

REDESIGNING EU AML POLICY

(ENHANCED SUPERVISORY COOPERATION, TECHNOLOGY ENABLERS)

A supervisor outlined the four main elements of the Commission's recent proposal: a new regulation on customer due diligence (CDD) and beneficial ownership; a new regulation to create an Anti-Money Laundering Authority (AMLA); a sixth directive, improving some elements of the framework a revision of the regulation for crypto assets to address the so-called travel rule. The roundtable would focus on three main elements: the current main trends in anti-money laundering (AML) and whether the COVID-19 crisis has created new challenges; technological challenges; and the proposed new authority. The creation of a new authority within the European Union is not frequent and so should be discussed in detail.

1. AML challenges as seen by the European Court of Auditors

A regulator noted that a previous panel suggested that AML is one of six important aspects of the Capital Markets Union (CMU). AML is a race against a clever and fast counterpart. There are two sides to the coin: national and European. The recent audit by the European Court of Auditors considered whether EU-level action is implemented appropriately, efficiently, and effectively. The audit focused primarily on the banking sector, but the conclusions are valid for the entire financial sector. There are three aspects: legal, organisation set-up and real functioning.

1.1 Implementing complex aspects of EU law is a challenge

A regulator stated that the third and fourth AML directives were difficult to create. AML 4 is now in existence, with the improvements of AML 5 expected, but full implementation in the member states is still lacking. There is complexity of the directive itself and complexity of transposition. A significant amount of national law must be changed to implement this directive. The European Court of Auditors advised the Commission to utilise a regulation instead. An advantage of the legal developments is the factoring in of AML risks in the prudential supervision in the European Central Bank (ECB).

1.2 Institutional fragmentation and poor coordination in the EU

A regulator commented that quality of information from national authorities is often poor and the breach of union law procedure has almost never been invoked. The European Court of Auditors found institutional fragmentation and poor coordination between institutions. Supervision remains at the national level and effective enforcement powers over any of the institutions are lacking.

1.3 Real functioning is still unsatisfactory

A regulator stated that it is difficult to assess the riskiness around organisations from a European perspective. The Council transposed the Financial Action Task Force (FATF)¹ list that is applied in the United States into European legislation. Risk assessment should be the primary tool. The Commission carries out a risk assessment every two years. The European court of Auditors criticised the Commission for not being up to date and not learning lessons from previous assessments. The fight against money laundering is driven by reports in the media. Difficulties with the AML directive stem from issues of coherence and level playing field.

A policymaker stated that, while it is true that the media sometimes influences policymakers, it is not the primary driver of policy. Well-substantiated complaints are necessary in order to activate enforcement tools. The European Commission did not "copy and paste" the FATF list of high-risk countries. Autonomous assessments take place, following the methodology of the European Commission.

1.4 Although cash is still king, the pandemic has caused a shift toward digital transactions, compounding the challenges

An official commented that there has been a shift from cash to more digital transactions. Regarding predicate offences², in addition to the misuse of state aid programs, there was scamming and cyberattacks through ransomware. This often involves crypto transactions.

A regulator noted that digitalisation enables tracking and many activities that were previously hidden will be more transparent. However, new types of risks that are not yet fully appreciated might develop.

2. Against this context the EU, in addition to its usual tasks, is awakening all the stakeholders, fostering harmonisation and transparency, and leveraging digital tools

An official stated that there are four major trends in AML in the EU: awakening, harmonisation, campaign for transparency and use of digital tools.

2.1 Awakening

An official explained that awakening refers to the process of recognising how important AML is. There is a move from a formalistic application of legal rules to a more risk based approach.

2.2 Harmonisation in Europe

A regulator stated that harmonisation started globally 30 years ago, with the FATF standards and the assessment

1. The Financial Action Task Force (FATF) is the global money laundering and terrorist financing watchdog. The inter-governmental body sets international standards that aim to prevent these illegal activities and the harm they cause to society. As a policy-making body, the FATF works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

2. A «predicate offence» is an offence whose proceeds may become the subject of any of the money-laundering offences established.

of 205 jurisdictions. At the European level, there is much closer harmonisation through the directives. The AMLA proposal is a new evolutionary step.

2.3 Transparency

An official commented that the campaign against anonymity will lead to stricter cash controls and new regulation on crypto transactions. There is a trend towards stricter requirements when it comes to beneficial ownership. The European Union can play an important role here for the global community.

2.4 Use of Digital Tools

An official stated that digital tools can make the AML fight much more effective and efficient. However, more data is needed, and this poses a regulatory challenge. Data protection must be reconciled with AML issues.

