AML-TF SUPERVISION AND DETECTION

1. Recent ML cases in the EU and lessons learned regarding supervisor responsibilities

An official noted that the fight against money laundering and terrorist financing is a priority for EU policymakers. The EU has a solid AML/CFT rule-set in place, but recent high-profile cases raise concerns that rules are not being implemented and enforced efficiently and effectively.

Important initiatives by governments, regulators and financial institutions have strengthened the effectiveness of Europe's AML/CFT regime. Two AML Directives introduced new risk-based approaches to AML/CFT. The ESAs issued nine regulatory technical standards, guidelines and opinions on the risk-based approach and the Council adopted an action plan to strengthen AML/CFT supervision, transforming the European approach.

An industry representative informed them that work done by the Commission and other parts of the EU shows that this is a mainstream issue and a massive global problem. Some 2% to 5% of global GDP is being illicitly moved around, but it is not a problem of resources but of effectiveness. The UK's Financial Intelligence Unit is funded by about €4 million a year, according to EU figures. Assuming all EU countries spend the same and adding Europol's yearly budget gives around €0.25 billion to spend. A 2017 survey of five European countries estimated that industry had about $85.5 billion. That is €74.5 billion for AML. The supervisory challenge is to build an environment where it can be spent well.

A representative of the public sector considered that money laundering erodes the foundation of the Union by hijacking one of its fundamental freedoms: free movement of capital. Money laundering should not only be targeted because it breaks the rules but because it attacks this freedom. AML is not marginal or a by-product of banking system reform but at the core of enhanced supervision. An effective AML policy increases trust in financial institutions, supervisors and of the European project itself. Failure to address it is detrimental to institutions, business and society.

1.1. The current effectiveness of information flows between different supervisory bodies

An official recalled that Latvia made headlines in 2018 after the US Treasury issued a notice against its third-largest bank, ABLV Bank, according to the Patriot Act Section 311, labelling it as a foreign financial institution of concern for primary laundering. The language used in the US Treasury notice was strong and accused shareholders and employees of institutionalising money laundering as a pillar of business practices. The bank based its business model on servicing non-resident customers with transactions mostly in dollars. With a large share of shell companies as customers, the bank's business model was difficult to sustain with this in force.

As the bank's liquidity situation deteriorated, counterparties stopped working with it. It took days for the regulator to restrict payments. Within a few-day time, the ECB decided that the bank was failing or likely to fail and liquidated it according to Latvia's insolvency regulations.

This case showed that the ECB cooperates effectively with the SRB and national supervisors on mechanisms for crisis resolution within the Banking Union and even more that there were loopholes in AML supervision. Latvian reforms had already started, but afterwards unprecedented measures were implemented to ensure zero tolerance with AML/CFT issues. Substantial changes to the national legal framework were made and some are still to be amended in order to transform the banking sector. A ban on banks and payment institutions cooperating with shell entities was also introduced.

In less than one year, domestic and EU deposits reached 91%, replacing high-risk foreign clients with shell company features. Although there is a degree of harmonisation at EU level, it is not EU or national institutions that opened this process against ABLV, but a third-country: the US. AML supervision is a national competence. The dialogue between the third-country and Latvia was on a bilateral basis and did not consider the Single Supervisory Mechanism's (SSM) direct supervision of the bank.

The bank had been sanctioned at national level and was in a remediation process. As AML supervisory practices and approaches vary substantially between member states and globally, it can be assumed that the sanctions are not sufficient for other parties. A review of existing cooperation mechanisms for AML in prudential supervisors must determine if they are effective and appropriate. This case is a good study as ABLV is supervised by the SSM, with a business model based on high-risk customers. It is hard to separate AML and conduct risks.

Financial intelligence information is collected at national level in the EU and only exchanged on individual cases. Analysing and gathering information on suspicious transactions is challenging for member states, as is having an adequate level of financial intelligence and being ahead in tackling sophisticated AML schemes. New and emerging technologies can help.

