
Discussion note on the framework for prudential and AML supervision for financial institutions across the EU

October 2018

1. *General comments*

- 1.1 We note that on 12 September 2018, the Commission published proposals¹ to strengthen the framework for prudential and AML supervision for financial institutions in the EU. We commend the Commission's objectives and welcome the Commission's envisaged work in this important area.
- 1.2 AFME is a pan-European trade association which represents the interests of the wholesale banking sector and has within its membership and its executive considerable expertise and experience in both compliance and prudential regulation matters, including AML. This is therefore an important subject for us and our members and we would welcome the opportunity to assist the Commission as its work in this area develops. We are also keen to work with the Commission and others to seek to restrict the use of the wholesale capital markets as a vehicle for money laundering and/or terrorist financing.
- 1.3 With that in mind, we set out below our initial comments on the Commission's proposals. We look forward to working further with the relevant authorities and other stakeholders involved as the Commission's proposals develop.

2. *Better use of the ESAs' powers and the enhanced role for the EBA*

- 2.1 Through the Joint Committee², the ESAs cooperate closely on AML and CTF³ issues. In particular, the Joint Committee produces guidelines⁴, opinions⁵ and regulatory technical standards encouraging AML/CTF supervisors and financial institutions to adopt a consistent approach to AML and CTF across the EU. These are important and welcome.
- 2.2 We note that the Commission has invited the ESAs to expand the Risk Based Supervision Guidelines to "specify common procedures and methodologies for the supervision and assessment by AML authorities of financial institutions' compliance with AML rules". We believe that this is an important and welcome step towards the harmonisation of AML/CTF regimes. This should allow the ESAs to ensure that their recommendations are being incorporated into national AML/CTF regimes and to encourage Member States where this is not presently so. We would very much welcome further clarity on how and when this recommendation will be implemented.
- 2.3 In addition, the Commission proposes that the EBA will have wide powers to undertake periodic independent reviews on AML issues and on the activities of financial institutions and AML/CTF supervisors. These will be followed up with EBA recommendations, and, importantly, we

¹ COM 2018/645 (available here).

² Available [here](#).

³ The objectives and tasks of the Joint Committee with respect to AML and CTF is available [here](#).

⁴ For example, we note that on 26 June 2017, the Joint Committee published important AML/CTF guidelines promoting a common understanding of the risk-based approach to AML/CTF.

⁵ Under Article 6(5) of the 2015/849, the ESAs are required to publish a joint opinion on the risks of AML and CTF affecting the EU's financial services sector.

understand that the EBA will have strengthened enforcement powers, will be able to request national supervisors to investigate cases and will be able to adopt its own rulings and impose sanctions on financial institutions. We welcome these steps, which should encourage greater harmonisation of AML/CTF regimes.

- 2.4 We note that the EBA will be able to collect information from financial institutions relating to procedures, governance, business model and activities undertaken for AML/CTF purposes. In principle, we welcome transparency and are pleased that these powers will be available at an EU-wide level. However, there needs to be close cooperation with Member State AML/CTF supervisors and FIUs to minimise duplication of effort and to ensure that this is undertaken efficiently. In addition, these powers need to be used on a fair and reasonable basis.
- 2.6 We note that the Commission proposes centralising the AML resource and expertise of the ESAs and the Joint Committee at the EBA. In addition, the Commission proposes setting up a standing committee, consisting of the heads of the national AML/CTF supervisors, which will replace the Joint Committee's AML Committee and will be responsible for tasks, such as the drafting of technical standards, guidelines and recommendations. Furthermore, the EBA will become a data hub on AML supervision collecting all the necessary information and data on AML issues.
- 2.7 These steps seem sensible. Most ML/TF in the financial services sector is in banking, as the Commission itself has recognised⁶. The steps should pool intelligence and will help to encourage the sharing of information and expertise. However, the above roles (including data collection, analysis and management as well as enforcement) on top of the EBA's existing roles present a hugely significant task and it is crucial that the EBA is properly and adequately resourced to manage this - which is not the case as of now, with its 1.8 heads working on AML.
- 2.8 In addition, we note that it is important that there continues to be a major role for ESMA and EIOPA in the AML/CTF supervision of financial institutions, particularly in the securities and insurance sectors where their wider expertise in these sectors will be helpful. In that respect, we are pleased that the EBA's proposed new standing committee will include observers from other parties including ESMA and EIOPA.
- 2.9 However, it is also important to note that much ML/TF activity takes place in sectors outside financial services. The likes of estate agents, lawyers, accountants, consultants, high-end retail, transport and the like are also at risk. While the Commission's present proposals relate only to financial institutions, the Commission, Council and Parliament need to ensure that all sectors are covered, not just financial services. The extent of AML/CTF regulation in the financial services sector is already wide-ranging and (while, as we have seen, it needs improving) it goes far beyond anything that exists in other sectors of industry. It is not clear how the EBA can effectively supervise sectors other than financial services.