3. Very substantial and sustained efforts on the ground have been made by both the public and private sectors

A regulator commented that the AML/combating the financing of terrorism (CFT) situation has changed dramatically in recent years, thanks to the efforts from the public sector and financial firms. The European Supervisory Authorities (ESA) review was the first key step. The formal mandates of this ESA review have been expanded and consolidated within the EBA since 2020. This has enabled the acceleration of change and provided a bridge until AMLA is created.

3.1 There have been remarkable achievements in recent years regarding risk-based AML approaches, further cooperation and capacity building

A regulator stated that there is now a common risk-based approach to AML/CFT. Cooperation has increased significantly. This involved joint work to strengthen cooperation between AML, prudential authorities, and financial intelligence units (FIUs), AML/CFT colleges³ and an AML/CFT database, which will be available from 2022. The European Banking Authority (EBA) supports competent authorities through training and bilateral advice.

4. Additional progress is expected

4.1 AMLA will be an essential step forward that should not become an excuse to reduce current efforts, while legislating on the form of regulations will finally deepen harmonisation and efficiency

A regulator stated that recent momentum on AML must be maintained. AMLA is a positive development but will take up to 2026 to implement and should not serve as an excuse for inaction. The monitoring of AML/CFT risk in the EU already suggests that most

competent authorities have engaged in significant referrals, but also that this is not easy. AML requires non-negligible adjustments on the part of existing competent authorities. When preparing AMLA, regulation is crucial. Minimum harmonisation was at the root of the difficulties in the past.

4.2 Carefully defining the governance of the AMLA and precisely articulating prudential and AML/CFT are key success factors for making steep progress in the whole financial sector

A regulator emphasised the importance of convergence on AML/CFT. Effective and efficient governance for AMLA will be critical. Prudential and AML/CFT objectives need to be clearly articulated throughout the entire life cycle of a financial firm. A common regulatory referential should be used, serving both prudential and AML. AML/CFT risks are not restricted to banks. A common approach across all financial sectors and beyond is needed.

5. A better use of technology is the single biggest initiative that can be taken in relation to fighting money laundering and terrorist financing

5.1 Money laundering and terrorism financing represent a deep threat to financial institutions and their managers, which requires tools up to the challenge

A regulator stated that most mainstream banks are now very aware of the need to avoid money laundering or terrorist financing. This change is due to the joint pursuit of those who facilitated money laundering and terrorist financing. There is not a country or major bank in Europe that has not faced these issues. The problem is not that banks are not willing to apply the rules, but that banks do not have the tools and technologies.

5.2 Effective KYC processes and PEP and RBO databases should help to address the fast increasing volume of suspicious transactions, provided that privacy challenges are overcome

A regulator stated that the main issue is technology around know your customer (KYC) processes. FIUs are presently being overwhelmed by suspicious activity reports (SARs). The Danish Financial Supervisory Authority has recently published a report considering how KYC processes could be improved. Countries that have electronic ID should be capable of using the electronic IDs for the verification of the identity of the customers. Most countries have registers that identify Politically Exposed Persons (PEPs)⁴ and their Relatives and Close Associates (RCAs). Banks should be able to request that public authorities share this information. The quality of the Registers of Beneficial Ownership (RBO)⁵ has improved, but they need to be better certified. There is a trade-off between fighting money

3. These colleges gather prudential and AML/CFT competent authorities for the purposes of AML/CFT supervision of credit and financial institutions both domestically and on a cross-border basis.

4. The FATF defines a politically exposed person (PEP) as "an individual entrusted with a prominent public function". The requirements set in the FATF Recommendations apply to PEPs, as well as to their family members and close associates.

5. Article 30(1) of the EU's Fourth Anti-Money Laundering Directive (4AMLD) requires all EU Member States to put into national law provisions requiring corporate and legal entities to obtain and hold adequate, accurate and current information on their beneficial owner(s) in their own internal beneficial ownership register.

laundering/terrorist financing and privacy. Europe must lead a public discussion, involving civil society, to develop views on these issues.

5.3 AI-enabled AML approaches are promising and should replace rule-based ones

An industry representative stated that technology should afford faster and more accurate AML capabilities, at least partly through applied artificial intelligence. AI enabled approaches are less brittle and will lead to a reduction in false positive alerts. AI can incorporate more contextual signals and generate targeted flags for investigators.

5.4 The explainability of alerts should help to address the AI black-box stigma

An industry representative advised that, in order for technology to improve AML performance, the how or the why behind any alert must be elucidated. This is referred to as explainability. The algorithms involved in AI are often perceived as black boxes. In the context of AML, AI explainability can be defined as how this type of AI approach uses the inputs to produce outputs, which are the alerts. It could also include whether insights are effectively communicated to the people that receive them.

