

# AML / TF DETECTION, SUPERVISION AND EU COORDINATION

## 1. Lessons from the past

### 1.1. The EU Commission post-mortem regarding Banks, AML competent authorities, and EU and National bank supervisors

An official stated that there have been important anti money laundering (AML) scandals in recent years. Major banks are being heavily criticised for failing in their duties in combatting financial crime. A policymaker added that that affects the international reputation of the EU financial system and the trust of consumers in banks, regulators and policymakers. The official also highlighted that supervisors have been heavily criticised for a lack of resources and a lax approach to scrutinising supervised entities' compliance. There have been investigations by US authorities and sanctions applied.

However, individual countries have implemented the AML directives in their own ways. Cooperation with financial intelligence units (FIUs) is improving.

A policymaker noted that in July the European Commission published a post-mortem analysis of recent scandals, because before deciding what to do, it is important to understand what has happened in the EU banking sector over the last few years. The policymaker detailed the problems identified.

Banks in many cases were not prioritising AML compliance. They ran risky business models from an AML standpoint, that were pursued with no commensurate AML controls.

Often in large banks there was no group-wide AML policy and the AML function was scattered across the different parts of the organisation. An official noted that the post-mortem exercise pointed to behaviours that led to the possibility that banks could be used for money laundering, for example ineffective or non-compliance with legal arrangements, governance failures, misalignment between the risk appetite and risk management and negligence regarding group policies.

AML competent authorities often have insufficient resources, lack prioritisation and have insufficient resources and have very different powers and sanctioning regimes. Indeed, AML national legislation has resulted in very different sanctioning regimes. In particular, the sanctions in place are not dissuasive enough, and sometimes they are not applied in a strict manner. There are not many on-site inspections carried out by AML supervisors.

National bank supervisors are uncertain as to what they need to do on AML and the type of supervisory measures that they should apply in the licensing process, though they have responsibility in the licensing process, the approval of shareholders and the approval of members of the management board. There are numerous hesitations about withdrawing licences on the basis of AML infringements.

There is no thought through cooperation of AML supervision into the Supervisory Review and Evaluation Process (SREP). Many authorities are involved, including AML authorities, prudential authorities, home and host authorities, in addition to the Financial Intelligence Units (FIUs). There is a lack of structured cooperation between all of the authorities involved, no joint supervisory decision process and no joint

supervisory action in many cases. That does not necessarily mean there needs to be a single supervisor but there is, for the moment, very often difficult and inefficient cooperation between competent authorities.

Cooperation with third countries has also been difficult, with hesitation about sharing confidential information and, apparently, a lack of trust between EU authorities and third countries' ones, resulting in information sharing asymmetries.

### 1.2. Know Your Customer (KYC) lessons learned from throughout the EU

A regulator commented that it is often stated that problems arise because of the lack of rule of law in certain jurisdictions, and poor cooperation amongst supervisors. Neither of these issues held in the case of Danske Bank's Estonia branch. Estonian supervisors had shown incredible courage in 2015 when they threw out the non-resident Danske Bank customers. Nobody could have done a better job. Anybody who knows Scandinavian culture will know that cooperation and consensus seeking is not a problem. On the contrary, there are many who are frustrated with the amount of sitting down together and agreeing on how to do things that happen in that environment.

Rather, there was a rogue branch and an issue of failed lines of defence.

Two issues were particularly important. One was that know your customer processes failed and the other was that when the customers were thrown out, they could walk into other banks without them knowing who they were, because those banks also had poor know your customer processes.

Looking across the EU, it is difficult to find a country or big bank that has not had similar problems. The list includes BNP Paribas, the French authorities, Deutsche Bank, the German authorities, Nordea, the Swedish authorities and ING Bank.

That suggests that it is not a question of a failure in an individual institution, and that is also what the European Banking Authority (EBA) Board of Supervisors decided in relation to the first cause brought in, to determine there was not a breach of EU law. The authorities have a greenfield opportunity here, compared to other areas where there would be duplication and complication of work among authorities and in the national value chain.

There is a need to build a know your customer (KYC) infrastructure which banks can report into. Yet, banks cannot do that because it raises serious questions in relation to the General Data Protection Regulation (GDPR), data integrity and bank confidential information. These issues have to be dealt with and settled at a political level, and at the EU level given GDPR and other regulations. That would be a significant contribution to fighting AML. It raises really difficult questions, and trade-offs for policymakers in terms of AML versus data confidentiality and GDPR.