1.2. The adequacy of existing tools and indicators

The fourth AML directive introduced a fundamentally new approach and changed expectations from a rule-based to risk approach. It is difficult to be specific at the level of a directive; so the ESAs delivered detailed guidance, via technical standards and guidelines, to establish supervisory expectations and rules for the new risk-based approach to AML/CFT.

An industry representative reminded the audience that a risk-based approach has always been important, although it might have been called another name. Ensuring that the institution makes well-informed decisions based on the risks in front of it has been core regarding credit risk for years. In the area of financial crime it is not an entirely new way to approach risk for organisations.

Such an approach has led to de-risking. In a case study, a country that disliked another's approach imposes a risk-based one, not on a bank but the entire country. Consequently, eight years ago, institutions were pushed to de-risk entire continents, such as Africa or Latin America. The pendulum has swung back, but a risk-based approach can be used for political or other issues.

A regulator noted that the amount of resources dedicated to AML is a political decision, which is derived from what is politically considered as an acceptable level of residual risk in the system. In such a context, a risk-based approach helps to spend money wisely. However, although supervisors and

the private sector understand that, no one wants to be faced with such an event although very unlikely, as it is a toxic issue reputationally; such a remaining uncertainty weakens the concept of risk-based approach. Indeed, it is comfortable to use risk-based approaches where the risk distribution is the thickest. Yet, it cannot be ignored that tail events happen. A risk-based approach entails risk to institutions that pursue it, from potential draconian reactions. The pressure on industry and supervisors is such that one has to accept that the subsequent supervisory reaction could even mean a complete shutdown of certain business lines. It is then crucial to avoid any uncertainty in the risk-based approach: uncertainty may happen but not as an element of the risk-based approach.

A regulator mentioned recent events in the north of the EU that resulted in the biggest bank losing half its market cap, and the departure of the management involved, including the CEO and its chairman.

An industry representative referring to nobody wanting to be caught stressed that it should not be a blame game if many people are faced with AML cases, although trying to do the best job. If regulators and law enforcement agencies are involved, or a selection of banks and financial institutions, and they get it wrong, the consequences should be different from when everyone is hiding.

One need is to implement existing rules includes the adopted European level AML framework. When the UK set up the Joint Money Laundering Intelligence Taskforce (JMLIT), it discovered that legislative provision already existed, so it was necessary to understand the circumstances where regulators felt comfortable using it. Indeed, a bank had already obligations in the Data Protection Act to share voluntarily with law enforcement agencies, but that was not thought to be sensible. Eventually consultation with law enforcement agencies and lawyers agreed that it should be subject to an information–sharing agreement. There is no new legislation; it is existing legislation being used in a sensible way.

A Central Bank official advised that free movement of capital in Europe comes with shared responsibility, but the free movement of capital has often been opposed in order to avoid such a responsibility. This is sometimes the first line of defence of the private sector. Beyond regulators and supervisors, the private sector should understand that if not for moral reasons, short-term high profits will eventually be outbalanced by losses, penalties, criminal prosecutions and public disgrace. Know Your Customer, top management and effective internal audit are all crucial.

It is possible to lose track of initiatives. Digitalisation, fintech, cyber things, fostering innovation and capital union are acceptable, but must be balanced with adequate and coordinated supervision. Extending regulatory coverage to all financial sectors and activities, to mitigate the migration to shadow banking risk, makes this possible. Otherwise, such a blind, almost theological, trust in markets will be gone. The fight against money laundering is a public duty which contributes to public good.

