

AML: key success factors

1. The EU is close to completing the anti-money laundering (AML) framework

1.1 Main objectives of the framework

The Chair suggested that there was general acceptance that AML is a fundamental part of financial market regulation. Negotiations have been in trilogue since the European Parliament presented its proposals. The first main objective of the package is to provide a single set of uniform rules for the obliged entities. Directly applicable regulation aims at preventing regulatory arbitrage and makes the cross-border activities of the industry straightforward. The second objective is to have an entity that ensures that these rules are interpreted and applied identically, which is the new anti-money laundering authority (AMLA).

The risk-based approach is the fundamental principle of AML. Entities have to understand their risks in order to address them effectively. Once a risk is identified and recognised, that provides legitimate grounds and legal justification for the legislator putting a burden on the entity.

1.2 The key levers for an EU AML framework

A policymaker noted that the proposed package relies on the Commission's action plan from 2020. One of the major building blocks is the single rule book. It is important to have more harmonisation at the European level. The rules should also be risk-based.

AMLA is a key feature. It is the future supervisor of the riskiest cross-border entities. The expectation is that it will provide very high quality, harmonised supervision. There is also a need for greater consistency in the national supervisory approaches.

The task with financial intelligence is sometimes underestimated, with respect to what financial intelligence units (FIUs) are doing between the obliged entities and law enforcement. There is a need for greater coordination and more powers for FIUs.

A regulator indicated that AMLA's biggest role concerns cooperation between countries. There cannot be fragmented supervision or analyses.

1.3 AMLA faces many challenges

A regulator emphasised that moving from a directive to a regulation, and moving towards more detailed requirements, but keeping the risk-based approach, and using technology are key.

Setting up AMLA is a huge coordination exercise. The discussions need to conclude first, and the legal

framework has to be introduced. There should be significant efforts to conclude the discussions, so the placement of the authority should not prevent action.

Finding the right person to lead AMLA will be a major task. The culture of AMLA should be focused on cooperation with the national supervisory authorities (NSAs). AMLA needs to not just work closely with the national competent authorities (NCAs), but also understand the context of national legal regimes, and work in close cooperation with FIUs, police, tax authorities and courts, in coordination with potential supervisors.

AMLA will also be responsible for monitoring new risks and sharing information on possible supervisory approaches to them. It will set standards through its supervision. That is an important building block but also a potential challenge. Wisely, AMLA will only supervise the institutions with the greatest risk, and it needs to remember the applicability of these standards to smaller entities and allow for proportionality.

High minimum standards must be aimed for, but that does not necessarily entail detailed provisions. One concern with the co-legislation process is that there is too much detail, and too much movement away from the risk-based approach.

An industry representative noted that the technical standards that AMLA should put in place should be harmonised. There should also be stronger and more respected FIUs.

1.4 Effective arrangements and cooperation for delivering consistency

A Central Bank official stated that the proposed package provides a lighter kind of supervision ("oversight") for the non-financial sector. The authorities are extremely varied and not harmonised. The rulebook will be harmonised for non-financial entities, but the system and distribution of competencies will be extremely fragmented.

The supranational unification of these matters will be in AMLA, and AMLA will face some complexity when it comes to the non-financial sector. The general board has different configurations, and for the non-financial sector the board will be composed of different national authorities. That might be challenging and might make the governance and functioning difficult, at least initially. AMLA will have the very important task of knowing this non-financial sector better and can provide the Commission with knowledge and information to plan possible further steps for even more advanced harmonisation.

1.5 Key success factors

A regulator noted that being too descriptive can pose dangers because supervisors or entities might check boxes more than actually look at the riskiest areas. The

AML and combating the financing of terrorism (CFT) of tomorrow are not caught by building rules on what is seen today. Regulating AML will have an impact on crime, but it cannot take the place of fighting crime.

2. A risk-sensitive regulatory and supervisory framework is not a comprehensive approach

An industry representative highlighted that a risk-based approach means focusing on the riskier patterns. However, that is not exhaustive, so some things will still go unnoticed. It is very important to manage expectations in that respect. During the trilogue there might be a temptation to increase the level of control. There must be caution to not go into too much detail and to not be too restrictive. The initial objective is to increase the current framework and make it efficient.

A regulator stated that risk-based supervision (RBS) is an essential tool for supervisors. A great deal of effort goes into creating the metrics. There will be situations where, for example, resources are not focused on supervising non-life insurance companies but instead on crypto asset providers and alternative investment funds. RBS models and the tools that will be developed can help AMLA and all supervisors to focus on the riskiest areas. Supervisors cover large populations. When tools are developed and risks are added, there needs to be continuous development to ensure the tools are fit for purpose. The model needs to be constantly re-assessed and improved.

A regulator noted that Malta worked both with the European Commission and the European Banking Authority (EBA) to build a risk assessment tool and recommended that AMLA follow a similar approach. The model being discussed needs to obtain a great deal of information and then it has to be analysed. The model needs to be calibrated so that there are mitigating factors and aggravating factors. The algorithms need to give a risk score to each and every entity. It is not only about size, so various components like product services, customers, channels and geographical distribution have to be captured.

An industry representative remarked that there was general agreement that taking a risk-based approach meant focusing on specific risks. While other risks might fall by the wayside, the goal of any institution is to ensure that the risk aperture is as small as possible. That might mean hiring more people or using more advanced technology.

Firms are headed in that direction already. For example, firms use technology to sift through their transactions data in order to find risk and financial crime typologies that they then incorporate into their transaction monitoring rules and thresholds. This information is also used to develop and implement risk-based customer-focused onboarding processes. On an ongoing basis, technology helps firms and the broader financial ecosystem because it helps firms collect data in a faster, easier to manage and scalable manner. The challenge,

however, is that there are multiple ways to use technology and in order for it to be effective, technology has to be used in a very specific and focused manner.

