

REDESIGNING EU AML POLICY

1. General background

1.1 Anti-money laundering (AML) has been a hot legislative and regulatory topic

A policymaker described how anti-money laundering (AML) has been a hot topic ever since the appearance of large-scale money laundering activities both internationally and within the European Union. The European Union has responded with targeted legislation in the form of the 5th Anti-Money Laundering Directive (AMLD5). Starting in 2020, EU legislators have also given extra powers to the European Banking Authority (EBA). However, more action is needed to address illicit and criminal activities. Therefore, in the last year the European Commission announced an action plan and a package of legal proposals. The policy maker considered that a more forward looking view should be taken on this issue.

1.2 The banking industry is challenged by the size and complexity of the problem

An industry representative acknowledged that the banking industry had been somewhat ineffective in its attempt to handle the size and complexity of this problem. This criticism applies equally to banks, the authorities, and the European system. CEPS published a paper on AML indicating that European firms spend over €110 billion on AML compliance each year but only 1.1% of illicit funds are interdicted. It is no surprise that only two days prior The Economist called the system 'hugely expensive and largely ineffective'.

The industry representative described how thousands of employees in Europe manually check alerts which have a 95% to 98% false positive rate. The recent CEPS paper indicates that only 10% of the 1.1 million annual SARs (Suspicious Activity Report) are investigated, although the industry representative considered that the true figure could be well below 10%. One Nordic country sees 75,000 SARs a year and has 32 people to handle them, which equates to over 2,200 SARs per person. This overwhelming volume demonstrates the need for more resources.

A public representative explained that after the pandemic there will be a huge effort for recovery. Given the amount of money that will be needed, it is important to avoid the perception that some people are escaping their obligations in terms of paying tax or declaring their financial movements.

1.3 There is an existing political impetus on AML

The public representative reiterated the need for Europe to deliver on AML. The Parliament is prepared to deliver in terms of legislation here. A policymaker noted the substantial degree of harmony between the panellists regarding the priorities around AML despite their different backgrounds, adding that the Commission is currently working on an AML package. This package will hopefully be finalised in a few weeks' time, and then the Commission will move into intense

negotiations. The policymaker suggested that there is a considerable degree of convergence between the views of the panellists, albeit with some entirely legitimate nuances. There is a substantial problem around money laundering within the Union and beyond, which demonstrates the importance of continuing to work on this issue. When the Commission publishes its proposal, it will be important to move forward quickly on AML with all the relevant stakeholders.

2. Challenges and potential solutions

2.1 Additional regulation should help to address an inconsistent implementation of AML legislations

A public representative stressed the existence of significant divergence in the implementation of AML directives across member states. The public representative supported the idea of moving towards regulation to address the aspects of AML policy that are currently being insufficiently implemented by some member states.

2.2 Improving supervision still requires unprecedented structural efforts at both national, EU levels on a cross sectoral basis

The public representative emphasised that the integration of the national Financial Intelligence Units (FIU) remains insufficient.

The ultimate problem is that efficient money laundering is usually conducted on a cross border basis. Money laundering cannot be addressed adequately by national authorities, which means there is a need for increased and effective cooperation on this at the European level.

An official stressed the importance of reducing regulatory arbitrage and creating a level playing field. It is important to avoid a race to the bottom, which could be created by an insufficiently harmonised implementation of the existing legislation. At the same time, it is essential to avoid creating an unnecessary bureaucracy which increases the overall workload but does not contribute to the prevention of money laundering. The official stressed the importance of allowing space for digital solutions when designing rules.

An official though that rules and harmonisation alone will not prevail against money laundering, if entities concentrate solely on following the rules without considering the bigger picture. Apart from better legislation, the three crucial elements in this fight are more resources, more digitisation, and more cooperation. The official explained that the idea of more cooperation means enabling a better exchange of information. In the financial sector, data sharing only takes place to a very limited extent. More extensive forms of data exchange such as the pooling of transaction data could help prevent the exploitation of information gaps, which enables arbitrage by

criminals, and would also result in more accurate suspicious transaction reports.

However, an official stressed adherence to data protection rules as another important public objective. Digital tools and solutions will reconcile the two important objectives of AML and data protection, which should demonstrate why digital transformation is a priority for the Financial Action Task Force (FATF) under the German presidency.

A regulator stressed that AML must be considered both as a prudential risk factor and in terms of consumer protection and consumer experience. While there is a trade-off between proper AML protection and proper data protection, this should not hinder effective collaboration and data sharing.

A public representative stressed the importance of effective supervision. The EBA has been given a larger role here, but the Council has recently suggested that the EBA might also need additional competences.

The public representative supported this proposal, although there is a potential problem due to the fact that the EBA's focus is the banking sector. There is a question as to whether the most effective way to supervise the non banking sector is through an entity that is particularly focused on the banking sector. An industry representative suggested that, until a credible EU authority is established, the de facto regulator of financial crime in Europe is the United States, because the US authorities have the most power and force in this area.

Another industry representative agreed on the need to focus on banks, noting that the banks are eager and willing to contribute on AML, but stressed the fact that recent developments have demonstrated that the topic is much broader than banking. AML efforts must include funds, brokers and family offices, for example.