Addressing KYC issues represents an opportunity where a difference can be made. There are opportunities to address problems leveraging notably innovative technologies, the benefits of which far outweigh the costs associated. Rather than discussing duplication of new institutions, there should be serious efforts across the EU to address this issue.

## 1.3. Latvia's response to problems faced from its banks

An official explained that Latvia without waiting for the results of the post mortem, has adapted and implemented a comprehensive set of reforms, with political commitment and the involvement of different public institutions and private sector players. Latvia's priorities are clear: decreasing the risks in the banking sector, enhancing coordination, increasing transparency, improving its sanction regime, in addition to properly liquidating ABLV Bank.

The first part of the strategy is the de-risking and consolidation of the banking sector. This goes together with the changes in the legislative framework and the supervisory activities. With the changes to AML and the combating of the financing of terrorism (CFT) legislation, Latvia banned banks and payment institutions from doing business with high-risk shell entities which threatened the integrity of the financial system in the past. Banks have eliminated that part of their customer base. In 2015, Latvia's banking sector had an almost 53% non-resident customer base. Now, excluding the EU customers, it is around 7-8%. With all of those changes, the banks have re-considered their business strategies and look for the new target markets, customers, alternative business lines and services. The supervisors have looked extensively at how the banks implement the new strategies.

The second pillar of the strategy is strengthening the AML/CFT supervision, including some changes in legislation. The international recommendations on how best supervisors can execute their AML/CFT role, were followed. There is one supervisor for AML, which is the prudential supervisor for banks. The aim was to maximise the synergies in one institution. In parallel, during the last two years, the resources of all supervisory and control institutions have increased, in some cases more than doubling, so the institutions can supervise more effectively.

The third part of the strategy is increasing transparency. Since April 2019, beneficial ownership and enterprise registers are publicly available. In mid-August, almost all entities registered in Latvia have disclosed the beneficial ownership information. The enterprise register has a right to de-register those companies that do not follow this requirement and apply to them simplified liquidation. In combination with the account central register, it is very efficient at eliminating AML/CFT risks.

## 2. Main short-term areas for improvement:

### 2.1. Clear AML leadership, existing rules enforcement, and then the creation of an AML EU single rule book

A policymaker added that before moving to major legislative or supervisory changes there must be a consideration of what can be done immediately. First, better compliance is needed from banks. Banks must attach a higher level of priority to combatting money laundering. There should be a better enforcement of the existing rules, even if they have their weaknesses. National authorities should make sure that AML is a priority. There will be more active involvement by the EBA, with more powers and more resources.

The European AML rulebook is quite loose, especially compared with the rulebooks for banking and insurance. There is scope to be more prescriptive about what financial operators and competent authorities should do. Turning some aspects of the AML directive into a regulation may help, as they would shed more light on supervisory measures and sanctioning powers. However, there should be more consistent rules throughout the single market and the Banking Union.

## 2.2. Improving customer onboarding

A regulator stressed that another essential aspect is the on-boarding of customers. The implementation of on-boarding policies is different in all EU countries. Furthermore, there should be some guidance regarding what should be considered to be an appropriate on-boarding to aid with standardisation. The EU will be as strong as its weakest link, and customers will eventually find out whether there is an easier way for them to get an EU authorisation to operate within the EU.

A policymaker agreed that know your customer processes do not work in a satisfactory manner, and that is something to fix, if possible, with new technologies.

Furthermore, GDPR does not necessarily stand in the way of KYC. The question is more about interpreting GDPR and applying it in a proper manner, which suggests some education is required. GDPR should not need to be changed.

Finally, private organisations and public bodies need to collaborate better in order to move away from a box ticking exercise and towards a smarter approach for detecting money launderers. Some member states have experiences of this, with public and private partnerships set up so that banks in particular understand what public authorities are looking for, and that is certainly something to work on.

## 2.3. An holistic approach to the anti-money laundering risk

A regulator indicated that another aspect is what role the prudential supervisors should have. The EBA has a risk-based approach to AML, but as for any risk-related part of prudential supervision, this means taking measures to make sure that the rules and procedures for AML are adequate for banks. Beyond the checks of individual transactions, which are the competence of the AML authority, there should be rules, processes and procedures, which should be an integral part of what national supervisors complete for the prudential supervision of banks.