Of the figures given earlier, 74% is spent on people, or about €80 billion a year. Motivation is crucial. Public-private partnership can deliver that. Talking to law enforcement agencies, hearing their priorities and responding, does not mean individual feedback on every transaction report. Feedback should give the sense of solving something and fighting crime together, not just compliance. It is not yet right in any country, but a great deal of learning is taking place. It would be wonderful for European supervisors to review the examples and consider how to bring them home, encouraged by the European institutions, so that more of this can be seen in Europe. An industry representative alluded in this respect to the Fintel Alliance, which is a public-private partnership, started by AUSTRAC in Australia. Five Australian banks and an industry partner seconded a member of its staff to AUSTRAC, to learn about receiving information and feeding it back to industry. One challenge is to motivate Suspicious Activity Reports (SARs) writers, as they receive little feedback and can feel that they write documents that then disappear. Initiatives like JMLIT and Fintel Alliance are encouraging and should be supported to help with resource and information management.

2. Main regulatory and supervisory evolutions envisaged by new AML plan

2.1. Expected roles of Financial Institutions, the EBA and ESAs and public sector entities

AMLD4 is progress but gives rise to a worrying overlap in group versus host country responsibilities. Cooperation is desirable, but the risk of overlapping responsibilities is that nobody actually handles them.

A participant noted that resources could be better spent. Authorities sometimes misuse a risk-based approach or do not use it appropriately. It could be more effective. Case studies raise the issue of interinstitutional cooperation, which is not costly to improve.

An official noted that cooperation is a problem between countries and for national and EU institutions. Many stakeholders are involved in AML exercises. The previous year demonstrated the scale of the challenge, with the public sector also cooperating in discussions on improving effectiveness. It is easy to say regulations must change but implementation and monitoring for problems is important. The information received by ministries of finance and policymakers from supervisors is critical to targeting higher risks with policy measures. Supervisors' experience shows the importance of cooperation between prudential and AML supervisors.

A Central Bank official noted that AML can be linked to the resolution framework recently created at European level. If a national resolution authority agrees with a proposal to implement a multiple-point-of-entry strategy, European regulation requires total separability, the internalisation of IT systems and treasury activities. The local affiliate should work as an independent separate entity. A multiple-point-of-entry strategy can be granted but if not agreed between the bank and the local authority and between authorities in the euro-area or between non euro-area members and euro-area members, it is cherry-picking by the banking sector, which is to be avoided. This could create loopholes in the system.

An industry representative agreed that it is difficult for national authorities to work together. They find it hard to share, so empowering the private sector naturally arises. GDPR must be complied with but notes can still be compared. The technology exists, and industry is comfortable sharing information provided that legal boundaries exist. Leaving information sharing to national authorities and hoping that fixes the problem is not a quick solution. How junctures are made is less important than stopping criminals.

2.2. The consistency of the implementation of AML framework across member states

A Central Bank official confirmed that the rules must be obeyed but many are too quickly designed and changed. However, not applying commonly agreed rules weakens supervisor and regulator credibility. The implementation of FATF standards is a must. It is not optional. The current standards must be implemented in a coherent and unified way at national level, before new ones are in place. Not applying the rules creates room for discretion or case-by-case supervision which must be avoided. To address this, further transparency is needed from

regulators and supervisors, together with more scrutiny and accountability for public decision makers.

Many battles were lost in recent years in Europe, so it is important not to lose more public trust in the banking sector. An understanding of the problem's significance is required. Comprehensive standards and harmonised implementation are key.

Europe is as strong as its weakest link. Recent money laundering cases in European banks raise concerns about gaps in the supervisory framework and so action is needed. AMLD4 is based on minimal harmonisation at the member-state level, setting out general principles and technical standards, including supervision guidelines, leaving implementation to member states' discretion. AMLD5 provides for the ECB concluding multilateral MoUs with AML supervisors. It does not detail provisions for cooperation between prudential and AML supervisors to facilitate timely and regular inputs. There is still an emphasis on national supervisors.

The Chair presented a question from the audience proposing that, without an AML regulation and an EU AML agency, the fight remains a game of looking for the next weakest link.

According to a speaker, the suggestion of an EU AML supervisor should be treated with scepticism, as it is hard to see how an EU institution can work with the national FIUs, court systems and police in real time. It would be a disruptive delaying factor due to the difficulty of the different national steps related to prosecution and police work.

