar basic terminology is used in the European Central Bank's correspondent banking survey, which refers to "agreements or contractual relationships between banks to provide payment services for each other" (BCBS, 2016).

In order to speed up international transactions like wire transfers and currency swaps, correspondent banking is frequently employed by banks in other nations whose services are needed by one bank. With correspondent bank accounts, banks can interact in foreign countries without having a branch or other physical presence, or provide services to their clients in foreign currencies (European Central Bank, 2017).

These accounts are essential for promoting international trade and banking, allowing banks to effectively serve their customers internationally. However, because they require extensive know-your-customer (KYC) and anti-money laundering (AML) protocols to stop illegal financial activity including money laundering and funding of terrorism, they also present compliance and regulatory issues.

According to Erbenova et al. (2016), a correspondent banking arrangement happens when one bank (the correspondent, for instance, a large international bank) offers other banks (the responder, for instance, a bank with operations in the Caribbean) a deposit account or other liability accounts along with related services. For transactions to be settled by crediting and debiting accounts, the system needs to exchange messages. One essential element of an efficient global financial system is correspondent banking ties. They facilitate the execution of numerous vital activities and services, such as trade finance, third-party payments (such as credit card and wire transfers), cash clearing for the banks themselves, liquidity management, and short-term borrowing or investment requirements.

2.3 Why Correspondent Banking Relationship?

According to CRS (2022), formal agreements or connections between banks to offer payment services to one another are referred to as correspondent banking. It is crucial to the global financial system since it is frequently utilized to complete cross-border payments. The Bank of England projects that the value of international cross-border payments will rise from over $150 trillion in 2017 to over $250 trillion by 2027. This is largely because of correspondent banking, which supports trade finance, migrant remittances, and humanitarian flows (the European Central Bank reported that approximately $746 billion worth of daily transactions were channeled through correspondent banking arrangements within Eurozone countries alone in 2019).

A standard correspondent banking arrangement is one in which a third party, a different financial institution referred to as a correspondent or service-providing bank, is employed by two financial institutions (respondent banks). They often represent the evaluation of the profitability and risk of the connections by correspondent banks. Decisions to end CBRs, in particular, frequently stem from the correspondent bank's lack of faith in the responder bank's ability to manage risk well. This situation has been exacerbated by recent changes in the regulatory and enforcement environment, particularly in relation to stricter prudential requirements, trade and economic penalties, anti-money laundering and reducing the financing of terrorism (AML/CFT), and tax transparency standards (CRS, 2022).

2.4 Which Products and Services Provided using Correspondent Banks?

When one bank (the "correspondent bank") offers banking services to another bank (the "respondent bank"), this is known as correspondent banking. Globally, hundreds of smaller banks frequently use large international banks as correspondents. Numerous services, including cash management (such as interest-bearing accounts in several currencies), international wire transfers, check clearing, payable-through accounts, trade-related services, and foreign exchange services, may be made available to respondent banks (FATF, 2016).

Financial services referred to as correspondent banking have been provided by one bank (the correspondent bank) to another (the responder bank) in order to help with a variety of procedures and transactions. These services, which are commonly provided by banks spread across many regions or nations, are essential for supporting liquidity, enabling cross-border transactions, and gaining access to financial markets (CPMI, 2016).

The major services provided by correspondent baking described below:

i. Clearing and Payment Services

Historically, correspondent banking companies have concentrated on offering global clearing and payment services. Money settlements are issued and received by the bank, which generates fees. A correspondent bank acts as a foreign agent for another bank and frequently has extensive local settlement networks. The banks would maintain nostro and Vostro accounts with each other in order to speed up the transfer of funds. Banks give reports that indicate the amount of money that has traveled through the account and the required balances, along with management information systems to track all payments and credit constraints. Modern communication technology has made it possible to implement new and improved payment and clearing processes that reduce costs while boosting the efficiency and precision of product delivery (Soon-Lim Chan, 2001).

International financial transfers and check clearing are the two most important clearing and payment services.

a. International Wire Transfers

Two accounts at the same bank are involved in the simplest financial transfers. Funds are moved between accounts, or accounting adjustments take place when funds are taken out of one account and credited to another. Every account might be a customer's or the banks own account. A book transfer can still be carried out directly even if the accounts on both ends of the transaction are held by different banks as long as there is a correspondent relationship between the two banks. To settle transactions for itself or its clients, one bank has a "correspondent account" with the other bank (The Mechanisms of Wire Transfer, 2021).

b. Checks Clearing

A check's transfer from the local bank where it was deposited to the correspondent bank where it will be picked up from the bank where it was drawn, along with the face amount being reversed. This process, also referred to as a "clearing cycle," frequently causes an equal debit from the bank from whence the money was taken and a credit to the correspondent account for the bank of deposit (Collis, D., & Hartman, A., 2016).

ii. Trade Related Services

Trade in services, which includes services rendered through foreign affiliates based overseas, tracks the value of services traded between citizens and non-residents of an economy. This statistic shows the proportion of GDP for imports, exports, and net trade, and it is expressed in millions of dollars. In addition to freight and passenger transportation, other services include travel, communications (phone, internet, satellite, etc.), building services, insurance and finance services, computer and information services, royalties and license fees, other business services (leasing, merchanting, technical and professional services, etc.), cultural and recreational services, and government services not on the above list. Though it is sometimes hampered by obstacles like national laws, trade in services fosters the flow of concepts, expertise, and technology (OECD, 2024).

Trade-related services include foreign documentary collections and letters of credit. Trade finance transactions are considered the fundamental activity, generating fees and commissions (Soon-Lim Chan, 2001).

Different types of trade finance instruments such as letters of credit and collection will be presented in the following manner:

a. Letters of Credit

The LC Issuing Bank sends a Letter of Credit (LC) to a correspondent bank, which is often located in the country of the seller (beneficiary). The Advising Bank is the correspondent bank that gets the LC. In international transactions, letters of credit are commonly utilized as a means of ensuring payment receipt. The use of letters of credit has become a crucial aspect of international trade due to the nature of overseas business, which includes factors like distance, different rules in each country, and the challenges of getting to know each partner personally. In addition, the bank acts on behalf of the buyer (the holder of the letter of credit) to make sure that the supplier is not paid until the bank receives documentation proving the goods have been sent (UOB, 2016).

b. Collections

The idea behind documentary collection is that exporters need to remove the risk of nonpayment associated with exporting goods abroad on an open-account basis, while importers need to promptly manage incoming collections. The transaction starts when the exporter ships the goods to the buyer's country; both must manage the paperwork exchange and reduce the associated payment risk. In order to collect the selling funds and provide the necessary paperwork to the buyer in compliance with the terms of the sales contract, they also entrust their bank with the pertinent documentation, which may include negotiable bills of lading. Here, three different methods of collection are employed: documents against payment (D/P), documents against acceptance (D/A), and clean collection (PNC, 2016).

c. Foreign Exchange Services

Conversion is the term used to describe the process of swapping one currency for another. The global currency market, on which currency transaction occurs virtually constantly, is also referred to as foreign exchange. "Forex" and occasionally "FX" are typical abbreviations for foreign exchange (FATF, 2016).

Payments of billions of dollars are made by governments and companies for goods and services purchased abroad, while currency conversions by regular bank customers are also included in the category of foreign exchange transactions. Foreign currency transactions have surged in volume in the past several decades along with greater globalization. Global foreign exchange is the largest financial market by far, with typical daily volumes in the billions of dollars (FATF, 2016).

2.5 Development of Banking in Ethiopia

Ethiopia began implementing economic reforms in the early 1990s in an effort to modernize and liberalize its economy. Among these were efforts to attract foreign investment, the privatization of state-owned companies, and the adoption of market-based policies. These changes caused the banking sector to begin opening up to foreign institutions and investors. In Ethiopia, state-owned banks began to give way to commercial banks in the late 1990s and early 2000s. The emergence of private banks increased competition among banks and contributed to the expansion of additional financial services, including correspondent banking (Tefera, T. A., 2016).

Ethiopia's correspondent banking sector has been molded by the nation's previous financial and economic advancements as well as global banking and finance trends. This is the historical context of Ethiopian correspondent banking's development. Ethiopia's economy was relatively isolated from the rest of the global financial system before the 1990s. The banking sector was dominated by state-owned banks, and opportunities for international banking activities were limited (Gashayie, A., 2016).

Technology, telecommunications, and international banking standards improvements made Ethiopia's progressive incorporation into the global financial system possible. The need for correspondent banking services increased as the nation worked to expand commerce and draw in foreign capital. The National Bank of Ethiopia (NBE) oversees all aspects of banking regulation, including correspondent banking. The NBE has created regulatory frameworks throughout time to control correspondent banking connections, guarantee adherence to international standards, and lower the risks involved in cross-border transactions (Mengesha, A., & Berde, B., 2023).

2.6 De-risking or Withdrawal of Correspondent Banking

De-risking in the words of the Financial Action Task Force (FATF), is the process by which financial institutions cut off or restrict their business ties to particular countries or client categories in an effort to avoid, as opposed to manage, risks in accordance with the FATF's risk-based strategy (FATF, 2016).

According to estimates from the United Nations Office on Drugs and Crime, 2-5% of the world's gross domestic product is laundered annually. The value was estimated at $1.6–$4 trillion yearly in an IMF report. Due to correspondent banks' crucial role in cross-border financial transactions, the United States has a strong AML-CFT system in place to address concerns about illicit funding. Correspondent banks may be held liable for AML-CTF violations by respondent banks under the present regulatory framework, as well as potential regulatory and reputational risks. Hence, in recent years, some big international banks have severed their correspondent banking ties with certain smaller banks, frequently located in developing nations that are considered"high-risk" for AML, due to worries about regulatory compliance with AML and customer due diligence (CDD) requirements. This phenomenon is called "de-risking," and banks cite increased costs and ambiguity about how far CDD should go to avoid regulatory penalty as among the major reasons for it, according to the Bank for International Settlements (BIS). Profitability reasons, worries about possible responsibility, and reputational harm are among elements that go into the decision to reduce correspondent ties. Additionally, new regulations that raise the expense of correspondent partnerships and lessen their attraction have been developed in response to the need to protect against cyber dangers (Congressional Research Service, 2022).

2.7 Potential Factors behind the Withdrawal of CBRs Lesson from Caribbean Countries

The withdrawal of CBRs is a reflection of multinational banks' business decisions. They have each reevaluated their unique business models and implemented new tactics in reaction to shifts in the macroeconomic and regulatory landscape. Macroeconomic factors, such as the ongoing low interest rates that have been present since the global financial crisis, together with modifications to regulatory frameworks have generally made low return, high-volume business lines like correspondent banking less appealing.

Four core groups of factors have contributed to global banks' decisions to end their CBRs. First, compliance issues related to AML/CFT regulations are the most often cited reasons for termination of CBRs. Second, tax transparency agreements impose an additional regulatory burden that carry their own set of compliance costs. Third, trade and economic sanction violations have very large fines and require another layer of due diligence. Fourth, additional profit and risk-related reasons for withdrawing CBRs, not directly related to AML/CFT compliance, reflect shifts in the banking landscape since the global financial crisis.

2.7.1 More Intense AML/CFT Efforts

The most commonly cited cause for CBR withdrawal is linked to AML/CFT compliance. The Financial Action Task Force (FATF) revised the worldwide standard for AML/CFT initiatives in 2012 with the goal of expanding the evaluation to include successful implementation and placing more of an emphasis on a risk-based approach. The main justifications for removing CBRs are the high penalties and reputational harm associated with infractions, low predicted earnings, and the compliance expenses related to the due diligence needed to fulfill these criteria (World Bank 2015). Financial institutions have recognized possible avenues for exposure to (AML/CFT) risks linked to deficiencies in the regulatory or legislative frameworks of the responding banks' home countries; doubts regarding the caliber of the responding bank's customer due diligence procedures; and the existence of comparatively riskier industries like gaming, money or value transfer services, payment settlement services, offshore sectors, or money transfer, particularly those with no physical presence (IMF 2017).

2.7.2 Increased Focus on Tax Transparency

There is a chance that the loss of CBRs was influenced by increased international pressure in recent years to improve tax transparency. This matter is especially important for nations that have offshore financial services hubs many of which are in the Caribbean and that have historically depended on low or no tax rates to draw in industry. In several Caribbean nations, offshore financial services constitute a significant business. Consequently, a number of countries who were previously recognized as hubs for tax evasion have faced mounting international pressure to provide more data more quickly. For instance, nations conducting business with American companies may face severe repercussions if they disregard the Foreign Account Tax Compliance Act (FATCA) of the United States. A further regulatory burden that raises compliance and transaction costs is imposed by adhering to tax information agreements, such as FATCA, the Common Reporting Standard (CRS), and the Organization for Economic Co-operation and Development's (OECD) tax information exchange agreement (Erbenová et al., 2016).

2.7.3 International Sanctions

Banks must add an additional level of compliance and due diligence in response to economic and trade penalties. Similar to AML/CFT infractions, penalties can raise the cost of upkeep for CBRs and lead to hefty fines. Data suggests that the number and value of CBR transactions, as well as CBRs, have decreased more in nations subject to US trade and economic sanctions. This is not anticipated to be a significant factor in CBR withdrawals in the Caribbean for nations and their domestic banking institutions. Despite not being directly impacted by the sanctions, Caribbean nations are nonetheless indirectly impacted by them (and as a result, are under greater oversight for customer due diligence) because offshore banks in the area handle international transactions from all over the world, and citizenship-by-investment programs accept applications from all over the world, including sanctioned nations.

2.7.4 Lower Profitability and Risk Aversion by Global Banks

Global banks have also made the decision to remove CBRs because to the macroeconomic climate and the stricter prudential rules that apply to them. Banks have been reevaluating their business operations for risk exposure ever since the global financial crisis. The banking industry has consolidated as a result of vulnerabilities in financial systems and individual banks during the crisis, especially in the US and Europe. In an effort to strengthen buffers, regulators have also mandated that banks retain higher levels of capital and liquid assets, which raises the cost of storing risk on their balance sheets. Furthermore, banks have withdrew their CBRs, especially from jurisdictions with low volumes or regulatory gaps, as a result of the low growth and low interest rate environment, which has forced them to become leaner and more risk averse while focusing on higher profits and core businesses (Erbenová et al., 2016).

2.8 Consequences of CBR Withdrawal

In the wake of the global financial crisis, banks all over the world withdrew from riskier and less profitable ventures like correspondent banking. There has been a growing push on major international banks lately to boost capital, simplify their operations, and assess their exposure to risk (Lagarde, 2016).