3. Integration of AML considerations into prudential supervision

- 3.1 The SSM Regulation⁷ does not allocate responsibility for the supervision and enforcement for AML and CTF of the banks under its direct supervisory oversight to the SSM. This lies with national AML/CTF supervisors, although there is a duty for the ECB to cooperate with AML/CTF supervisors. The current boundary for the supervisory responsibility for AML/CTF risks therefore is far from

⁶ See section 1 of the Explanatory Memorandum of 2018/646 (available [here](#)) which states that "it is in the banking sector that money laundering and terrorist financing risks are most likely to have systemic impact".

⁷ Recitals 28 and 29 of Regulation 1024/2013 (available [here](#)).

crystal clear. The strengthening of the EBA's responsibilities for supervising AML/CTF regimes should be a welcome step in this regard⁸.

3.2 The ECB⁹ has identified conduct risk¹⁰¹¹ as one of the key areas of risk for the banking system. This is assessed by the ECB via the annual Supervisory Review and Evaluation Process (SREP) which takes a view on the bank's business model, internal governance and risk management, including its risk appetite framework, and the risks to its capital and liquidity and which may result in additional capital or liquidity requirements or other supervisory measures being taken¹²¹³. However, the ECB has noted that it can only rely on the information provided to it by national competent authorities in the area of AML, and, to date, there have been issues (e.g., concerning data protection and varying national approaches to the implementation of the AMLD) which would appear to have limited the ECB's ability to gain the full picture. The Commission points out that the 5AMLD requires the ECB to conclude a multilateral memorandum of understanding on the exchange of information with AML/CTF supervisors by 10 January 2019. In addition, we note that the Commission is proposing an amendment to the CRD¹⁴ so that all authorities and bodies that receive information relating to AML should be explicitly covered by confidentiality waivers. These are important steps in encouraging information exchange, which we welcome and should improve communication channels between AML/CTF and prudential supervisors.

3.3 Furthermore, we note that banks that do not fall under the scope of the SSM supervision are subject to national prudential authority supervision. These prudential supervisors are not always within the same organisation as the AML/CTF supervisor (which is often the conduct regulator), or the FIU. While in some Member States the AML/CTF supervisors, FIUs and prudential supervisors may interact frequently, we understand that this may not be the case in all Member States, nor are there harmonised standards or best practice. The Commission notes that the ESAs are encouraged to issue substantive guidelines covering cooperation and information exchange between AML and prudential supervisors. Whilst this is encouraging, it is important that this translates into clear channels for the exchange of AML/CTF information between the AML/CTF supervisors, FIUs and prudential supervisors in the EU. We note that the Commission has invited the EBA to undertake a 'stock taking exercise' to identify the various AML issues relevant from a prudential perspective and to identify deficiencies in current supervisory practices¹⁵. The EBA is then invited to adopt guidance¹⁶ (in the form of guidelines and technical standards) on how prudential supervisors should account for AML risks. Following that, the Commission notes that national prudential supervisors must clarify the practical arrangements for the incorporation of AML-related aspects

⁸ The Commission states that the EBA should have a "clear responsibility as regards the coordination of material AML-related supervisory issues at international level".

⁹ See the letter dated 18 August 2017 from Danièle Nouy (Chair of the Supervisory Board of the ECB) to Sven Giegold MEP (available [here](#)).

¹⁰ According to the 18 August 2017 letter, this includes "compliance with anti-money laundering laws".

¹¹ In the ECB's document entitled "ECB Banking Supervision: SSM supervisory priorities 2018" (available [here](#)), "cases of misconduct" are recognised as a source of banking sector risk.

¹² In a letter dated 3 May 2018 from Danièle Nouy (Chair of the Supervisory Board of the ECB) to Sven Giegold MEP (available [here](#)), he said that "money laundering risks are incorporated into ECB prudential supervision via the supervisory assessment. In principle the single supervisory mechanism supervisory review and evaluation process methodology includes the components necessary for a comprehensive prudential treatment of anti-money laundering risk."