5.5 However, making AI successful requires enabling banks' and banking systems' data capabilities and organisation

An industry representative emphasised the importance of focusing on data. The availability of data in a near-time fashion is critical. The socio-technical challenges around how companies self-organise to look after data are an issue. From an intra-FSI perspective, data should be shared across financial institutions, lines of businesses and geographical regions. From an inter-FSI perspective, standard data schema across financial institutions is advised. Technology can assist in this.

5.6 Improving the financial sector's agility, mobilising sufficient investments and data protection, and customers' rights, are key challenges still on the road to reap the benefits from technology

A regulator stated that banks and supervisors are underutilising technology, in particular artificial intelligence. There are three key impediments. One is that technology develops very quickly, and it is difficult for organisations to keep pace. Secondly, there are data protection and access to financial services issues. Thirdly, the expectations from regulators and supervisors are not completely stabilised. A review of the use of fintech solutions at the EBA demonstrated that the use of innovative solutions is most frequently observed for AML/CFT, so there is some progress.

An official suggested that technology can be the solution to the conflict between AML and data protection. Techniques like migrating algorithms or encryption technology mean that there is no need to give up on the high standard of data protection or be inefficient with AML.

An industry representative agreed that technology can help to reconcile the conflict between AML and data protection.

6. The AMLA, encompassing a supervisory arm and an FIU arm, is a masterpiece for the whole EU AML/CFT framework still in the making

A policymaker stated that the creation of AMLA is a central element of the legislative package tabled in July 2021. Following the major AML scandals that occurred in the EU, the consultation process, the impact assessment process, and discussions with the co-legislators, it was concluded that there would be added value in having an EU decentralised agency responsible for AML matters. AMLA will not replace national authorities but aims to ensure that national supervisors and national FIUs cooperate better. AMLA will have a supervisory arm and an FIU arm. AMLA should be able to conduct joint cross-border analysis of suspicious transactions. AMLA will host and manage a number of tools and platforms for this purpose, starting with FIU.net.

In respect of governance, a policymaker explained that two general boards are proposed, where all national authorities and all national FIUs will be represented. These general boards will be responsible for developing both the non binding and the binding elements of the single European rulebook. An executive board will follow the model of the Single Resolution Board (SRB). For supervisory decisions, a fully independent board that is not composed of national authorities is needed. Operations of AMLA are planned to begin in 2024, with supervisory activities starting in 2026. The AMLA proposal addresses the deficiencies found by the European Court of Auditors report. AMLA will have three fundamental functions: coordination for better information exchange, standard setting and uniform application of the rules.

6.1 Certain financial institutions operating on a cross-border basis may be supervised at the EU level, while the non-financial sector will not be left aside

A policymaker commented that a single supervisor could be fully in charge of a few very large cross-border entities, rather than having 20 national supervisors looking at the institution. Oversight and indirect supervision of the non-financial sector is also needed. Tools such as peer reviews or breach of union law procedures can be utilised to ensure that the national public authorities supervise the non financial sector in an appropriate way.

6.2 Improving the efficiency of FIUs is also necessary

A policymaker stated that new tools are needed to increase the effectiveness of the work of EU FIUs. Common standards are necessary to achieve sufficient harmonisation and ensure high standards.

6.3 A detailed and accurate understanding of the issues to address is necessary to work out the appropriate arrangements regarding direct supervision, the articulation of prudential and AML supervision, access to information, enforcement powers and staffing

A regulator advised that supervisors should act according to facts and what the law suggests. Instead, the European Court of Auditors rode a political wave. Breach of union law should be used to correct

deficiencies, not to look back in time. The Commission has a great greenfield opportunity to set standards around use of technology. Difficult questions are being raised, including in terms of direct supervision. The distinction between governance supervision as a prudential supervisor and governance supervision as an AML supervisor must be treated with caution to avoid two sets of recommendations that cannot be reconciled with one another. ESAs should be collaborative places where issues can be discussed. Cooperation in the EBA is good, partly due to the management there.

A regulator emphasised the seriousness of the decision-making in this area. The AMLA proposal is a real response to the European Court of Auditors' recommendations and a shift to centralisation, but it does not go into the details. There are some risks. Right of access to information has been a problem for supervisory authorities around Europe. Efficient exchange of information will be difficult with the FIUs in particular. Enforcement powers are necessary. The SRB may be a positive example in this respect. Effective everyday functioning requires appropriate levels of staffing. The Commission should take part in the initial establishment of the authority.

An industry representative stated that their organisation welcomes the Commission's proposal. Greater harmonisation in the EU AML framework is an important step forward. The new authority should have sufficient resources and capabilities to understand the use of new technology and fintech in the market.

A policymaker noted that there is up to two years to discuss the proposal in the Council, in the Parliament and with all stakeholders to ensure it is successful.