By concentrating cross-border flows, the pressures on CBRs are highlighting the financial fragilities of the afflicted countries, which may pose threats to financial stability that undermine the chances for growth and development. However, a variety of variables, including alternative arrangements made by financial institutions, particularly with relation to trade and remittances corridors, have so far substantially mitigated the direct economic damage. Since these alternative agreements do not always address the underlying causes of CBR withdrawal, it is possible that they have raised remittance prices in some nations. Additionally, it is unclear how long these arrangements will last. Furthermore, there may be dangers to the affected nations' financial stability due to the observed increasing concentration in cross-border transfers, both in terms of value and volume per active correspondent (AC). The loss of CBRs may eventually have a detrimental effect on chances for growth and development (IMF, 2017).

Burdens on CBRs could interrupt financial services and cross-border flows, as well as trade finance, remittances, and aid flows, thereby actually undermining financial stability, inclusion, growth, and development goals. On financial inclusion, for example, a recent survey (Eckert, Guinane, and Hall, 2017) specifies that two-thirds of non-profit organizations (NPOs), which are measured unconditionally high risk, are experiencing banking problems, including delays of wire transfers, increased fees, account closures, and refusal to open accounts. A large number of these NPOs blame correspondent banking troubles for wire transfer issues.

2.9 Correspondent Banking Versus International Trade

According to Faster Capital (2024), Correspondent banks have critical role by facilitating the international trade by the following aspects:

2.9.1 Role of Correspondent Banks in International Transfer

Money is moving across borders at a rate that has never been seen before, creating a complicated network of transactions that is the worldwide financial landscape. Correspondent banks are essential in our complex global economy because they make cross-border transfers easier. In essence, a correspondent bank is a bank that offers services to another financial organization. These services can be anything from currency exchange to transaction clearing and settlement, which promotes the growth of global investment and commerce.

2.9.2 Role of Correspondent Banks in Telegraphic Transfer

Telegraphic transfers (TT) are a dependable and effective way to move money across borders in the field of international finance. Correspondent banks play a crucial part in the TT process, which is sometimes disregarded. Financial institutions that offer services on behalf of another financial institution are known as correspondent banks. Correspondent banks serve as go-betweens between the sending and receiving banks in TT transactions, enabling the smooth movement of payments.

2.9.3 Role of Correspondent Banks in Global Transactions

The complex network of transactions that make up the global financial landscape involve several institutions and are interrelated in ways that are frequently hidden to the public. The correspondent bank is a key component of this complicated network. These intermediaries are essential in enabling cross-border money transfers and other international operations. Correspondent banks facilitate cross-border payments, trade financing, and other financial transactions by serving as intermediaries between two financial institutions that are not directly affiliated.

2.9.4 Role of Correspondent Banks in Trade Settlements

In trade settlements, correspondent banks are essential since they serve as an intermediary between two banks to enable cross-border transactions. By lowering the total number of steps required, they aid in streamlining the cross-border payment process. In order to guarantee the timely, accurate, and safe execution of trade settlements, correspondent banks are essential.

2.10 Ethiopian Trade Volume

According to the U.S. Department of Commerce (2024), Ethiopia's real gross domestic product (GDP) in 2022 was 6% more than the average GDP of East Africa, which was 4%. Although historically Ethiopia's economy has been driven by agriculture, in recent years the service sector has expanded to become the country's greatest contributor to GDP. In the Ethiopian fiscal year 2021–2022, services, agriculture, and industry accounted for 40%, 32%, and 29% of GDP, respectively, according to the National Bank of Ethiopia (NBE). The rise of the hotel and restaurant industry, wholesale and retail commerce, and communication and transportation services are the main drivers of the service sector. Infrastructure projects including roads, railroads, dams, industrial parks, and housing have a major role in the industrial sector's growth.

Ethiopia's trade imbalance has been growing over the previous 11 years, as total imports have increased by more than 12% yearly on average. After climbing to over $11 billion in 2021, the trade imbalance reached $14 billion in 2022, with $18 billion in total imports, mostly from fuel, semi-finished products, and consumer goods. An annual NBE study states that consumer products accounted for 42% ($7.6 billion) of overall import spending, while capital goods accounted for 17% ($3 billion) (U.S. Department of Commerce, 2024).

Over the past ten years, Ethiopia has gradually boosted its imports from the United States. Ethiopia imported more over $1 billion worth of products from the United States in 2022. The greatest category of commodities was transportation equipment, mostly used in aviation, followed by agricultural machinery, construction equipment, and engineering services. Because of Dubai's closeness to and availability of dependable air shipping and air passenger services, many American corporations with headquarters in the United Arab Emirates (UAE) conduct business in Ethiopia through Dubai as an intermediate export platform (U.S. Department of Commerce, 2024).

Ethiopia's top exports were coffee (27%), gold (15%), oil seeds (9%), vegetables (7%), flowers (5%) and legumes (5%), according to United Nations COMTRADE data from 2021, the most recent year for which data is available. United Arab Emirates (18%), the United States (14%), Somalia (9%), China (7%), and Germany (6%), were the top five destinations for Ethiopian exports in 2021. Ethiopia exported commodities to Asia (48%), Europe (21%), the Americas (15%), and Africa (15%), in that order. Ethiopia imports most of its goods from Asia (61%, of which 40% are from China), Europe (25%), the Americas (8%, of which 89% are from the United States), and other African nations (7%) (U.S. Department of Commerce, 2024).

2.11 Policy Options to Address the Loss of CBRs

2.11.1 SWIFT KYC Registry

In December 2014, the SWIFT KYC Registry started operational. Without focusing on clients, it concentrates on banks that engage in correspondent banking. Banks that engage in correspondent banking can utilize the SWIFT KYC Registry as a single resource to supply data required for regulatory compliance. Correspondent banks can utilize this information to perform sufficient due diligence on their clients, or the relevant response bank. At SWIFT, every piece of data is verified and examined by a specialized operations team. Every bank that contributes data always keeps ownership of such data. Only with consent from the entity who owns the data may other banks access the data of another bank. Furthermore, SWIFT is also launching what is known as the SWIFT Profile. According to FATF/OFAC/EU lists, this profile offers a uniform representation of a bank's SWIFT traffic activities with sanctioned or high-risk nations. Banks can use the SWIFT KYC Registry to communicate this information with certain counterparties. In the upcoming months, more services whether offered by SWIFT or by outside parties will be added to the SWIFT KYC Registry (CPMI, 2016).

2.11.2 Sanction Screening

One control that is used to identify, stop and disrupt financial crime and sanctions risk in particular is sanctions screening. It involves comparing two text strings to look for patterns that could point to a potential match. It contrasts lists of names and other identifiers of approved parties or places with data gathered from an organization's activities, such as transactional and customer records. The goal of sanction screening is to provide suitable compliance controls to evaluate the efficacy of sanctions screening systems, whether automated, human, or both, in light of the ongoing growth and complexity of international sanctions legislation (FCA, 2024)

Sanctions can be used to accomplish diplomatic or foreign policy goals, as well as to penalize bad actors. Legislation or international bodies like the United Nations are usually used to adopt them. Security Council. Several penalty lists contain individuals and groups connected to the sponsorship of terrorism. For example, the United Nations Security Council Committee enforces legislation comparable to the Al Qaida and Taliban Order (2006), and the Patriot Act prohibits companies from giving material assistance to terrorist groups (FCA, 2024).

2.11.3 Wolfsberg Financial Crime Principles for Correspondent Banking

The Wolfsberg Group, an association of thirteen global banks, has developed principles and guidance for managing financial crime risks in correspondent banking relationships. These principles aim to enhance the effectiveness of anti-money laundering (AML) and counter-terrorist financing (CTF) measures. Here is an outline of the Wolfsberg Financial Crime Principles for Correspondent Banking (Wolfsberg Group., 2014):

Risk-based approach: Banks should adopt a risk-based approach to managing correspondent banking relationships. This involves conducting thorough due diligence to understand the risks associated with each correspondent banking client and tailoring controls accordingly.

Know Your Customer (KYC): Banks must have robust KYC procedures in place to identify and verify the identity of correspondent banking clients. This includes obtaining information on the ownership structure, business activities, and beneficial owners of the correspondent bank.

Enhanced due diligence (EDD): Enhanced due diligence should be conducted for high-risk correspondent banking relationships. This may involve obtaining additional information on the correspondent bank's customers, transactions, and geographic risk factors.

Ongoing monitoring: Banks should continuously monitor correspondent banking relationships for suspicious activities. This involves implementing systems and processes to detect unusual transaction patterns or red flags indicative of financial crime.

Transaction screening: Banks should screen correspondent banking transactions against sanctions lists, watchlists, and other relevant databases to identify and prevent transactions involving sanctioned entities or high-risk individuals.

Suspicious activity reporting: Banks must have procedures in place to promptly report suspicious activities to the relevant authorities. This includes documenting and escalating suspicious transactions in accordance with regulatory requirements.

Information sharing: Banks should collaborate and share information with other financial institutions and regulatory authorities to combat financial crime effectively. This may involve participating in industry forums, sharing best practices, and exchanging intelligence on emerging threats.

Training and awareness: Banks should provide training and awareness programs to employees involved in correspondent banking activities. This ensures that staff are equipped with the knowledge and skills to identify and mitigate financial crime risks effectively.

Governance and oversight: Banks should establish robust governance frameworks to oversee correspondent banking activities. This includes assigning responsibility for compliance with the Wolfsberg principles to senior management and conducting regular reviews of compliance controls.

These principles provide a comprehensive framework for managing financial crime risks in correspondent banking relationships and are widely recognized and adopted by banks and regulatory authorities worldwide

2.11.4 AML Anti-money Laundering

Anti-money laundering (AML) encompasses a range of measures designed to prevent criminals from disguising illegally obtained funds as legitimate income. These measures involve regulatory controls, procedures, and technologies implemented by financial institutions and governments to detect and deter money laundering activities (Kobil, D., 2019).

2.12 Conceptual Framework of the Study

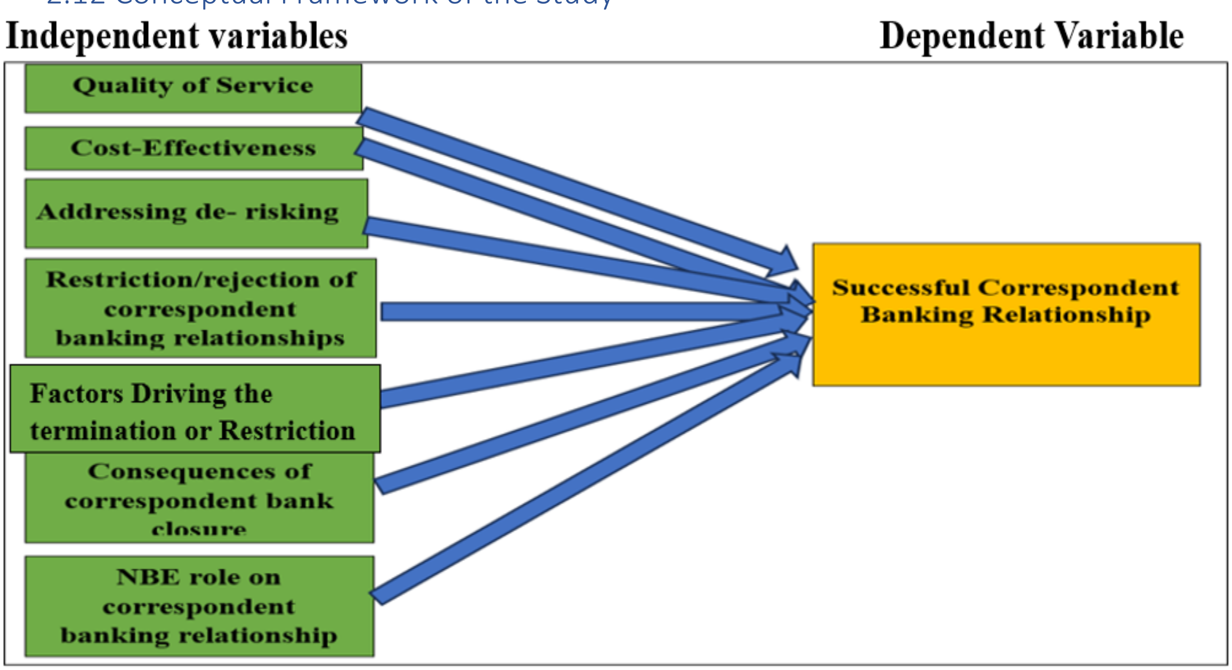

Figure-2.1: Conceptual framework of the Study

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1. Introduction

This section provides a detailed explanation of the methods that was used to collect the data required for the study. It includes information on the target population and sampling strategy, the research design, the data source and type, the data presentation, analysis, and interpretation process, and any ethical issues that may arise.

3.2 Research Approach and Design

The main objective of the study is to evaluate correspondent banking relationship in the context of Ethiopian Commercial banks. In order to achieve this purpose, the study was employ a descriptive research design to describe the status of the Banks' relationships and the cause-and-effect relationships between variables. In line with the purpose of the study, the researcher would employ both qualitative and quantitative approach. The quantitative data were collected through questionnaire from all private banks respondents and the qualitative data were collected through interview from National Bank representatives.

3.3 Data Source and Sampling Technique

3.3.1 Source of Data

The major sources of data for the study were all private banks that are currently operating in Ethiopia and the National Bank of Ethiopia. Now around 30 private commercial banks are registered with the NBE and provide banking services (NBE, 2024).

3.3.2 Target Population

The target population of this study was Directors and Managers in International banking, and Risk departments of all private local banks. The number of Directors and managers of the two departments were one hundred eighty/180.

3.3.3 Sampling Technique and Sample Size

A non-probabilistic purposive sampling strategy was applied to choose the study's sample population. As such, deliberate selection was used to choose each bank's respondents. Four individuals/experts, which directly concerned these issues in each commercial bank. These are international banking director, risk and compliance director and both department' managers. Therefore, from each commercial bank, there were four participants and one hundred twenty /120/ respondents participated in this study.