A regulator stressed the importance of understanding the diversity and size of the pool of obliged entities: the EBA estimates that 160,000 financial institutions are subject to AML regulation in the European Union, which means this is a very large and diverse universe. It is also important to consider harmonising supervision because there is also diversity in terms of the regulatory authorities. For example, there are 57 AML/CFT supervisors from across the European Union represented on the EBA's AML supervisory committee. There must be collaboration across regulatory institutions within and between member countries.

2.3 An effective AML policy requires combining various essential elements: an EU AML authority, facilitated information sharing, extensive use of technology, further harmonised regulation, ...

An official pointed out three key areas of focus: the need for a well-designed European AML supervisory authority; further harmonisation of substantive law; and a low threshold exchange of information between all relevant parties.

The UK has a model called the Joint Money Laundering Intelligence Taskforce. The UK has torn down the barriers to information sharing between banks, regulators, and law enforcement authorities. Nordea has been involved in pilots of this model in Sweden.

The model would enable an EU level approach with better resourced FIUs, more information sharing and targeted data intelligence led efforts, for example on human trafficking.

An official reiterated the importance of harmonisation, considering it essential to transfer parts of the directive to a regulation in order to reduce national divergence. A regulator agreed on the need for a more harmonised regulatory framework in certain areas, as the EBA had outlined in its response to the call for advice on the Commission's proposals to enhance the regulatory framework. The EBA's key areas of focus included customer due diligence, the list of obliged entities, the determination of beneficial ownership, and increased powers and a harmonised regime for sanctions.

2.4 Permanent technology investments are required

An industry representative stressed the need for public authorities to be better resourced and better coordinated in order to combat fragmentation, which argued in favour of the Commission's proposal for the establishment of an AML authority and further assistance for FIUs.

The industry representative considered that the mere existence of an EU authority would not be enough, however. One other necessary measure would be a better use of technology and data. It is vital to ensure better public private collaboration between banks and public authorities, and the area of transaction monitoring is a useful case study here.

A regulator considered the impact of technology an important challenge. Technology could be better utilised to facilitate AML/CFT, but it also provides new means for criminals to commit crimes. This means the industry must enhance the range of obliged entities and ensure it remains up to date with technological developments. As the regulation is reformed, the industry must enhance the coordination between parts of its regulatory framework. It is vital to ensure that AML is an important part of any new regulation, technology or finance structure. From this perspective, AML is also relevant to the prudential framework for banks.

2.5 Europe requires a single formal KYC process delivering quality assured data

An industry representative considered that KYC processes are very formulaic and negatively impact clients, highlighting the example of Austria, which has built an environment where clients upload KYC relevant information to an appropriate system through their tax or legal advisers or full year auditors. This enables the entire industry to know that the information is quality-assured while only having one formal KYC process. Currently, if a client interacts with five or 10 banks, the KYC process must be carried out five or 10 times.

An official suggested that Know Your Customer (KYC) standards are one area in need of harmonisation. There is a need to regulate for standardised data sets for national and legal persons as well as for identification processes, including the means for remote identification. To enable the more effective prevention of money laundering, Europe should

consider creating a KYC utility for onboarding, i.e., a database from which obliged entities could quickly and inexpensively retrieve identification data in compliance with data protection law. However, there must be high standards and a certain degree of flexibility because it is important to enable the application of a risk based approach here.

3. There is a need for a single supervisory authority with oversight of the full string of payments

A policymaker informed them that the Commission will write a report on the possibility of public private partnership on AML in the current year. This might not be part of the package currently being prepared, but it will set the scene and consider what more can be done in this area. In any case, the policy maker agreed on the importance of information sharing, which the previous speakers had stressed.

A policy maker noted that an industry representative had commented on the need for European supervisory initiatives to focus more on managing AML risks in partnership with banks. The industry representative described how there is a string of payments involved in money laundering. The only way to tackle money laundering is to make this full string of payments available to a single authority. The industry representative suggested that therefore their institution supports the introduction of a supervisory authority.

The two most important aspects here are to make AML comprehensive and to have a single supervisory body with oversight of the full string of payments, enabling a network analysis of the patterns involved in money laundering. If there is a faulty payment, the authorities must provide feedback on it. This is the only way to enhance the industry's ability to attack different patterns. In order to do this, it will also be essential to calibrate the industry's models. An industry representative echoed the importance of cross border cooperation and collaboration. The speaker's institution is ready to contribute and collaborate; the industry will find the means to achieve this.

A regulator stated that, as the private sector representatives outlined, the authorities' collaboration with the private sector is also weak and must be enhanced. It is important to create new ways to enhance this collaboration. As one small example, in the last year the EBA established AML colleges for the largest financial institutions, which is a concept borrowed from the prudential supervisory framework. The AML/CFT authorities sit down together and discuss the AML behaviour of a single institution operating across different countries.

4. The main priorities for progress

A policymaker invited the panellists to outline their number one priority for the Commission's package on AML. A public representative stressed the need for a regulation to limit the arbitrage between member states. An official suggested Europe should create an AML supervisory body based on a harmonised law. An industry representative considered that Europe could create a gateway to facilitate better information sharing and strike the balance between the General Data Protection Regulation (GDPR) and financial crime, which would facilitate more collaboration between the public and private sectors. An industry representative stated that the most pressing need is to equip EU supervisors with the ability to access the full string or network of payments. A regulator agreed with these priorities and added that, from the EBA's perspective, the industry will only ever be as strong as its weakest link, which demonstrates the need for a high minimum common denominator.