Additionally, an intelligence database should be built. It will not be about individual transactions or individual subjects. It will be about intelligence and aggregate information that could be shared easily across authorities within the existing regulations on personal confidentiality. The hope is that it will help in detecting common trends and common collaborations within the industry.

## 2.4. The role of the EBA on coordination

A regulator stated that one of the big challenges cited, is coordination among agencies, within countries and across the EU.

A regulator noted that the EBA has just gone through the current review of the ESAs' founding regulation, and it has a new mandate, among the three European Supervisory Authorities (ESAs) – the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA) and the EBA – to lead efforts on anti-money laundering. The conclusions of the post-mortem exercise that the European Commission put forward were shared. These changes in organisational structure do not require going beyond the changes agreed in the ESAs review.

One of the mandates the EBA gets in this context, is an AML standing committee in which all of those organisations are required to be participants and to engage. The EBA's analysis suggests there are over 70 authorities that should be represented in the committee, so it is not a simple committee to manage. The rules and procedures of how it will operate are being worked on, but it reflects the organisational complexity in the EU with regard to these issues.

Collaboration among authorities is really a big issue both within the EU and across third countries. There is again the experience of supervision. The college of supervision has proved to be very effective. The EBA will suggest that there should be AML colleges for multinational groups, so that the AML authorities discuss these issues and make sure that there are group policies in place, that those group policies are effectively implemented and that there is intelligence being shared among those authorities that are supervising the same banking group. The Chair asked whether the EBA has become a supervisor. The regulator confirmed that it has not.

### **3. Should the EU have a single AML authority?**

#### **3.1. Better supervision is needed**

A policymaker stressed that there is no formal view at the moment from the Commission on a single authority yet. However, on the supervisory front the status quo is not an option. The political guidelines from the President-Elect state that better supervision is needed, and the mission letter given to Vice President Dombrovskis also refers to the need for better supervision.

Nonetheless, better supervision does not necessarily mean a single supervisor. What might be needed is a network of supervisors who work and collaborate more effectively than currently. In that network, national competent authorities would retain an essential role.

The EU is as strong as its weakest link. If there are a couple of supervisors that do not do the job properly in the wrong corner of the single market then dirty money can flow into that country and then, by virtue of the single market and the Banking Union, that money can be laundered throughout the EU. That may trigger a number of reflections on the organisation of supervision in Europe.

A regulator confirmed that the EBA gets information and questions to investigate by many interested parties, and not just within the organisation, so there was whistleblowing. An authority without regulation is not really feasible currently. There needs to be convergence on regulation before consideration of an authority.

#### **3.2. A single AML supervisor is an attractive solution...**

An industry representative suggested that there are four good arguments for considering a European regulator. One is resource and critical mass. The FIUs are outgunned, which could be countered by bringing them together. Second is the weakest link problem. If there is a weak supervisor that lets in a weak bank, then criminals will use that bank to access the single market. Third is the ability to see the whole picture. One FIU can today not see all the Suspicious Activity Reports (SARs). This could be compared to the role of ESMA in securities markets who sits in the middle on all of the transaction flows. Fourth is the need for a credible partner for the US, who is today scrutinising the European AML practises and handing out large fines for wrongdoings in the past.

An official is in favour of the single supervisor said that otherwise all of the initiatives, like a KYC infrastructure and better regulation, cannot find the best way to fight such a cross-border phenomenon.

#### **3.3. ... However, a single AML supervisor may face important challenges**

A regulator noted that conducting AML supervision is a dirty job with dire reputational consequences. It is not a coincidence that the proposal is to give that gift to an institution which does not exist; it cannot say, 'No, thanks.'

However, the regulator expressed the view that a single authority would not have solved any of the problems there have been. One should first deal with the issues in the value

chain. The regulator stressed that while more cooperation, exchange of experiences and all of the work that goes on at the EBA is positive, the question of the definition of an appropriate value chain able to finding money laundering is essential. In this respect the fact that the main value chain and the most relevant institutions are essentially within the banks and the police, was stressed, while underlining that supervisors play an ancillary role and should not be too overconfident in terms of what they can achieve. Indeed the role of supervisors is to look at what banks do and ensure that they live up to the rules.

The regulator insisted on the fact that is the bank and the police nexus which have to work, and they have to work speedily because money moves incredibly fast. In this respect creating a new supervisor risks moving the process away from the national level where a speedy process takes place. This is unlikely to achieve anything but a slower response. The regulator warned that value would only be added by doing a greenfield operation rather than something that complicates an already complicated value chain that needs to be improved.