Table-3.1: List of Commercial banks in Ethiopia

Serial No.	Name of Banks
1	Abay Bank S.C
2	Ahadu Bank S.C
3	Amhara Bank S.C
4	Addis Int.Bank S.C
5	Awash Bank S.C
6	Berhan Bank S.C
7	Bank of Abyssinia
8	Bunna Bank S.c
9	Cooperative Bank of Oromia
10	Dashen Bank S.C
11	Enat Bank S.C
12	Gadaa Bank S.C
13	Goh Betoch Bank S.C
14	Global Bank S.C
15	Hijra Bank S.C
16	Hibret Bank S.C
17	Lion International Bank S.C
18	Nib International Bank S.C
19	Oromia Bank S.C
20	Omo Bank S.C
21	Rammis Bank S.C
22	Shabelle Bank S.C
23	Sidama Bank S.C
24	Sinqee Bank S.C
25	Siket Bank S.C
26	Tsehay Bank S.C
27	Tsedey Bank S.C
28	Wegagen Bank S.C.
29	Zemen Bank S.c
30	Zamzam Bank S.C

Source: - NBE, 2024

3.4 Data Collection and Analysis Technique

The researcher used KoBo toolbox to gather data from respondents, and then process the data by using SPSS version 22, a statistical package for social science. The data collected from respondents via a questionnaire were evaluated using both descriptive such as percentage, mean & standard deviation and inferential statistics such as correlation and regression. The descriptive statistical analysis describes the variables correspondent banking connection and the respondent's general information. Correlation analysis is a statistical method used to analyze the relationship between variables referred to as autonomous and dependent.

3.5 Data Validity and Reliability

Reasonableness determines if the measurement instrument truly reflects the intended quantity or the veracity of the research findings. The questionnaires were developed based on a survey of pertinent literature and the foundation of previous research questionnaires to assure validity.

Reliability measures are internal consistency metrics that highlight item responses that are consistent across components and demonstrate scores that remain constant over time when the test is taken (Creswell, 2009). Using a Cronbach's coefficient alpha of 0.70, the consistency of the instrument was evaluated along the route in order to evaluate its reliability. Additionally, as the Cronbach's alpha number gets closer to 1.0, the measure's item internal dependability gets more reliable.

Table 3.2 Reliability Statistics

Variables	Cronbach's Alpha
Quality of Service	0.771
Cost-Effectiveness	0.807
Addressing de- risking	0.796
Factors Driving the termination or restriction of CBR	0.803
Restriction of services from CBs	0.808
Consequences of CB closure	0.804
NBE role on CBR	0.801
Successful Relationship with CB	0.782

Source: - (Survey result, 2024)

The Cronbach's alpha coefficient was discovered in order to evaluate the internal consistency of the variables in this research instrument. The Cronbach's alpha coefficient for a questionnaire that was adapted and produced from research was determined to be 0.802 when it was evaluated using SPSS. This implies that there is possibility for further examination of the data.

3.6 Ethical Considerations

Ethics in the context of research, according to Saunders, et al. (2003), is the suitability of the researcher's conduct with regard to the rights of the subjects or participants in the study. Respondents only be asked for information willingly, after being informed of the purpose of the study and receiving a promise of information confidentiality. Furthermore, the purpose of the study was disclosed in the introduction of the questionnaire.

CHAPTER FOUR

4. DATA ANALYSIS AND DISCUSSION

Background Information

In order to provide an explanation for the data collected, this chapter presents the research study's analysis and findings. Of the 120 questionnaires that the investigator distributed, 120 (100%) were completely filled and returned. This chapter provides information on both descriptive and inferential data analysis techniques.

4.1 Demographic Distribution of Respondents

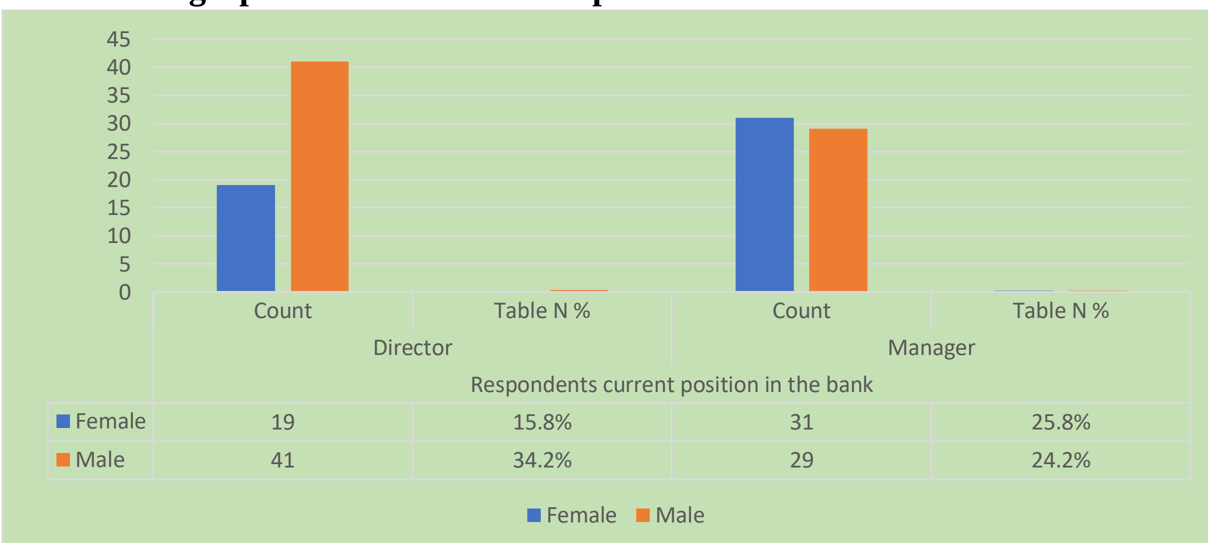

Figure-4.1: Respondent current position in the bank

As seen in figure 4.1 above, men occupy the majority of director positions (34.2%), with women making up 15.8% of the filled positions. The proportion of men and women in management positions differed from that of directors; as a result, the percentage of women increased to 25.8% while that of men decreased to 24.2%.

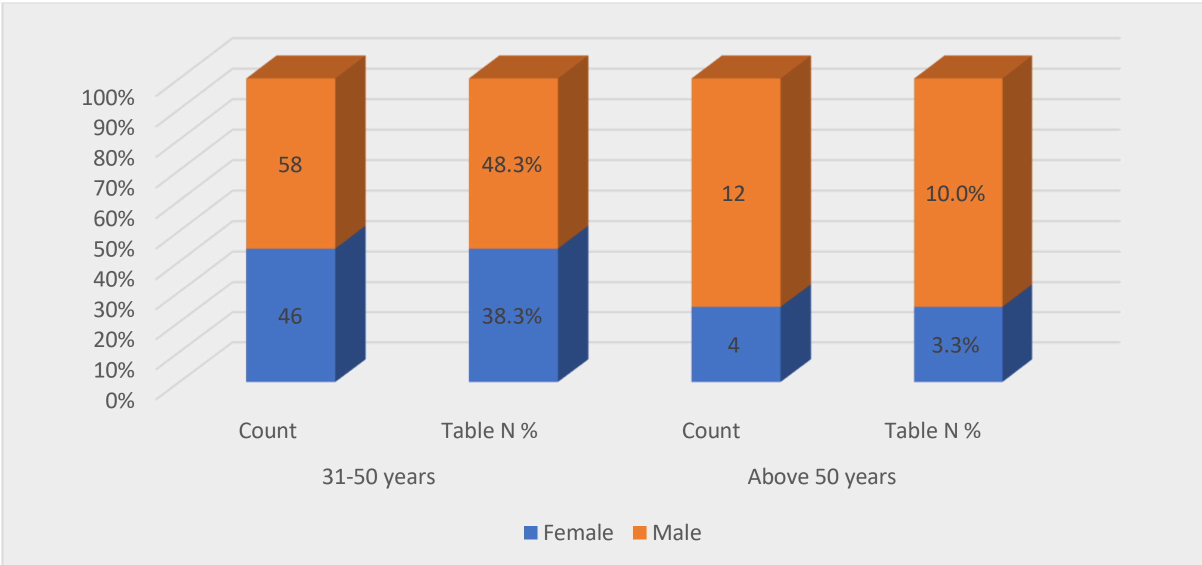

Figure-4.2: Age of the respondents

Figure 4.2 above illustrates that males make up the majority, with the age range between 31 and 50 years which is 48.3% and 38.3% are women. Approximately 10% and 3.3% of respondents who identified as male and female, respectively, are older than 50 years.

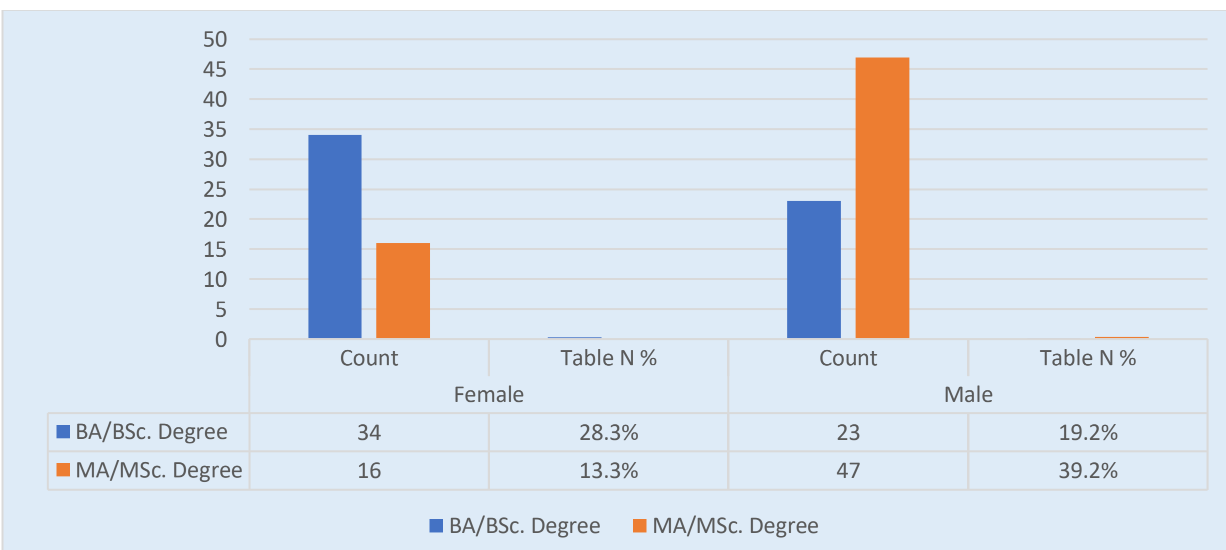

Figure-4.3: Educational background of respondents

As we can see in the above (Figure-4.3) 28.3% of female and 13.3 % of male have BA/BSc. Degree; and 39.2% of males and 19.2% females have MA/ MSc. Degree.

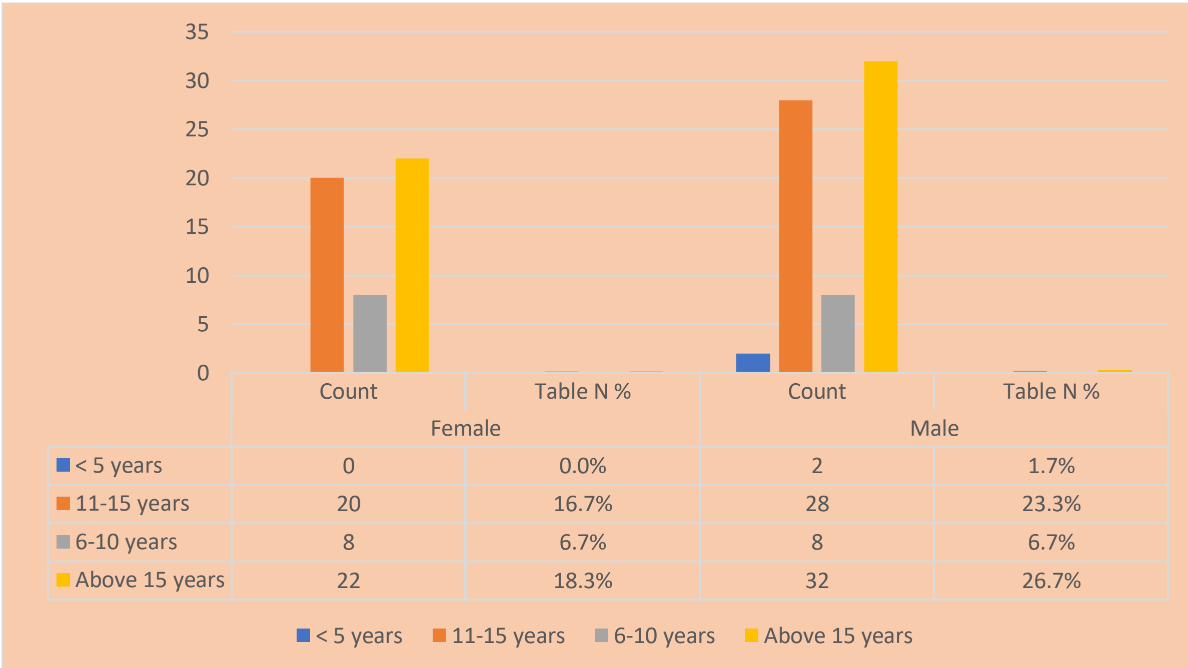

Figure-4.4: Work experience of respondents

Just 1.7% of male respondents had an average experience of less than five years, compared to more than 80% of respondents who have more than ten years of experience, as seen in the above figure.

