

Money laundering remains a major risk for banks (and not only for the Nordics)



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The risk of being exposed to money laundering (ML) scandals is real for the European banking sector – and not just the Nordic groups currently under the spotlight. Investors and analysts are at a loss trying to anticipate when banks will be hit by ML troubles. There are no traditional analytical metrics to flag ML risk. Many believe that it is a black swan. “Bad things can happen to good banks out of the blue,” the market sighed in disbelief when Danske Bank’s ML problems surfaced.

The current focus of ML investigations is heavy on the Baltic channels but the threat is geographically far broader. Russian, Ukrainian or Central Asian illicit funds pop up elsewhere – Cyprus, the Balkans, Malta, as well as tropical tax havens all over the world (including US and UK territories). In addition, there are funds to be laundered from other parts of the world – East Asia, the Middle East, Africa, the Americas.

Much of this money is still channelled through European banks, not least because launderers perceive there are cracks and holes in the anti-ML (AML) supervisory structure in the EU. Visibly more so than in the US, which has a tougher AML supervisory regime with stricter conduct requirements for banks and with more punitive fines.

In general, money launderers operate at the sharp edge of technology. They are also well financed and well advised, and highly motivated to succeed. The soft spot of some large European banking groups impacted by ML at the top-management and board level is not so much fraud and dishonesty. It is lack of sufficient AML foresight and tolerance of weaker AML controls in a belief that the glass is half-full rather than half-empty. At middle-management levels in affected outposts, fraud and dishonesty can also play a role.

The existing framework makes managing ML risks possible...

Appropriate infrastructures and technologies are already in place to receive, analyse and disseminate suspicious transactions and other information on ML and financing of terrorism. National Financial Intelligence Units (FIUs) – such as the National Crime Agency in the UK, TracFin in France, ZfF in Germany, or UIF in Italy – have been collecting data from deposit-taking institutions and other sources for some time. At the EU level, through a decentralised computer network, FIUs match suspicious transactions and customers across borders (without sharing specific names due to privacy constraints). A growing number of RegTechs offer smart monitoring of banks’ individual and business clients for fraud, corruption, and ML.

Effective AML regulation is well in place across the EU. The EC’s Fifth AML Directive (AML5), adopted last year in the midst of the growing ML scandals,

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enhances the powers of the FIUs, tightens transaction conditions for prepaid cards and e-money, and ends the anonymity of bank accounts and of safe-deposit boxes.

Importantly, it also requires member states to create a unified list for politically exposed persons (PEPs), facilitates information exchange and co-operation among authorities, and grants public access to ultimate beneficial ownership (UBO) of EU-based companies. The latter is important due to the mushrooming of shell companies whose owners reside in different jurisdictions. Such “custodial bias” makes the tracking of illicit money difficult.

Last November, the European Parliament adopted AML6, to be implemented from 2021. In addition to already-existing regulations, AML6 will clarify the 22 ML predicate offences which all EU member states must criminalise, also increasing further international co-operation for ML prosecution.

... But AML bank supervision across the EU remains sub-optimal...

The AML supervisory framework for EU banks remains underwhelming. The ECB and the SSM involve themselves primarily with prudential, not misconduct-related supervision (including for ML). At the national supervisory level ML risk is not always vigorously pursued. If imposed, fines are low, and criminal investigations are few and far between.

ML cases most often surface as a result of whistleblowers or investigative reporting (e.g. through the Organised Crime and Corruption Reporting Project), rather than supervisory foresight. This was the case with the Troika Laundromat, the Azerbaijani Laundromat, or the Great Gambia Heist.

There is a strong case for a more effective and proactive pan-EU approach to AML supervision for banks, rather than the current fragmented state of affairs. The EC has in the past proposed that the EBA take a leading role in AML supervision across the EU. It remains to be seen how this can be achieved, however, without changing the EBA's governance structure. Its decision-making board is comprised of member states' national supervisors with inherent biases, thus making effective independent supervision more challenging. Whether this option, or a different route (establishing a de-novo pan-EU AML supervisory body), is pursued, it is very likely that this threat will be addressed more vigorously to comply with AML6 and with the realities on the ground.

It is also probable that in the future the ML threat will be more effectively included in the SREP assessment, a welcome enhancement to EU bank supervision.

...With the exception of the UK

The UK's Financial Conduct Authority (FCA) has adopted a risk-based approach for AML supervision for several years. It appears to be one of the very few EU supervisory authorities to have introduced a mandatory financial crime data return for all UK-based deposit takers. This has been in place since 2016. The conduct supervisor uses the information from the returns as part of its AML risk assessment.

Unlike other supervisory bodies, the FCA also has civil and criminal powers to investigate ML and terrorism finance: it is a supervisor with sharp teeth. The FCA's proactive approach is explained by the magnitude of financial activities in London, including by numerous foreign banks and investment firms from jurisdictions with weaker AML frameworks.

The FCA has already clarified that in a post-Brexit timeframe it will continue to apply and mirror vigorously the provisions of EU money-laundering directives, including AML5, 6 and its successors, and strengthen international co-operation on AML. This can be good news for EU-27 AML supervisors, which should emulate their UK counterpart.



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