Enhanced coordination at EU level is needed to address AML/CFT coherently and pragmatically. The Romanian presidency has significantly advanced the ESAs' review package and concluded with enhanced powers for the EBA. As capital and banking groups are cross-border, so should AML supervision be. Regional or EU-wide Financial Intelligence Units (FIUs) must be implemented. The FIU is risk-based and focused more on terrorist financing than on money laundering but its remit must expand and be followed by feedback to others.

A Central Bank official advised that the basic tools and rules exist but were not implemented by all or identically. Giving more powers to the EBA is good. The creation of a super-institution against money laundering at a regional or European level would be welcome but should not stop the implementation of what already exists. Two more years to build a new institution and elect a board should not be an excuse. The rules exist and should be applied. The guidelines have been agreed. The framework for exchanging information between the ECB and competent authorities was signed in January 2019.

There is no incapacitation caused by a lack of tools but a common will to implement them is needed, with coordination and cooperation between national authorities under the European umbrella. It must occur not only within the EU, because capital does not stop at borders.

An official agreed that discussion about an EU institution is not an excuse not to implement or apply rules or regulations. AML directives have minimal harmonisation. Within the Banking Union, regulations have options and discretion for countries, which creates room for further regulations. Regulators should evaluate sanction worries across member states. It is premature to say that an EU supervisor is needed today. First steps were taken and regulation regarding the EBA adopted. Time is needed to see how it works. Even with existing improvements, something more will be needed. It requires a positive, European approach.

The Chair asked private sector representatives to consider whether the ideal ambition level is to move from directive to regulation or tighten the regulatory framework and institutional setting.

An industry representative noted that it should not mean the lowest common denominator. An example is AMLD5 and AMLD4 before it asked for beneficial ownership registers for every EU country. Government-verified information would be great. Some countries will do that better than others and some will find legal challenge locally. The industry wants the type of beneficial ownership register that does the best job. Total harmonisation might not be in industry's interest but generally, every discrepancy between regulatory regimes is a problem. A regulator agreed, noting that harmonisation should not be tied to the lowest common denominator.

2.3. The opportunities offered by new technology

A regulator advised that problems in EU banks were stopped by courageous Estonian colleagues who inspected and requested the closure of the non-resident portfolio. The bank threw out 15,000 customers, a 10% share of the Baltic market of non-resident customers at that time, but no one knows where they went. Technological customer reporting infrastructure at the European level could help banks identify customers who were dumped from elsewhere.

This requires more data recording, data reporting and data assessing. For many regulators and supervisors, either not enough data is being reported and recorded or the capacity to interpret micro-level data is insufficient.

There is scope to use technology more. It is an obvious area for a European institution, as the information is useful across the EU. Technology should also make the Know Your Customer process easier as existing electronic IDs could be used more easily than physical documents. Technology can help spend resources more wisely, so the EU should make that leap.

An official noted that technology is an important part of the debate. Attempts to strengthen systems and existing IT tools already lag. New technologies and methods for data analytics and transaction monitoring are needed. Further cooperation enabled by the JMLIT's proposals introduced into the legal system, is bearing good results with investigators, but the first analytical work is difficult, as shown from the public sector side. New technologies can help.

A speaker insisted on the fact that instead of focusing on a EU AML supervisor, efforts should be made to establish a register and infrastructure about dicey customers and issues where technology can help. Technology should be used in coordination with the FIUs. That could be developed by using AI and machine learning on FIU data. That should be done at the EU level, because there are conflicts with GDPR that can only be addressed there. It is hoped that the issue will be on the EU's agenda during the Finnish presidency.

A Central Bank official noted that financial services can be hesitant to employ new technologies without a seal of approval from a regulator. The feeling of the first mover's disadvantage is not the right way to roll out technology. Contextual transaction monitoring has been successfully implemented. AI deserves consideration. Onboarding and getting to know the customer through electronic IDs, is a low-hanging fruit to consider.