4.2 Banks Profile

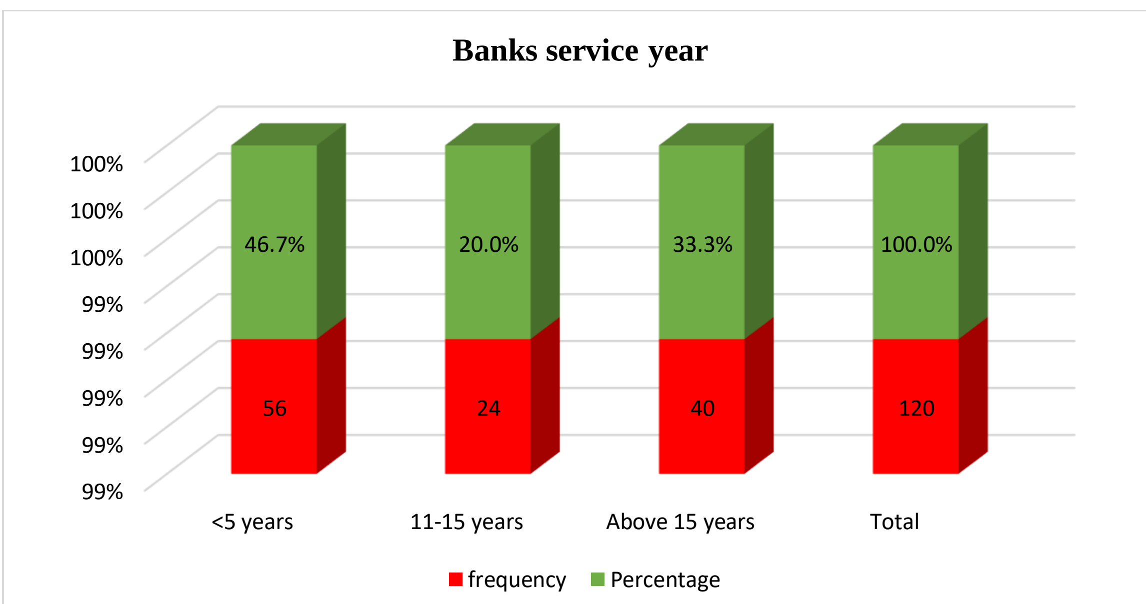

Figure-4.5: - Banks service year

Figure 4.5 above illustrates that 46.7% of banks had a service year of less than five years, 20% had a service year between eleven and fifteen years and 33.3% had a service year more than fifteen years. This suggests that almost half of Ethiopia's commercial banks are relatively new to the industry, having been in operation less than five years.

Table-4.0: Geographical distribution of correspondent bank relationships

Name of the bank	Service Year	Geographical distribution of the correspondent bank relationships.					
		Europe	USA	Asia	Africa	Middle East	Others
Ahadu	Less than 5 years	1		1	6	1	
Amhara	Less than 5 years	2			7	1	
Gadaa	Less than 5 years	1			3	1	
Goh	Less than 5 years	1			4	1	
Hijra	Less than 5 years	1			4	1	
Omo	Less than 5 years	1			3	1	
Rammis	Less than 5 years	1			3	1	
Shabelle	Less than 5 years	1			2	1	
Sidama	Less than 5 years	1			2		
Sinqee	Less than 5 years	2			6	1	
Siket	Less than 5 years	1			1	1	
Tsehay	Less than 5 years	1			7	1	
Tsedey	Less than 5 years	1			7	1	
Zamzam	Less than 5 years	1			4	1	
Abay	11 to 15 years	4			6		
Addis International	11 to 15 years	3	1	1	6	1	
Berhan	11 to 15 years	2			8	1	
Buna	11 to 15 years	2	1	1	8	2	
Global	11 to 15 years	3			8	1	
Zemen	1 to 15 years	3	1		2		
Awash	Above 15	6	1		3	1	
BOA	Above 15	3	2		3	2	
Cooperative Bank of Oromia	Above 15	3	1	1	7	1	
Dashen	Above 15	7	2		8	1	
Enat	Above 15	3			5		
Hibret	Above 15	5	1		6		
LIB	Above 15	2		1	4		
NIB	Above 15	1	4		8		
Oromia	Above 15	1	3		5	1	
Wegagen	Above 15	6	2		6	1	

(Source: -Survey result, 2024)

The above table displays that most of Ethiopian commercial banks form their correspondent relationships in African nations. Very small proportion of the newly emerged commercial banks formed their relationships with in Europe and Middle east. As depicted in the above (Table 4.0), the newly emerged banks have no relationship with USA.

Table-4.1: The overall relationship of CB of banks that have service years less than 5 years

Name of the bank	Service Year	Actively exercised CBR	Relationship Request	Relation rejects during request	Withdrawal of CBR after established relationship
		N	N	N	N
Ahadu	Less than 5 years	9	30	21	0
Amhara	Less than 5 years	10	30	20	0
Gadaa	Less than 5 years	5	27	22	0
Goh	Less than 5 years	6	20	14	0
Hijra	Less than 5 years	6	26	20	0
Omo	Less than 5 years	4	10	6	0
Rammis	Less than 5 years	4	30	26	0
Shabelle	Less than 5 years	4	10	6	0
Sidama	Less than 5 years	4	15	11	0
Sinqee	Less than 5 years	9	20	11	0
Siket	Less than 5 years	2	20	18	0
Tsehay	Less than 5 years	7	50	43	0
Tsedey	Less than 5 years	5	15	10	0
Zamzam	Less than 5 years	6	20	14	0
Overall Average		**6.07**	**23.06**	**17.28**	**0**
NB: 74.93% CBR rejected during request stage					
NB: 26.32% currently active CBR					
NB: 0% withdrawal of CBR after established relationship					

Source: - (Survey result, 2024)

Table 4.1 presents 14 banks with less than five years of service. During the first stage before the relationship being established, an average of 23.06 requests were made to form a correspondent relationship; of these, only 6 (26.32%) were approved and have active CBRs; the remaining 17.28 (74.93%) were refused.

Table-4.2: The overall relationship of CB of banks that have service years between 11-15 years

Name of the bank	Service Year	Actively exercised CBR	Relationship Request	Relationship rejects during request	Withdrawal of CBR after established relationship
		N	N	N	N
Abay	11 - 15 years	10	35	25	0
Addis International	11 - 15 years	12	37	23	2
Berhan	11 - 15 years	11	12	0	1
Buna	11 - 15 years	13	14	0	1
Global	11 - 15 years	12	35	18	5

Zemen	11 - 15 years	6	10	4	0
Overall average		**10.67**	**23.83**	**11.67**	**1.5**
NB: 48.97%% CBR rejected during request stage					
NB: 44.77% currently active CBR					
NB: 12.43% withdrawal of CBR after established relationship					

Source: - (Survey result, 2024)

Table 4.2 lists six banks whose service years ranged from eleven to fifteen years. The average number of requests to form a correspondent relationship was 23.83, of which 11.67 (48.97%) were denied in the initial phases prior to the relationship being created, 11.67 (44.77%) were approved and are presently in active CBR, and 1.5(12.43%) terminated their relationship after CBR establishment.

Table-4.3: The overall relationship of CB of banks that have service years above 15 years

Name of the bank	Service Year	Actively exercised CBR	Relationship Request	Relationship rejects during request	Withdrawal of CBR after established relationship
		N	N	N	N
Awash	Above 15	10	16	5	1
BOA	Above 15	10	16	5	1
Cooperative Bank of Oromia	Above 15	13	14	0	1
Dashen	Above 15	25	27	0	2
Enat	Above 15	8	17	7	2
Hibret	Above 15	12	29	16	1
LIB	Above 15	7	16	8	1
NIB	Above 15	13	23	8	2
Oromia	Above 15	10	25	13	2
Wegagen	Above 15	15	23	5	3
Overall average		12.3	20.6	6.7	1.6
NB: 32.52% CBR rejected during request stage					
NB: 59.70% currently active CBR					
NB: 11.51% withdrawal of CBR after established relationship					

Source: - (Survey result, 2024)

Ten banks had more than 15 years of service, as shown in Table 4.3. The average number of requests to form a correspondent relationship was 20.6, of which 6.7(32.52%) were denied at the preliminary stage prior to the relationship being created, 12.3 (59.7%) were approved and are presently in active CBR, and 1.6 (11.51%) withdrew their relationship after CBR was established.

- Out of the three bank service year groups, the first service year group (less than five years) had the highest percentage of rejection (74.93%) at the request stage. In the service year, group (11–15 years) the second-highest percentage of rejection at a request stage at 48.97%, whereas in the service year group above 15 years, the final high rate of rejection at 32.52%.

It is conceivable to conclude from the above finding that the CBR of the previous banks affected the image of the newer banks.

4.2 Descriptive Analysis of CBRs in Private Commercial Banks in Ethiopia

The mean and standard deviation of the respondents were calculated in order to assess the correspondent banking relationships of the Ethiopian private commercial banks. The analyses explained in the following tables.

Table-4.2.1: Quality of Service

	N	Mean	Std. Deviation
Service provided by foreign correspondence meets the customers' requests well.	120	2.16	1.366
CBR of the bank effectively addresses the operational efficiency of the bank'	120	2.17	1.279
The bank can get various international banking facilities through its correspondent bank relationship.	120	2.04	1.325

Source: (Survey result, 2024)
Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

As can be seen from Table 4.2.1 above, the average response to all three questions is below the disagree scale. This suggests that foreign correspondent banks' services fall under customer expectations and that CBR has not sufficiently addressed the bank's operational efficiency. Furthermore, it may be concluded that banks are not able to use their correspondent relations to receive a variety of international financial services.

- It is possible to infer from the above-mentioned findings that local bank clients do not receive the services they desire from correspondent banks. In other words, local banks do not receive services that they would want from their correspondents.

Table-4.2.2: Cost-effectiveness

	N	**Mean**	**Std. Deviation**
Correspondent bank' fees and charges associated with transaction fees are reasonable.	120	1.60	.571

Relying with few foreign correspondent banks is more expensive than dealing on large number of CB.	120	4.33	.626

Source: (Survey result, 2024)

Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

As illustrated in the above table 4.2.2, the average score (X=1.60) suggests that the fees charged by correspondent banks and those related to transaction fees are **irrational or unfair**, and the average score (X=4.33) indicates that respondents agreed that dealing with a small number of foreign correspondent banks is more expensive than dealing with a large number of CBs.

From the above finding It is possible to decided that the cost incurred for CB services are more expensive and local banks should diverse their network of CBRs to reduce the cost of transaction.

- Based on the aforementioned findings, it is possible to conclude that local banks should diversify their network of CBRs in order to lower transaction costs.

Table-4.2.3: Addressing de-risking

	N	Mean	Std. Deviation
Internal controls and procedures are in place in order to prevent criminals using the bank's facilities for money laundering and terrorist financing.	120	4.21	.660
Automated compliance system is in place to detect and report suspicious transaction and customers	120	1.74	.835
Know your customer (KYC) procedures implemented before establishing business relations, whenever doubt exists about the adequacy of previously obtained records and whenever suspicion of money laundering and financing of terrorism arises.	120	4.38	.566
The bank utilizes SWIFT platform to get solutions with a fast and cost-effective KYC solution that enables to monitor manage and grow their correspondent banking.	120	2.51	1.309
Customers are screened against international sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis	120	4.20	.588
Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious international transactions and customers	120	4.33	.568
Changes on existing management, shareholders structure and practices are timely communicated to concerned foreign banks.	120	1.80	.922
The bank updates its relationship document at regular intervals subject to an investigation or regulatory action, which leads to a material change in the regulation, or there has been any other material change that influences the relationship.	120	1.74	.855

The bank complies with AML/CTF obligations, FATF recommendations, Customer due diligence (CDD) including transaction monitoring and other ongoing customer due diligence measures, and submit suspicious matter reports when required.	120	4.29	.474

Source: (Survey result, 2024)

Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

The mean value for "Internal controls and procedures are in operation in order to prevent criminals exploiting the bank's facilities for money laundering and terrorist financing" (X=4.21) is shown in the above (Table 4.2.3). This suggests that local banks **encourage and enforce** internal control procedures and rules in order to stop financing of terrorism as well as money laundering.

The aforementioned table's mean result for "automated compliance system is in place to detect and report suspicious transaction and customers" (X=1.74) suggests that the correspondent banks' automated compliance system **is not in exercise** to do so.

According to the mean result of the question "Know your customer (KYC) procedures performed before establishing business relations, anytime suspicion of money laundering and financing of terrorism arises, and whenever question arises regarding the sufficiency of previously collected data" (X=4.38), local banks are determined that **establishing KYC principles will reduce** the risk of money laundering and financing of terrorism.

The mean result for "The bank uses the SWIFT platform to obtain solutions with a quick and inexpensive KYC solution that allows them to monitor, manage and expand their correspondent banking" (X=2.51) indicates that local banks use the SWIFT systems only for transferring cash only; they can’t use it to identify their customers by filling their whole profile to know the customers.

According to the mean result for "Customer is screened against international sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis" (X=4.20). It is possible to infer that **local banks screened out** those customers against UN and OFAC to maintain their correspondent relationships.

As demonstrated by the above table's mean result of "Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious international transactions and customers" (X=4.33), indicates that to improve the ability to identify suspicious international transactions and customers local banks provide regular trainings to their staff.

The above table shows that the mean result "Changes on existing management, shareholders structure and practices are timely communicated to concerned foreign banks" (X=1.80) indicates that local banks **do not notify their correspondent** banks in a timely manner about changes related to management, shareholders structure, and practices.

Table 4.2.3 shows that the mean result for the statement, "The bank updates its relationship document at regular intervals subject to an investigation or regulatory action, which leads to a material change in the regulation, or there has been any other material change that influences the relationship" (X=1.74) suggests that local banks did not update the documents for the purpose of being investigated or subject to supervision.

The mean result of "The bank complies with FATF recommendations, AML/CTF obligations, Customer due diligence (CDD) including transaction monitoring and other ongoing customer due diligence measures, and submit suspicious matter reports when required" (X=4.29) suggests that the bank compiles the necessary information regarding FATF recommendations, AML/CTF obligations, CDD, and other CDD measures, as well as suspicious matter reports when required.

- As the aforementioned points on addressing de-risking demonstrate, local banks have made significant foundation on certain areas and were anticipated to fix the shortcomings on others for better relationship with their correspondents.

Table-4.2.4: Factors Driving the Termination or Restriction of CBR

	N	Mean	Std. Deviation
Rising fines and penalties on correspondent banks and high amount of due diligence fees	120	4.46	0.62
The responsiveness and communication of the respondent bank for the request of CB.	120	4.43	0.683
Inability of respondent bank to process CDD/customer due diligence	120	4.38	0.551
Company reputation/the bank history related to implementation of AML/CTF or sanctions obligations, or criminal or civil proceedings relating to money laundering, terrorism financing or other serious crimes.	120	4.31	0.499
Change to supervisory requirements in CB’s jurisdictions and overall risk appetite of the CB	120	4.24	0.58

Lack of confidence in respondent banks' adequacy of controls to manage AML, CFT, Wolfsberg Questionnaire, tax evasion or other risks that they could bear through liability and fines in their home jurisdictions.	120	4.23	0.601
Political situation and risk grade of the country	120	4.20	0.717
Poorly managed Correspondent relationship or inadequate internal control systems	120	4.18	0.686
Profitability or low volume of transactions	120	3.96	0.715
The ownership, control and management structures of the bank	120	3.93	0.747

Source: (Survey result, 2024)

Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

The mean result of "rising fines and penalties on correspondent banks and high amount of due diligence fees" **(X=4.46)**, as shown in Table 4.2.4 above, suggests that the **prime** factors influencing for termination or restriction of CBR are rising fines and penalties on correspondent banks and high amounts of due diligence fees.