2.1 Balancing data privacy with data quality

An industry representative remarked that data will be challenging from an implementation and industry perspective. It is very important that from the start everything is clear in terms of the relationship with the General Data Protection Regulation (GDPR), for example. This applies to both data management and access. A data hub at AMLA is essential. It is also essential to share information across countries and institutions.

A regulator emphasised that cooperation, information, and intelligence sharing are necessary next steps to elevate the efforts against money laundering and terrorist financing. There seems to be growing concern as to whether the required level of data protection and privacy is achievable, and this is related to the increasing digitisation of society and the ever-growing amount of data that is available. There is no choice but to find a balance. Not doing so will make it almost impossible to fulfil the mandate for combating financial crime.

This also goes back to the management of expectations, and having public acceptance by providing sufficient information on how the associated privacy consequences fulfil a higher purpose. That entails an open discussion of pros and cons, and of the trade-off between new initiatives in the preventive efforts and privacy. Criminals are not entertaining such notions. They are just continuing to develop their methods.

A one-size-fits-all solution is not possible. The focus should be on developing a regulatory framework that sets sufficient legal safeguards, while allowing for new, effective initiatives to grow on a national level. AMLA will be busy with the tasks assigned to it, so there will be a start at the national level. That allows for greater efficiency, and for front-runners to be innovative, preferably in public/private partnerships, and thereby gain valuable learnings that could benefit everyone.

The Council proposal for the new AML regulation with a national exemption regarding the sharing of information is the right first step. It is key to remember that the legal frameworks, such as GDPR and the Human Rights Charter, provide a set of checks and balances rather than direct prohibition on information sharing.

Data-sharing initiatives should be subject to confidentiality requirements, minimal human processing and access to data. The responsibility for compliance should remain with the obliged entities. Therefore, there is a need to engage with relevant stakeholders, such as data protection authorities, so there can be assurance that new information sharing initiatives are structured with the necessary safeguards.

A regulator noted that without data, entities cannot be assessed and scored. The expectations for AMLA are high in terms of consistency and it becoming a point of reference for all NCAs. It should be leading by example.

A Central Bank official highlighted that the system is deliberately not entirely risk based. The number of obliged entities in scope is in excess of hundreds of

thousands. It is not feasible for AMLA or national authorities to have a thorough look at all of them.

To some extent, although the framework is inspired by the consideration of risks, the issue is money laundering risks and not prudential risks. Money laundering risks are not necessarily dependent on dimensions or on the types of activities. There might be other elements involved such that even small enterprises or individual people could pose higher risks of money laundering.

The question is whether there are weak spots to be aware of. The experience of FIUs could demonstrate that even with trusts and company service providers, or car dealers and legal professionals, for example, there are heightened money-laundering risks without there being the capacity to reach out. That is an area of challenge where the system might have some weaknesses.

An industry representative stated that using more technology in the field is a significant opportunity. Technology is good at looking at vast amounts of data. It can also be easily adapted to new rules. However, every opportunity comes with some risk. The first risk is that technology's ability to manage data depends on the quality of data put in. Without good quality data there will not be good outcomes. The same applies to the scenario. When a transaction is checked, the patterns that do not look good have to be identified, but that requires good scenarios and the machine being instructed in a good way to do what it should. The whole system also needs to be explainable, for example to regulators and auditors. Additionally, human expertise will always be required.

An industry representative commented that AI is suitable for some aspects of AML but not for others. However, AI is an iterative technology, so if it is not ready for some things it will become better over time. A regulator stated that accuracy, efficiency, and immediate decision-making are some benefits of AI.

3. AMLA being modelled along the lines of the European Supervisory Authorities (ESAs)

A policymaker emphasised the scale of the task of determining how AMLA will work internally and with the many other supervisors and stakeholders. The architecture of AMLA in the Commission proposal is novel. There is a long list of what is expected of AMLA. One set of expectations is that it is efficient, effective and highly independent. There is also the question of how to integrate the supervisory schemes that exist in the member states.

The executive board in AMLA is supposed to take care of the authority's functioning, look into the direct supervision function of AMLA, and ensure consistent, high-quality supervision across the internal market, with any decision addressed towards national authorities. Therefore, the desire is for a smaller, independent executive body.

The suggestion is to also have a general board, to draw on the extensive experience there is with national supervisors, and to take account of the needs of national supervisors. That is modelled along the lines of the ESAs. It is recognised that this is not an easy structure, but there is a good balance between the different tasks that AMLA will perform.

3.1 AMLA needs sufficient human, financial and technical resources

An industry representative emphasised that a strong AMLA needs access to sufficient human and financial resources. Human capabilities are both about the number of people and their quality. That means people who are well-trained and know what they are talking about. Access to technology is also important. There has to be an adequate infrastructure and good partnerships in order to have adequate collaboration between all countries.

A regulator noted that AMLA has an opportunity to create an effective and efficient technological system internally from the beginning. AMLA needs to develop a system that can make good use of advances in AI. It is also important to develop the human resources, human knowledge and human expertise needed for the use of the digital innovations.

There is a need for knowledge and an understanding of all of the processes, and the functioning of the new technology and solutions. The machine learning curve is much faster, if it is set up in the right way, and that can help significantly with doing the work efficiently. Artificial intelligence is already successful in detecting and preventing suspicious activities, because it can recognise patterns and abnormalities. That is something AMLA could be pioneering.

The Chair remarked that countries have done well over the past 30 years to become technically compliant, but effectiveness with respect to AML is poor. Technology and information sharing are tools to make the system more effective. The European Union, which currently is not the best performer from a global perspective, should become the spearhead in the global fight in AML, and do so quickly. The package should be brought into force.