As indicated the mean result of "the responsiveness and communication of the respondent bank for the request of CB" (X=4.43) implies that the second major factors influencing for termination or restriction of CBR.

The mean result of "inability of respondent bank to conduct CDD/customer due diligence" (X=4.38) suggested the third important factor impacting the termination or restriction of CBR. It's most likely that the banks' inability to finish CDD may result in the suspension or termination of CBR.

The mean result for the variables "bank reputation/history connected to AML/CTF implementation, sanctions obligations, or criminal or civil proceedings pertaining to money laundering, terrorism financing, or other serious crimes" (X=4.31) demonstrated that a bank's adverse background is one of the four possible reasons for CBR suspension or termination.

According to the mean result, for the variables "Change to supervisory requirements in CB's jurisdictions and overall risk appetite of the CB" (X=4.24), implies that raising the CB's overall risk and monitoring requirements is the fifth reason that might lead to a suspension or limitation of CBR.

Displaying a mean value of "Lack of trust in the suitability of measures implemented by respondent banks to handle AML, CFT, tax evasion, and other risks that they may face through penalties and liabilities in their home jurisdictions," In the table above, (X=4.23) suggests it is the sixth reason why CBR may be terminated or restricted.

According to the above table's mean result of (X=4.20), "Political condition and risk grade of the nation" rank as seventh among the potential grounds for CBs to limit or withdraw their CBRs.

Inappropriate internal control systems or badly managed correspondent relationships appear to be the eight probable reasons of CBR limitation or restriction as a mean value of (X=4.18) indicated above.

The table above illustrates that low profitability or low volume of transactions is the ninth potential reasons for CBR removal or restriction as confirmed by the mean value (X=3.96) of the respondents' responses.

As displayed by the mean value of respondents (X=3.93) it is possible to decided that the ownership, control and management structures of the bank is the last possible reasons for CBR removal or restriction.

- Based on the average replies, the reasons for CBR withdrawal or restrictions are prioritized in ascending order and displayed in Table 4.2.4 above.

Table-4.2.5: Restriction of Services from CBs

	N	Mean	Std. Deviation
Transaction and customer limitation.	120	4.33	.663
Country restriction to process transactions	120	4.43	.590
Overall average of restriction of services from CBs	**120**	**4.33**	**0.627**

Source: (Survey result, 2024)
Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

The average mean score (X=4.33) and standard deviation (SD=0.627) in (Table 4.2.5) above demonstrate that respondent banks **have limitations** on services provided by their correspondent banks, including transaction & customer limitations and country-specific restrictions on transaction processing.

Table-4.2.6: Consequences of Correspondent Bank Closure

	N	Mean	Std. Deviation
Losing of potential customers	120	4.46	0.685

Negative influence on foreign currency mobilization and import volume of the bank.	120	4.43	0.658
High fees due to multiple banks involvement to process foreign transactions.	120	4.43	0.545
The financial inclusive and quality service of the bank highly affected.	120	4.31	0.562
Profitability of the bank is highly affected	120	4.28	0.611
MTOs and potential customers have been particularly affected.	120	4.27	0.695
Overall average	**120**	**4.36**	**0.626**

Source: (Survey result, 2024)
Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

As illustrated in the above (Table-4.2.6), the major consequence of correspondent bank closure is “Losing of potential customers”, the mean (X= 4.46) indicates that respondents strongly agree on it. The local banks strongly harmed because of closing of CB which means their potential customers will be forced to use other banks for their international banking relations.

The second consequence of correspondent bank closure of CB is “Negative influence on foreign currency mobilization and import volume of the bank”. As seen, the initial effect of the aforesaid reaction is that local banks lose out on potential clients as a result of the CB closing. This would negatively impact the bank's ability to mobilize foreign currency and volume of imports.

The third consequence of correspondent bank closure of CB is “High fees due to multiple banks involvement to process foreign transactions” the mean (X=4.43) indicates that respondents strongly agree on these issues. The local banks will have to rely on the cooperation of other institutions in order to retain their prospective clients if they lose their direct CBRs.

The fourth consequence of correspondent bank closure is “The financial inclusive and quality service of the bank highly affected”, the mean (X=4.31) indicates that respondents strongly agree on it. When local banks lose CBR, their clients leave for other banks, which has a significant negative impact on both the bank's ability to accept foreign currencies and the quality of its services.

The fifth consequence of correspondent bank closure is “Profitability of the bank is highly affected”, the mean (X=4.28) indicates that respondents strongly agree on it. The aforementioned effects clearly bolster this concern; if the bank loses these prospective clients, its profitability would be severely impacted.

The final consequence of correspondent bank closure is “MTOs and potential customers have been particularly affected.”, the mean (X=4.27) indicates that respondents strongly agree on it. In many cases, money transfer organizations rely on CBRs as well; as a result, their operations are affected when CBRs close.

Table- 4.2.7: The Central Bank /NBE/ Role on CBR

	N	Mean	Std. Deviation
There are instructions set by the NBE to oversee the relationship between the local bank and foreign correspondent banks	120	1.48	.580
NBE hold seminar and awareness creation programs with local banks about the difficulties with CBs.	120	1.49	.635
NBE evaluate and approve correspondent relationship of the bank prior to establishment.	120	4.28	.608
NBE promptly addresses issues and concerns raised by financial institutions regarding correspondent banking problems.	120	1.33	.537
NBE conducts regular assessments and audits to ensure compliance with correspondent banking regulations	120	1.53	.607
Overall average of the Central Bank /NBE/ Role on CBR	120	2.02	0.593

Source: (Survey result, 2024)
Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

According to (Table 4.2.7) above, the mean value (X=1.48) indicate that respondent banks have strongly disagree with the issue raised as “There are instructions set by the NBE to oversee the relationship between the local bank and foreign correspondent banks”.

The mean value (X=1.49) indicate that respondent banks have strongly disagree with the issue raised as” NBE hold seminar and awareness creation programs with local banks about the difficulties with CBs”.

The mean value (X=4.28) indicate that respondent banks have strongly agree with the issue raised as” NBE evaluate and approve correspondent relationship of the bank prior to establishment”.

The mean value (X=1.33) indicate that respondent banks have strongly disagree with the issue raised as “NBE promptly addresses issues and concerns raised by financial institutions regarding correspondent banking problems”.

The mean value (X=1.53) indicate that respondent banks have strongly disagree with the issue raised as “NBE conducts regular assessments and audits to ensure compliance with correspondent banking regulations”.

More or less the above responses supported by the Interviewed section of the NBE experts as described below:

> *"There is an old National Bank of Ethiopia directives that allows commercial banks a head start. However, NBE must get the profile of all correspondent banks of commercial banks to approve the relationship. The approval step necessitates the fulfillment of the following requirements:*
>
> *The most recent financial statement of the correspondent bank, license of the correspondent bank, the list of directors, senior management and major shareholders of the correspondent bank, the articles of association and memorandum of association of the correspondent bank, and the credit rating of the correspondent banks.*
>
> *Lastly, the National Bank of Ethiopia's sole responsibility is to enforce the correspondent bank's anti-money laundering (AML) policy and process to guarantee the bank stays out of any fraudulent or money-laundering activities and approves the relationship request after confirming the aforementioned KYC documents.*
>
> *The majority of European and American banks often reject requests from Ethiopian banks due to the capacity of Ethiopian commercial banks as well as a number of other conditions. Consequently, the majority of our banks have equivalent banking relationships with banks in Turkey and Djibouti occasionally deal with China. It has been stated clearly and forcefully that the National Bank of Ethiopia's only duty is to assist commercial banks with their first business formation with correspondent banks. If not, it has no say in helping commercial banks acquire overseas banks or evaluating existing correspondent bank relationships. I noticed that the banking supervision department exclusively handles local banking operations, regardless of the fact that it oversees and regulates the international operations of commercial banks."* (Interview NBE_1)

Finally, Interview NBE_1 was asked to suggest whether the current involvement of national bank is enough to facilitate the relationship of correspondent banks,

> *"Commercial banks can set up correspondent banking relationships based on whatever best fits their client base, profitability, and business operations. Selecting a bank to serve as a correspondent bank is not mandated by the central bank."* (Interview NBE_1)
>
> *"There has long been directive with a list of procedures stating as to how commercial banks surrender their surplus foreign currency to the National Bank which is held in foreign banks."* (Interview NBE_2)

Regarding whether or not commercial banks are controlled by National bank of Ethiopia while dealing with correspondent banks.

> *"All commercial banks are subject to a single directive for verification. Specifically, this is accomplished by implementing FXD/77, which mandates that commercial bank promptly clear import payments for foreign banks. National Bank works to reduce and resolve issues resulting from failing to comply with the order in the process of adhering to it. The lack of*

a written directive compelling National Bank to conduct on-site inspections and assess Ethiopian commercial banks was emphasized. Nevertheless, notwithstanding their own internal rules and procedures, banks are required to abide by the worldwide principles and platform." (Interview NBE_2)

Table-4.2.8: Successful Relationship with Correspondent Banks

	N	Mean	Std. Deviation
The bank has a widely geographically distributed relationship and has many alternatives of correspondent banks.	120	2.00	1.216
Proactive risk management using policies procedures and compliance measurement by respondent banks mitigate potential regulatory risks of the bank.	120	2.37	1.347
There is trust, confidence, minimum cost minimum risk and consistent communication with CBs	120	1.94	1.176
Overall average	**120**	**2.10**	**1.246**

Source: (Survey result, 2024)
Scale: < 1.80 Strongly Disagree, between 1.81 and 2.60 Disagree, between 2.61 to 3.40 Neutral, between 3.41 to 4.20 Agree and > 4.21 Strongly agree

As illustrated in the above (Table 4.2.8) there are three questions raised to assess respondent relationship with correspondent banks. As a result, the mean score (X=2.00) indicates that respondents disagree about the issue raised as "The bank has a widely geographically distributed relationship and has many alternatives of correspondent banks".

The mean score (X=2.37) indicates that respondents disagree about the issue raised as "Proactive risk management using policies procedures and compliance measurement by respondent banks mitigate potential regulatory risks of the bank".

The mean score (X=1.94) indicates that respondents disagree about the issue raised as "There is trust, confidence, minimum cost minimum risk and consistent communication with CBs".

4.3 Inferential Statistics

Before utilizing the data, the following steps were taken to make sure it complied with the assumptions of the regression analysis:

4.3.1 Multicollinearity Test

A multicollinearity test is essential to ascertain whether or not the independent variables in a pattern A multicollinearity test is required to ascertain whether or not the independent variables in a pattern are related, after the consistency of the statistics in the regression pattern is seen. The relationships between the independent variables and the results are significantly associated. In addition, a multicollinearity study was carried out to examine the impact of independent factors on the establishment of a successful relationship with correspondent banks. Regression models that are appropriate should not show any form of correlation or multicollinearity with the independent variables.

Examining multicollinearity as a framework for the VIF value:

1. **If the VIF in between 1-10, then there is no multicollinearity.**
2. **If the VIF < 1 or >10, then there is multicollinearity problem**.

For both the top (1.200) and bottom (1.858) boundaries of the VIF results, the model meets the requirement (there is no multicollinearity) problem, as shown in (Table 4.3.5) below.

4.3.2 Correlation Analysis

The degree of interaction between two variables is shown by their correlation. Due to their convenience of use and ability to represent a large amount of information in a single number, correlation coefficients are often employed to explain data (Mooi & Sarstedt, 2011).

The correlation figures estimated significance ranges from -1 to 1, where a value of -1 indicates a perfect negative link (also known as a perfectly linear relationship) and a value of 1 indicates an absolutely positive association. There is no association when the correlation coefficient is zero (Mooi & Sarstedt, 2011).

Table: -4.3.1 Pearson Correlation

		QS	CE	AD	FDT	RS	CCBC	NBER	SRCB
QS	Pearson Correlation	1							
	Sig. (2-tailed)								
CE	Pearson Correlation	.014	1						
	Sig. (2-tailed)	.876							
AD	Pearson Correlation	.620**	-.229*	1					
	Sig. (2-tailed)	.000	.012						
FDT	Pearson Correlation	.221*	.013	.178	1				
	Sig. (2-tailed)	.015	.891	.052					
RS	Pearson Correlation	-.115	.327**	-.268**	.095	1			
	Sig. (2-tailed)	.209	.000	.003	.300				
CCBC	Pearson Correlation	.031	-.089	.062	.387**	.080	1		
	Sig. (2-tailed)	.737	.332	.502	.000	.382			
NBER	Pearson Correlation	.340**	-.014	.270**	.142	-.124	.023	1	

	Sig. (2-tailed)	.000	.877	.003	.121	.176	.806		.040
SRCB	Pearson Correlation	.790**	-.047	.579**	.246**	-.091	-.109	.188*	1
	Sig. (2-tailed)	.000	.610	.000	.007	.323	.237	.040	
**. Correlation is significant at the 0.01 level (2-tailed).									
*. Correlation is significant at the 0.05 level (2-tailed).									

Source: (Survey result, 2024)

4.3.2.1 Successful Relationship with Correspondent Banks with Quality Service

The degree of connection between the two variables is a strong positive association, with r=.790**. The aforementioned Pearson connection illustrates quality service has significant impact on successful relationship with correspondent banks.

4.3.2.2 Successful Relationship with Correspondent Banks with Addressing De-risking

Table 4.3.1 shows a moderate positive link between successful relationship with correspondent banks with addressing de-risking, The value of r=.579** indicates that the two variables have a positive association.

4.3.2.3 Successful Relationship with Correspondent Banks with Factors Driving the Termination

Table 4.3.1 displays the correlation coefficient (r = .246*) indicates a weakly positive association between successful relationship with correspondent banks with factors driving the termination of CBRs.

4.3.2.4 Successful Relationship with Correspondent Banks with National Bank of Ethiopian Role

Table 4.3.1 displays the correlation coefficient (r = .188*) indicates a weakly positive association between Successful Relationship with Correspondent Banks with National Bank of Ethiopian Role.

4.3.3 Regression Analysis

Regression analysis is the scientific measurement of the normal relationship between two or more variables with respect to the different units of the data. The cause and effect of the relationship between the variables are abundantly verified by regression. In regression analysis, the independent variable is the one that relates to the cause, while the dependent variable is the one that relates to the result.

Checking for Linearity

The regression pattern can be expressed using a linear method. The linearity of the y and x variables can be tested by adjusting the independent variables to contradict the dependent variable (Mooi & Sarstedt, 2011). The purpose of the normality test is to ascertain whether or not the multiple linear regression analysis of the regression model pertaining to employee creativity and leadership styles satisfied the multicollinearity assumption. As illustrated in figure 4.1 below, the relationship between the independent and dependent variables is linear

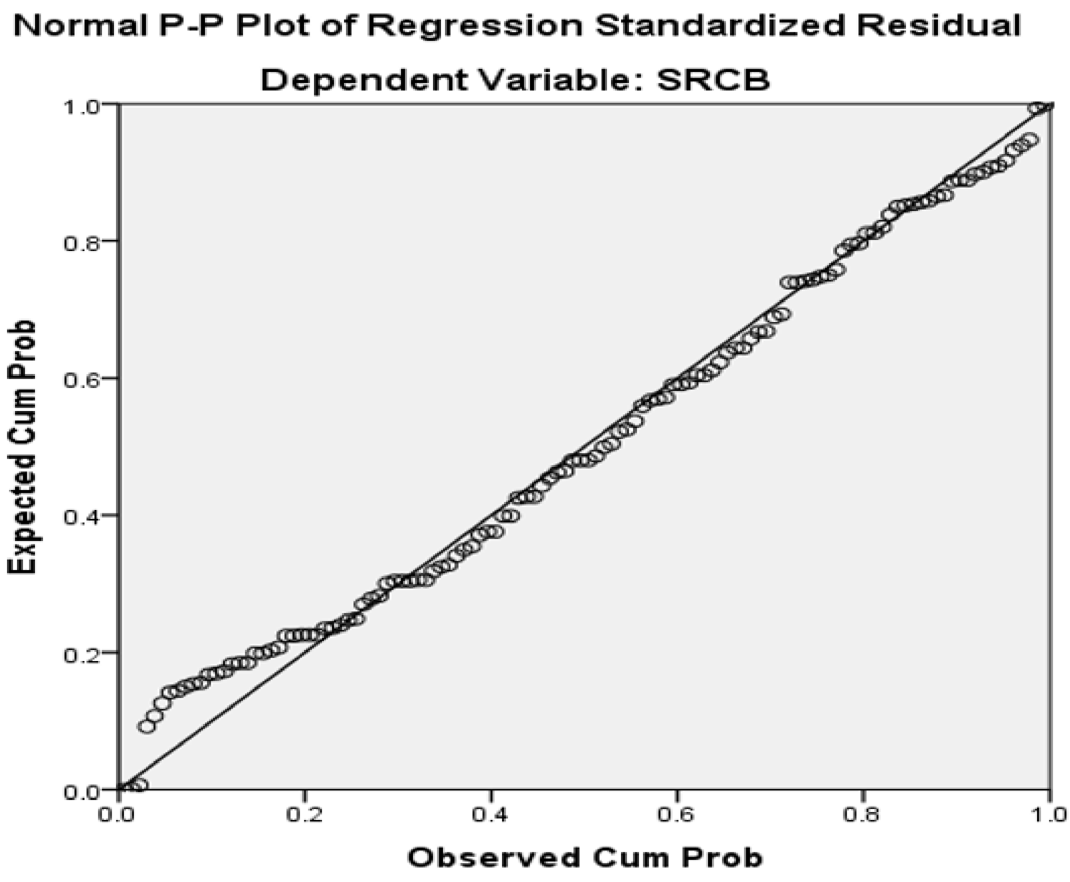

Figure-4.1: Normality test result

The regression model can be used if the data distribution is regular or extremely close to normal. A typical P-P plot graph's regression normalized residual shows that the line is near the diagonal line and travels along its course.

Regression Model Summary

Multiple linear regression analysis has been done to evaluate the independent variables on the successful relationships with Corresponding banking relationships. The study utilized the degree of successful relationship with correspondent banks as the major variable and the underlying reasons of as the secondary factors. The R-squared summary of the regression model's results (see table 4.3.2) indicated the extent to which the successful relation with correspondent banks with determinant factors accounted for the variation in the success measure. This resulted in the model's coefficient of determination, or R^2, which shows that 0.689 of the variation in the measurement (successful relationship with correspondent banks) function can be explained by quality service, addressing de-risking, factors driving the termination or restriction of CBR and Consequences of Correspondent Bank Closure. Conversely, a R square of 0.618 indicates that an explanatory variable has a 68.9% influence on the dependent variable whereas the remaining 31.1% of was explained by other factors.

Table- 4.3.3: Summary of linear regression model.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.830[a]	.689	.669	.598	.689	35.368	7	112	.000

a. Predictors: (Constant), NBER, CE, CCBC, QS, RS, FDT, AD

b. Dependent Variable: SRCB

F-test for Successful Relationship with Correspondent Banks

The ANOVA table presents the degree of significance, with each predictive variable's relationship to the underlying reasons of successful relationship with correspondent banks compared to an alpha value of 0.05. The significance of an item's acceptability is indicated in (Table 4.3.4). Nonetheless, the results in the table demonstrated that the independent variable significantly impacted successful relationship with correspondent banks and this was acceptable at a significance level of 0.000 or less than 0.05. This table indicates that F is valued at 35.36. Total the significant 0.000. Given that the probability of this prediction error is less than 0.05, or sig 0.000, and the forecast's confidence level exceeds 95%, we can infer that sig < 0.05 signifies both. Consequently, the relevance of the model was established by its linear connection in multiple regressions, which also indicated that the variation the model explained was not due to chance fluctuation.

Table-4.3.4: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	88.558	7	12.651	35.368	.000[b]
	Residual	40.063	112	.358		
	Total	128.621	119			

a. Dependent Variable: SRCB

b. Predictors: (Constant), NBER, CE, CCBC, QS, RS, FDT, AD

Source: - (Survey result, 2024)

Regression Analysis for Successful Relationship with Correspondent Banks

We can see that the degree to which each independent variable influences the dependent variable is that of influence for successful relation with correspondent banks based on their unstandardized beta coefficient values which point to quality service, addressing de-risking, factors driving the termination and consequences of correspondent bank closure as the most significant determinant factors of successful relationship with correspondent banks. The F-test table also showed a linear relationship between the regression equation model and the data. According to Table 4.3.5 regression analysis of unstandardized coefficients of Beta and Sig values for the four independent variables revealed that the quality service, addressing de-risking, factors driving the termination and consequences of correspondent bank closure were (0.597), (0.396), (0.755) and (-0.723), with significance values of 0.000, 0.040, 0.011 and 0.001, respectively. Therefore, dependent variable (successful relationship with correspondent banks) is significantly influenced the above described four variables.

Table 4.3.5: Successful Relationship with Correspondent Banks Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.298	1.472		.202	.840		
Setvice_Quality	.597	.060	.712	10.031	.000*	.552	1.812
Cost-Effectiveness	-.154	.156	-.058	-.993	.323	.827	1.209
Addressing_Derisking	.396	.191	.149	2.078	.040*	.538	1.858
Factors_Termination_Restriction	.755	.291	.154	2.591	.011*	.790	1.266
Restriction Service	.096	.145	.039	.663	.509	.825	1.213
Consequences_Correspondent Bank Closure	-.723	.203	-.205	-3.553	.001*	.833	1.200

NBE_ Role on Correspondent Banking_Relationship	-.345	.182	-.107	-1.896	.060	.868	1.153

a. Dependent Variable: SRCB

To express the dependent variable (successful relationship with correspondent banks) and independent variable (quality service, addressing de-risking, factors driving the termination and consequences of correspondent bank closure in mathematical equation)

Let:

Y= successful relationship with correspondent banks**,**

X_1= quality service**,**

X_2= addressing de-risking**,**

X_3= factors driving the termination or restriction

X_4= consequences of correspondent bank closure

Therefore, the general relationship is written mathematically as follow:

$$Y_i = 0.597\,X_1 + 0.396\,X_2 + 0.755\,X_3 - 0.723X_4$$

Discussion of Regression Results

The purpose of this study is to learn more about the factors that propel successful relationship with correspondent banks and to investigate the effects of a select set of explanatory variables on it. The study determined that the explanatory variables of quality service, addressing de-risking, factors driving the termination and consequences of correspondent bank closure were critical for successful relationship with correspondent banks.

Quality Service has a Constructive Effect on Successful Relationship with Correspondent Banks

The findings of the regression analysis show that a quality service has a considerable positive impact on successful relationship with correspondent banks (sig.000). A single unit increase in quality service the success of relationship with correspondent banks will increase by 0.571 (with a positive beta value of 0.571).

Addressing De-risking has a Constructive Effect on Successful Relationship with Correspondent Banks

The findings of the regression analysis show that an addressing de-risking has a substantial positive impact on successful relationship with correspondent banks (sig.040). A single unit increase in addressing de-risking the success of relationship with correspondent banks will increase by 0.396 (with a positive beta value of 0.396).

Factors Driving the Termination has a Constructive Effect on Successful Relationship with Correspondent Banks

The findings of the regression analysis show that factors driving the termination has a substantial positive impact on successful relationship with correspondent banks (sig.011). A single unit improvement in factors driving the termination the success of relationship with correspondent banks will increase by 0.755 (with a positive beta value of 0.755).

Consequences of Correspondent Bank Closure has Effect on Successful Relationship with Correspondent Banks

The findings of the regression analysis show that the consequence of correspondent bank closure has a negative impact on successful relationship with correspondent banks (sig.001). A single unit increase in consequences of correspondent bank closure the success of relationship with correspondent banks will be decreased by 0.723 (with a negative beta value of 0.723).

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter is organized as follows: a summary of the findings; conclusions; and recommendation for improvement of research in the last section.

5.2 Summary of Findings

The purpose of this study was to evaluate correspondent banking relationships of Ethiopian commercial banks with their correspondents. The studies were intended to answer the following three main questions: What looks like the relationship between the correspondent bank to the responder bank; what kind of approach or methodologies followed by local banks in managing the corresponding relationship? and what kind of polices or governing rules followed by National Bank of Ethiopia to monitor the commercial banks of Ethiopia and correspondent banks in dealing with their relationship?

- **Number of existing correspondent Banks**

The collected data indicates that the number of foreign bank relationship established by all private banks does not show a significant different between them in terms of number of existing correspondent banks ‘relationship, they all seem to have a similar number of corresponding banks ranging as small as 6 to as high as 25. However, there is a wide difference in size, quality & capacity between them. And most local banks establish relationship with correspond banks in Africa while only few banks manage to have relationship with banks in North American & Europe.

- **Geographical distribution of the correspondent bank relationships.**

According to the collected data, most of local private’ banks do not have a direct relationship with USD clearing banks located in North America or Europe. Thus, they provide international trade service by using one or two additional banks as intermediary bank, which in turn increases the number of banks involved in a single transaction and this will lead to a rise in the total service fee requested by each foreign banks from local banks. And this is often met by local’ banks payment as well as by collecting from customers.

Since every single transaction involves many banks it takes significant period of time to be able to reach to the final beneficiary. Due to this, many local banks constantly face difficulties in delivering their services to the customers promptly. In addition, increasing a large number of participating banks mean, there is a high probability that the transaction would be returned or rejected by their respective KYC' policies. This creates a big obstacle for the clients to carry out their business as planned on timely basis.

- **Terminated-correspondent banking relationship**

I have noticed that quite a few foreign banks have successfully established relationship with private banks in Ethiopia and now they have seemed to terminate their former relationship after staying in business together. According to the information obtained so far, thirty-seven Ethiopian bank' accounts closed in different foreign banks and observing those banks that closed their accounts with more than one bank are 20 foreign banks. And these banks are located in North America & Europe.

According to the information collected from the banks those big European & American banks that have both terminated their relationship or still in business with very few local banks, have no willingness to work with any new other banks at all.

This is now becoming the main reason why Ethiopian banks are not able to receive & send foreign currency from all over the world on time.

Particularly, when we look at the banks that are leaving Ethiopia, they are all big banks found in North America & Europe. This shows that Ethiopian banks are losing their major USD, EURO & GBP paying banks. At the same time, the inability to replace them with other alternative banks after the termination of the relationship has made the problem more widespread.

In general, Ethiopian banks should have been expanding their service scope, but on the contrary, they are forced to provide limited services through the few bank accounts they have opened during their first years of establishment. Some of them went to the extent of closing their accounts and this made the banks unable to provide complete International banking services to their customers.

- **Rejected or Restricted - correspondent banking relationship**

Although there have been business relationship with mainly similar and limited European banks, local banks could not establish relationship with most distinguish European banks & not with a single North American bank. And we have come to understand that most of the foreign banks reject or restrict the relationship request from Ethiopia banks on their first email encounter or exchange.

It is difficult to single out the main reason why these banks reject the request of local banks to work together without even making inquiries about their Capital amount, organizational structure, ownership share, profit, readiness of KYC document, number of branches, internal control etc. They just simply reject the entire request made by Ethiopian banks. What confirms this is that, the foreign banking relationship made & achieved by third generation banks have found to be the same in terms of geographical distribution, banks & currency types.

When most of the existing firs generation banks faced with the problem of those foreign banks that terminate relationships after a long standing work relationship while those banks whose establishment period is middle recent, their effort to establish foreign bank relationship have succeeded only in Africa, but failed to succeed with European & North American banks.

What reinforces this is that, in the years when first generation banks were established, the number of rejected request were very small compared the middle banks with regard to the recent banks, almost all American banks & most of European banks rejected their relationship request.

Descriptive analysis of CBRs in private commercial banks in Ethiopia

- **Quality of Service**

Almost all private banks in Ethiopia have given the same response regarding the services they are getting from foreign banks. Ethiopian banks have not been able to provide complete foreign banking services according to their customers' requests and as a result, they have not been able to satisfy their customers' request.

Most of private banks found in Ethiopia have limited relationship with banks in North America and Europe. Especially those recent banks have no business relationship at all. Consequently, they neither receive nor send foreign currency across the world. Therefore, they tend to experience limitation in their provision of foreign bank service, which further makes them unable to address customers' request on timely basis.

- **Cost-effectiveness**

The fees and charge paid by Ethiopian banks for the services they receive from foreign banks are exaggerated. Especially, those local banks that have no relationship with European banks and North American banks cannot send or receive money from any part of the world. Therefore, they involve other banks by incurring higher transaction costs.

- **Policy responses to address the withdrawal of CBRs**

The collected data shows on most local banks is that they are well aware of the international laws and principles such as strong internal control, developing of AML/CFT policy, KYC policy, CDD policy and as such they often tend to perform well. However, we have come to understand areas where most local banks have made poor performance. Thus, in terms of implementing automated compliance system that scrutinize suspicious transactions and customers is not their business integral part. Besides, with reference to using swift platforms as KYC solution and updating continuous management change to foreign banks, they found to be weak. All in all their performance in updating and exchanging the necessary document to foreign correspondent banks have found to perform not well.

- **Factors Driving the Termination or Restriction of CBR**

Local banks when requested about the possible reasons or factors that could lead to either termination or complete rejection from the very beginning by foreign banks; they have mentioned all factors that ranging from profitability or volume of transactions, to the responsiveness and communication of the respondent bank. All variables listed on the table have been found to be leading causes for withdrawal of Correspondent Banks.

However, the major reasons raised by all local banks out of the ones stated on the table is first that of engaging in the exchange of fraudulent transactions between local banks and their customers. And if anyone is found in any form of be it transferring, receiving and sending foreign currency with those internationally band countries and individuals, the penalty would be severe for all parties involved.

The second main reason or factor raised involves first generation banks' noncompliance by the international rules and principles, which further ruin their reputation globally. In addition, in effect, foreign banks have lost trust and confidence in the other local banks. Third main factor that we have understood is lack of responsiveness and communication from the local banks for every continuous requirement sent to them.

- **Restriction of Services from CBs**

Local Banks, despite somehow managing to succeed in establishing relationship is already few foreign banks; the service they get is limited in terms of both type and country. And this shows that nearly all local banks have now reached to a point where they no longer be able to satisfy their customers through different international banking services coverage.

- **Consequences of Correspondent Bank Closure**

Local banks' relationship with foreign banks have not been successful. Therefore, they have been losing potential customers, not provide inclusive and quality service, and face higher transaction cost. Following these, they have experienced negative impact on their resource mobilization to provide import and export service and on their profit margin performance.

Out of the problem mentioned above the major ones identified are first the fact that they are losing their potential customers together with facing higher service charge.

Whereas the second and the third position have been taken by week foreign currency resource mobilization and failure to provide quality service respectively.

- **The Central Bank /NBE/ Role on CBR**

National Bank, in its part, has done nothing with regard to supporting local Banks either establish new relationship with foreign banks or help them maintain their already established relationship. With reference to monitoring local banks' compliance with international rules and principles and efforts to solve problems, arising between local and foreign banks through continuous seminar and consultation has not been considered at all.

We also found out that NBE has no mechanism or directive to take a corrective measure for problems. As the data shows the only area where the national bank involves in the relationship between local and foreign banks is just to approve or give a green light after the relationship is made through the sole effort of local banks. This is to say that the entire effort to find a foreign bank and strike a business relationship is left for local Banks.

- **Successful Relationship with Correspondent Banks**

In general, we could say that, nearly all local banks seem not to have efficient and firm foreign bank relationship through which they could provide international trade service such as money transfers and all hard currency related activities. Besides, they have not been able to establish a correspondent bank relationship that are geographically distributed. Local banks fail to put in place proactive policy and procedures to mitigate potential risks that could possibly arise between them. Moreover foreign banks have little trust and confidence in local banks. Due to this, both the cost of their transactions and to risk is very high.

- **Interview questions**

According to the information received from National Bank higher officials there exist a department known as a banking supervision department which takes care of regular auditing with regard to local banks' compliance to the international rules and regulation so that they could maintain smooth foreign bank relationship. However, I found out contradictory response from the department that they only inspect local banks establishment and their local services within the national boundaries.

Hence, local banks, in their effort to establish relationship with foreign banks, National bank of Ethiopia does not involve except to approve their initiation request. I have found out the National Bank does not believe in further involvement on the two parties' processed based establishment.

Even though National bank believes that local, banks should operate under the international guidelines and principles they do not control if the rules are properly implemented by local banks.

Therefore we can conclude that National Bank of Ethiopia doesn't support Ethiopian local banks in areas such as recruiting correspondent banks in times of first time establishment and communicating also by providing training on KYC' document preparedness. Moreover, they fail to prepare seminars and discussions to address both the existing and the ever-growing problems of local banks.

The national Bank of Ethiopia does not have directives or controlling mechanisms that are appropriate to the seriousness of the problem or one that takes into account the ever-increasing requirements of foreign banks to establish any correspondent banking relationship.

In general, the response of the two National bank senior officials is that, there is an old directive that approve when local banks establish relationship with foreign banks. Following this I made my own investigation but I couldn't find which old directive they said exist, when it came into effect and what it enforced as well.

5.3 Conclusion

Based on the findings outlined in the study, several conclusions can be drawn regarding correspondent banking relationships (CBRs) of Ethiopian commercial banks:

Number and Distribution of Correspondent Banks:

- Ethiopian commercial banks exhibit a similar range in the number of correspondent bank relationships, but there are significant differences in their size, quality, and geographical distribution.
- Most Ethiopian banks establish relationships with correspondent banks in Africa, with limited connections to banks in North America and Europe.
- The reliance on intermediary banks for USD clearing in North America and Europe increases transaction complexity and fees, leading to delays in transactions and difficulties in delivering prompt services to customers.

Termination of Correspondent Banking Relationships:

- Several foreign banks, particularly those in North America and Europe, have terminated relationships with Ethiopian banks, leading to the closure of numerous bank accounts.
- The reluctance of major European and American banks to work with new Ethiopian banks exacerbates the challenge of sending and receiving foreign currency promptly.

Rejected or Restricted Relationships:

- Ethiopian banks face difficulties in establishing relationships with distinguished European and North American banks, with many requests being rejected outright.
- The rejection of relationship requests by foreign banks appears to be independent of factors such as capital amount, organizational structure, or readiness of documentation.

Quality of Service and Cost-Effectiveness:

- Ethiopian banks report dissatisfaction with the services provided by foreign banks, leading to limitations in fulfilling customer requests.
- The fees and charges incurred by Ethiopian banks for services from foreign banks are deemed excessive, particularly for those without direct relationships with European and North American banks.

Policy Responses and Factors Driving Termination or Restriction:

- Ethiopian banks demonstrate awareness of international laws and principles but exhibit weaknesses in implementing automated compliance systems and using SWIFT platforms.
- Factors such as profitability, noncompliance with international rules, and lack of responsiveness contribute to the termination or rejection of correspondent banking relationships.

Consequences and Role of the National Bank of Ethiopia (NBE):

- The closure or restriction of correspondent banking relationships negatively impacts Ethiopian banks, leading to loss of potential customers, higher service charges, and difficulties in resource mobilization.
- The NBE's role in supporting Ethiopian banks in establishing and maintaining correspondent banking relationships is limited, with little intervention in solving problems or providing corrective measures.

Successful Relationship Challenges:

- Ethiopian banks face challenges in establishing efficient and firm correspondent banking relationships, leading to high transaction costs and exposure to risk.
- Lack of proactive policies and procedures further exacerbates the challenges, with foreign banks demonstrating little trust and confidence in Ethiopian banks.

Based on the findings of the study regarding the impact of various factors on successful relationships with correspondent banks, several conclusions can be drawn:

Quality Service and Successful Relationships:

- The study suggests that high-quality services provided by commercial banks positively influence successful relationships with correspondent banks. Commercial banks strive to offer superior service to maintain fruitful correspondent banking relationships.

Addressing De-Risking for Successful Relationships:

- The analysis indicates that effectively managing de-risking significantly increases the likelihood of establishing profitable connections with correspondent banks. Local commercial banks need to adopt sound policy solutions to mitigate the consequences of risks, thereby strengthening their relationships with correspondents.

NBE's Role and Relationship-Controlling Directives:

- The National Bank of Ethiopia's (NBE) oversight primarily focuses on the establishment procedures and requirements for correspondent banking relationships. However, there is a lack of clear guidelines on how to manage or preserve these relationships once established, indicating a gap in regulatory oversight.

Factors Driving Termination and Successful Relationships:

- Addressing the factors that lead to termination or restriction of correspondent banking relationships significantly enhances the likelihood of successful relationships. Commercial banks must implement effective strategies to mitigate the reasons behind suspension or limitation of correspondent banking services to maintain fruitful relationships with correspondents.

Consequences of Correspondent Bank Closure:

- The closure of correspondent banking relationships has detrimental effects on maintaining successful business relationships. The consequences of termination agreements significantly impact local commercial banks, with a substantial portion of newly formed banks experiencing canceled correspondent banking relationship requests. This suggests that past actions of former banks can influence the prospects of newly formed banks' correspondent banking requests.

- The study underscores the importance of quality service, effective de-risking strategies, and addressing factors driving termination for maintaining successful relationships with correspondent banks. It also highlights the need for clearer regulatory guidance from the NBE regarding the management and preservation of correspondent banking relationships. Overall, proactive measures taken by commercial banks to mitigate risks and address termination factors are crucial for sustaining fruitful relationships with correspondents.

Based on the information obtained from senior officials at the National Bank of Ethiopia (NBE) regarding their approach to supervising and supporting local banks in establishing correspondent banking relationships, several conclusions can be drawn:

- **Limited Involvement in Correspondent Banking:** Despite the presence of a banking supervision department within the NBE, responsible for auditing local banks' compliance with international regulations, it appears that the NBE's oversight primarily focuses on domestic banking operations. The NBE does not actively engage in facilitating or supporting local banks in establishing correspondent banking relationships with foreign banks.
- **Passive Approval Process:** The NBE's role in correspondent banking relationships seems limited to approving initiation requests from local banks. Beyond this initial approval, the NBE does not actively participate in the establishment process or provide support such as training on KYC document preparedness.
- **Lack of Supportive Measures:** The NBE's approach does not include proactive measures such as organizing seminars or discussions to address the challenges faced by local banks in establishing and maintaining correspondent banking relationships. This lack of support indicates a gap in the NBE's efforts to assist local banks in meeting international banking standards.
- **Absence of Directives or Mechanisms:** Despite acknowledging the seriousness of the problem and the increasing requirements of foreign banks, the NBE lacks appropriate

directives or controlling mechanisms to address the challenges faced by local banks in correspondent banking. There is no clear directive specifying the NBE's role or responsibilities in facilitating correspondent banking relationships.

- **Unclear Enforcement of Old Directives:** The reference to an "old directive" by NBE officials suggests a historical framework for approving correspondent banking relationships. However, there is ambiguity regarding the existence, effectiveness, and enforcement of this directive, as the investigator could not find relevant information about its details or implementation.

In general, Ethiopian commercial banks encounter significant obstacles in establishing and maintaining correspondent banking relationships, which impacts their ability to provide comprehensive international banking services and meet customer demands efficiently. Addressing these challenges requires proactive measures from both Ethiopian banks and regulatory authorities like the NBE to enhance trust, compliance, and efficiency in correspondent banking operations. The National Bank of Ethiopia's approach to correspondent banking relationships appears to be passive and lacking in proactive measures to support local banks. The absence of clear directives, limited involvement, and lack of supportive mechanisms highlight areas where the NBE could enhance its role in facilitating and regulating correspondent banking activities for the benefit of Ethiopian banks and the broader financial system.

5.4 Recommendation

Recommendation on the Role of Local Banks

- **Geographically Distributed CBRs:** Ethiopian banks should proactively seek to establish more correspondent banking relationships in North America and Europe to diversify their network and reduce reliance on intermediary banks. Strengthen relationships with existing African correspondent banks while exploring new opportunities within the continent to enhance transaction efficiency;

- **Improve Documentation and Transparency:** Local banks should consider adopting FATF’s recommended standard, AML and KYC’ policies for originator and beneficiary details in payment messages. Which serves to increase transparency and puts correspondent banks at ease. Advocate for sound policy solutions that address the consequences of de-risking and support sustainable correspondent banking relationships. Ensure they are not deemed risky, local banks have to continuously work on strengthening their internal policy, procedure and all other international standards;

- **The responsiveness and communication of the local bank:** Where the correspondent bank requests further information on any transaction local banks shall provide a response with full information to the level detail request by the correspondent banks. In cases in which the local bank is unable to provide a timely, suitably detailed response to assuage the correspondent's concerns, or if a pattern of non-responsiveness develops, the correspondent may opt to restrict or close the CBR with the respondent;
- **Engage in Dialogue with Foreign Banks:** Ethiopian local banks should encourage a continuous dialogue with foreign correspondent banks. This essential step ensures correspondent relationships are maintained. For this reason, all local banks should make extra efforts to establish an ongoing dialogue with CBs. Familiarity with each other's practices and developing personal business relationships are important conditions for local banks;
- **Automate Compliance Systems:** Implement automated systems for compliance to ensure continuous and accurate adherence to international regulations. Ethiopian private banks shall use an automated system that screens all parties and relevant transactions in real- time. The bank also requires that intermediaries identify on whose behalf the transaction is being conducted. When the correspondent bank can see that the local banks are implementing solutions and taking steps to actively monitor transactions, it is more likely to view the local banks as a trusted partner that can increase quality business- rather than put the correspondent at risk.
- **SWIFT KYC Registry:** Local banks should use SWIFT KYC Registry to store all their information or documents and it validated by dedicated SWIFT operational team. This SWIFT KYC registry enables the banks validated profile easily accessible for other foreign banks. Besides this program provides the banks traffic activity with sanctioned or high-risk countries as per FATF/OFAC/EU.
- **Increase Profitability:** Focus on increasing the profitability of the bank to make them more attractive to foreign banks;

- **Enhance Service quality:** local banks should give focus on improving the quality of services provided through correspondent banks to meet their customers need more effectively;
- **Lower Transaction cost:** Negotiate for more favorable terms and reduced fees with existing correspondent banks to lower transaction costs. Besides local banks shall engage to improve their correspondent bank relationship to get a direct access for all transactions. This enables them to minimize transactional cost by avoiding number of involving intermediary banks;
- **Proactive Policy Implementation:** Ethiopian local banks should adopt proactive policies and procedures to overcome challenges in correspondent banking relationships;
- **Giving due consideration to the problem:** Ethiopian local banks, after having fully understood the extent and magnitude of the problem, they should incorporate their respective banks' higher officials and related concerned individuals into participatory platform aiming to solve the problem. They ought to put in place sufficient, highly trained personnel, to take care of the entire process thoroughly from beginning to end and local Banks should approve and allocate enough funds from their budget to create awareness through training and face-to-face communication.

- The correspondent bank relationship established by those first generation local banks has now suffered a great deal due to several factors and this has led to other local banks' request rejection. Since every banks relationship (be it good or not) affect other banks success in establishing successful relationship. All Ethiopian banks should cooperate and work towards maintaining their relationship carefully and execute their duties and responsibilities for both the industry and the country at large.

Recommendation on the role of Ethiopian Bankers Association

Ethiopian banks have suffered in general from these correspondent banks because they deal with these correspondent banks individually. It is the time to consider solidification and forming strong financial association, and face correspondent banking problems as one unit.

Recommendation on the Role of National Bank of Ethiopia (NBE)

- **Develop Clear Directives:** Establish clear, comprehensive and updated directives to manage local banks' relationships with correspondent banks.
- **NBE oversight:** ensure the effective implementation of AML/CFT KYC' utilities and international standards by local banks and monitor the status of Ethiopian banks' relationship with their correspondent banks;
- **NBE support:** National bank of Ethiopia should organize seminars and discussion regarding the existing problems and come up with solution. Besides the foreign banking, inspection team of the bank should conduct regular audit and assessment to check the compliance of local banks for correspondent bank requirements.

Recommendation on the role of Government

The ever-growing problems faced by private local banks related with their relationship with foreign correspondent banks should have been given the government concern because it has sever repercussion that results in a decline of foreign currency earnings which further put strain on the country's balance of payment. In other words, the inadequacy of hard currency caused by weak relationship have led to a fall both in the profit earning capacity of the business companies and the expected tax collection of the government. Therefore, the government should play its role in addressing the problem through:

- Participatory discussing with every concerned bodies and make an effort to understand the full extent to the problem.
- The government should work through its embassies, ministry of foreign affairs; consular services towards supporting local banks establish successful work relationship with foreign banks through gaining widespread acceptance in the eye of their corresponding counter parts.

By implementing these recommendations, Ethiopian private banks can improve their correspondent banking relationships, enhance service quality, reduce costs, and mitigate risks associated with international transactions. The proactive involvement of the NBE and the adoption of sound policies by local banks are crucial for achieving these goals.

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Appendix-1: Questionnaire for Commercial Banks

Dear Respondents,

My name is Lissan Getachew. I am working my Executive master of business Administration final thesis taking up on a topic entitled "Assessment of Correspondent Banking Relationships: The case of private Commercial Banks in Ethiopia". The purpose of this research is to assess how local banks manage their relationship with correspondent banks.

The Questionnaire have three parts, the first has been created to record the respondent's personal profile, the second only focuses on the information of the respondent's bank. The final section has eight sub titles to evaluate the overall correspondent banking relationship of local banks and you must complete all closed questions by putting "√" mark on the box provided next to all choices. The questionnaire has only five open-ended questions under the bank information, and the purpose of them is to allow respondents give the response without being restricted by the researcher's provided options.

Selected respondents are individuals who are working in private commercial banks and have experiences in international banking and Risk and compliance department under different positions. In line with this, I kindly request for your time and full cooperation to respond to the questionnaire and I can assure that all your responses will be held confidential and be strictly used for academic purposes only

Regards!

For any enquiry, my cell phone No. is +251913833131

Email: lissangetachew@gmail.com

Part I: Background Information

Name of the bank: ___________________________________

Current position in the Bank: ___________________________

Type	Category	Please Put a tick (√) Mark
Gender	Male	
	Female	
Age	20-30 years	
	31-50 years	
	More than 51 years	
Educational Background	Diploma	
	BA/BSC Degree	
	MA/MSC	
	PHD	
Work Experience with in the Banks industry.	< 5 years	
	5-10 Years	
	11-15 years	
	Above 15 years	
Years of experience for international banking or for Risk and compliance management.	<5 years	
	6-10 years	
	11-15 Years	
	Above 15 years	

Part II: Bank Data

1. How long has the bank been operating?

   ____
2. Number of existing correspondent Banks?

   ____
3. Geographical distribution of the correspondent bank relationships.

   A. Europe. _______________

   B. USA. ________________

   C. Asia. ________________

   D. Africa.________________

   E. Middle East.____________

   F. Others._________________
4. For how many banks your bank sent a request for a correspondent banking relationship.
   ____
5. Related to question number four, how many of them rejected your relationship request?
   ____
6. At what stage they rejected your bank request.

   A. At the first email request to initiate the relationship.
   B. After submission of required documents
   C. During all KYC, document review.
   D. After finalizing the approval of KYC, document.

7. In total, how many banks terminate their relationship with your Bank?

No	Correspondent Banks Name	Countries of Banks	Type of Currency Account		
			USD	EUR	GBP

PART III. Questions to be filled by International Banking Directors, Risk and compliance directors and both department' managers.

1. Strongly Disagree 2. Disagree 3. Neutral 4. Agree 5. Strongly Agree

S. No	Item	1	2	3	4	5
Quality of Service						
1	Service provided by foreign correspondence meets the customers' requests well.					
2	CBR of the bank effectively addresses the operational efficiency of the bank'					
3	The bank can get various international banking facilities through its correspondent bank relationship.					
Cost-Effectiveness						
4	Correspondent bank' fees and charges associated with transaction fees are reasonable.					
5	Relying with few foreign correspondent banks is more expensive than dealing on large number of CB.					
Adherence to policies, procedures and international standards or addressing de- risking						
6	Independent audit function designated to test the effectiveness of the compliance program against international standards.					
7	Internal controls and procedures are in place in order to prevent criminals using the bank's facilities for money laundering and terrorist financing.					
8	Automated compliance system is in place to detect and report suspicious transactions and customers.					
9	Know your customer (KYC) procedures implemented before establishing business relations, whenever doubt exists about the adequacy of previously obtained records and whenever suspicion of money laundering and financing of terrorism arises.					

10	The bank utilizes SWIFT platform to get solutions with a fast and cost-effective KYC solution that enables to monitor manage and grow their correspondent banking.					
11	Customers are screened against international sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis					
12	Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious international transactions and customers					
13	Changes on existing management, shareholders structure and practices are timely communicated to concerned foreign Banks.					
14	The bank updates its relationship document at regular intervals subject to an investigation or regulatory action, which leads to a material change in the regulation, or there has been any other material change that influences the relationship.					
15	The bank complies with AML/CTF obligations, FATF recommendations, Customer due diligence (CDD) including transaction monitoring and other ongoing customer due diligence measures, and submit suspicious matter reports when required.					
Factors Driving the termination or restriction of correspondent banking relationships						
16	Profitability or low volume of transactions					
17	Inability of respondent bank to process CDD/customer due diligence					
18	Change to supervisory requirements in CB's jurisdictions and verall risk appetite of the CB					
19	Lack of confidence in respondent banks' adequacy of controls to manage AML, CFT, Wolfsberg Questionnaire, tax evasion or other risks that they could bear through liability and fines in their home jurisdictions.					

20	Rising fines and penalties on correspondent banks and high amount of due diligence fees					
21	Political situation and risk grade of the country					
22	Poorly managed Correspondent relationship or inadequate internal control systems.					
23	The ownership, control and management structures of the bank					
24	Company reputation/the bank history related to implementation of AML/CTF or sanctions obligations, or criminal or civil proceedings relating to money laundering, terrorism financing or other serious crimes.					
25	The responsiveness and communication of the respondent bank for the request of CB.					
Restriction of services from CBs						
26	Transaction and customer limitation.					
27	Country restriction to process transactions					
Consequences of correspondent bank closure						
28	MTOs and potential customers have been particularly affected.					
29	High fees due to multiple banks involvement to process foreign transactions.					
30	The financial inclusive and quality service of the bank highly affected.					
31	Losing of potential customers					
32	Negative influence on foreign currency mobilization and import volume of the bank.					
33	Profitability of the bank is highly affected					
The Central bank /NBE/ role on correspondent banking relationship						
34	There are instructions set by the NBE to oversee the relationship between the local bank and foreign correspondent banks.					
35	NBE hold seminar and awareness creation programs with local banks about the difficulties with CBs.					

36	NBE evaluate and approve correspondent relationship of the bank prior to establishment.					
37	NBE promptly addresses issues and concerns raised by financial institutions regarding correspondent banking problems.					
38	NBE conducts regular assessments and audits to ensure compliance with correspondent banking regulations.					
Successful Relationship with Correspondent Banks						
39	The bank has a widely geographically distributed relationship and has many alternatives of correspondent banks.					
40	Proactive risk management using policies procedures and compliance measurement by respondent banks mitigate potential regulatory risks of the bank.					
41	There is trust, confidence, minimum cost minimum risk and consistent communication with CBs					

Appendix-2: Interview questions for National Bank of Ethiopia

Foreign Exchange Monitoring and Reserve Management Directorate

My name is Lissan Getachew. I am working my Executive master of business Administration final thesis taking up on a topic entitled Assessment of Correspondent Banking Relationships, the case of private Banks in Ethiopia. The purpose of this research is to assess how local banks manage their relationship with correspondent banks and what kind of governing rules followed by National Bank of Ethiopia to monitor this relationship.

Accordingly, I kindly request your time and full cooperation to respond the below interview questions and I can assure that all your responses will be held confidential and be strictly used for academic purposes only.

1. Is there any directive set by NBE to oversee the relationship between the local bank and foreign correspondent banks?
2. How NBE evaluate and approve correspondent relationship of the bank prior to establishment?
3. Does NBE hold seminars and awareness creation programs with local banks to get an update about the difficulties with CBs?
4. Does NBE conducts regular assessments and audits to ensure compliance with correspondent banking regulations.
5. Do you think NBE is providing enough support and implement strategy to mitigate the problem of local banks related to CBR?
6. What is your general opinion and suggestion about the role of NBE' in CBRs of local banks?

Appendex-3: Reliability Statistics

	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
Service provided by foreign correspondence meets the customers' requests well.	134.84	96.924	.792	.769
CBR of the bank effectively addresses the operational efficiency of the bank'	134.83	98.510	.786	.771
The bank can get various international banking facilities through its correspondent bank relationship.	134.96	98.763	.744	.773
Correspondent bank' fees and charges associated with transaction fees are reasonable.	135.40	119.402	.030	.804
Relying with few foreign correspondent banks is more expensive than dealing on large number of CB.	132.67	121.669	-.142	.809
Independent audit function designated to test the effectiveness of the compliance program against international standards.	135.15	107.927	.651	.785
Internal controls and procedures are in place in order to prevent criminals using the bank's facilities for money laundering and terrorist financing.	132.79	120.956	-.089	.808
Automated compliance system is in place to detect and report suspicious transactions and customers.	135.26	109.134	.589	.787
Know your customer (KYC) procedures implemented before establishing business relations, whenever doubt exists about the adequacy of previously obtained records and whenever suspicion of money laundering and financing of terrorism arises.	132.63	118.724	.086	.803
The bank utilizes SWIFT platform to get solutions with a fast and cost-effective KYC solution that enables to monitor manage and grow their correspondent banking.	134.49	102.992	.579	.783
Customers are screened against international sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis	132.80	118.985	.060	.804
Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious international transactions and customers	132.68	119.919	-.011	.805
Changes on existing management, shareholders structure and practices are timely communicated to concerned foreign Banks.	135.20	110.598	.446	.792
The bank updates its relationship document at regular intervals subject to an investigation or regulatory action, which leads to a material change in the	135.26	112.076	.403	.794

regulation, or there has been any other material change that influences the relationship.				
The bank complies with AML/CTF obligations, FATF recommendations, Customer due diligence (CDD) including transaction monitoring and other ongoing customer due diligence measures, and submit suspicious matter reports when required.	132.71	119.015	.083	.803
Profitability or low volume of transactions	133.04	116.746	.184	.801
Inability of respondent bank to process CDD/customer due diligence	132.63	117.178	.220	.800
Change to supervisory requirements in CB's jurisdictions and overall risk appetite of the CB	132.76	117.344	.193	.801
Lack of confidence in respondent banks' adequacy of controls to manage AML, CFT, Wolfsberg Questionnaire, tax evasion or other risks that they could bear through liability and fines in their home jurisdictions.	132.78	119.756	-.001	.805
Rising fines and penalties on correspondent banks and high amount of due diligence fees	132.54	122.637	-.213	.811
Political situation and risk grade of the country	132.80	117.472	.136	.802
Poorly managed Correspondent relationship or inadequate internal control systems.	132.82	115.277	.296	.798
The ownership, control and management structures of the bank	133.08	116.625	.181	.801
Company reputation/the bank history related to implementation of AML/CTF or sanctions obligations, or criminal or civil proceedings relating to money laundering, terrorism financing or other serious crimes.	132.69	120.131	-.026	.805
The responsiveness and communication of the respondent bank for the request of CB.	132.57	119.088	.037	.805
Transaction and customer limitation.	132.68	118.759	.062	.804
Country restriction to process transactions	132.57	123.122	-.257	.811
MTOs and potential customers have been particularly affected.	132.73	117.508	.140	.802
High fees due to multiple banks involvement to process foreign transactions.	132.58	119.053	.063	.803
The financial inclusive and quality service of the bank highly affected.	132.69	117.997	.146	.802
Losing of potential customers	132.54	117.612	.136	.802
Negative influence on foreign currency mobilization and import volume of the bank.	132.57	122.634	-.204	.811
Profitability of the bank is highly affected	132.72	118.810	.069	.804

There are instructions set by the NBE to oversee the relationship between the local bank and foreign correspondent banks.	135.52	115.563	.337	.797
NBE hold seminar and awareness creation programs with local banks about the difficulties with CBs.	135.51	118.689	.073	.804
NBE evaluate and approve correspondent relationship of the bank prior to establishment.	132.73	116.957	.211	.800
NBE promptly addresses issues and concerns raised by financial institutions regarding correspondent banking problems.	135.68	118.221	.136	.802
NBE conducts regular assessments and audits to ensure compliance with correspondent banking regulations.	135.47	117.461	.173	.801
The bank has a widely geographically distributed relationship and has many alternatives of correspondent banks.	135.00	100.840	.728	.775
Proactive risk management using policies procedures and compliance measurement by respondent banks mitigate potential regulatory risks of the bank.	134.63	106.049	.441	.791
There is trust, confidence, minimum cost minimum risk and consistent communication with CBs	135.06	102.896	.663	.779