¹³ AML/CTF concerns may be taken into consideration as part of the following areas: (i) Internal governance and the assessment of institutions' compliance function and procedures: this assessment aims to ensure that institutions have a full system of governance, compliance and internal controls in place to prevent the materialisation of AML risk from materialising, in line with the Basel III capital framework. (ii) Operational risk and the assessment of conduct risk: the assessment of this category of risk to capital ensures that institutions are strong enough to withstand the negative consequences of the occurrence of AML risk. The ECB takes into account legal and reputational risks arising for banks from AML concerns when it assesses the need for supervisory measures under the SREP (such as capital add-ons, organisational measures and recalling board members) for those supervised entities to ensure an adequate coverage of such risks. (iii) Business model: the assessment of the potential impact of AML risk on the viability and sustainability of the bank's business models.

¹⁴ Capital Requirements Directive.

¹⁵ The Communication states that "the European Banking Authority is invited to undertake first a stock-taking exercise allowing an overall identification of the various anti-money laundering issues relevant from a prudential perspective, as well as a mapping at Union level of existing practices of factoring anti-money laundering aspects into prudential supervision."

¹⁶ The Communication states that "the European Banking Authority is invited to adopt common guidance supporting the Union's prudential supervisors in appropriately and consistently accounting for money-laundering and terrorist financing risks in their activities".

into their prudential supervision¹⁷. These are laudable steps which we welcome, but we note that at this stage there is no detail on how these steps should be achieved and according to what timeframe. And there are a large number of entities involved in the flow of data.

- 3.4 Current AML policies and procedures, and the monitoring and surveillance systems that are built to implement them, have relied on red flags which have focused on conduct issues. That is because historically AML has been seen more as a conduct issue than a prudential issue. The emphasis has been on preventing money laundering (and other financial crime such as bribery) carried out by the customer. Red flag indicators (e.g., the involvement of politically exposed persons, the client engaging in unusual or apparently loss-making trades and the customer's involvement in high risk industries) have been the focus of organisations like the Financial Action Task Force (FATF) and conduct regulators more generally.
- 3.5 Other red flag indicators (including but not limited to ownership concentrated in a few high net worth individuals, proportion of non-resident clients, proportion of customers in high risk jurisdictions, proportion of deposits made in non-euro currencies etc.) could perhaps be harnessed in a more reliable manner to detect the prudential risk associated with money laundering in a consistent manner throughout the EU¹⁸. We would encourage, and be prepared to participate in, further research into developing such key risk indicators and discussions on how they could be consistently and further integrated into SREP processes.
- 3.6 Indeed, a crucial question is how best to deploy the key risk indicators. We would not see a need for prudential supervisors to develop a set of reporting requirements that would effectively duplicate those already required by AML/CTF authorities. We see this as likely to result in increased cost and bureaucracy without commensurately increased efficiency. Rather, we believe that closer cooperation between AML/CTF and prudential supervisors and the exchange of appropriate information in a timely fashion, as has been proposed by the Commission, is the key.

4. Greater use of supervisory colleges to consider AML issues

- 4.1 As noted above, the Commission proposes that the ESAs issue “substantial guidelines covering in detail the cooperation and information exchanges between AML and prudential supervisors and promoting the establishment of anti-money laundering colleges”.
- 4.2 Supervisory colleges are used to help home and host prudential supervisors develop a better understanding of an international bank's risk profile and to provide them with an overarching framework for addressing the key issues that are relevant from a prudential perspective. They allow for information sharing and cooperation on an ongoing basis and for collective decision making on prudential measures.
- 4.3 Supervisory colleges focus on prudential supervision. Whilst in principle this should also encompass conduct risk, as noted above, the quality of the information available to the prudential supervisors is entirely reliant upon what information is passed to them by the national AML/CTF supervisors.
- 4.4 Therefore, while we welcome the prospect of an equivalent supervisory college system for AML/CTF authorities - which would coordinate the activities of the AML/CTF supervisory authorities in the jurisdictions where a bank operates, and would provide a means for improving

¹⁷ The Commission states that “it is of great importance that all prudential supervisors clarify the practical arrangements that concern incorporation of AML related aspects into prudential supervision, taking into account the EBA's guidelines.

¹⁸ The only way of checking robustly if a bank is engaged in money laundering activity is by undertaking an assessment at transaction level.

the exchange of information between AML/CTF authorities - it is important to ensure that any supervisory college system developed for AML/CTF purposes is well coordinated with the existing supervisory college system for prudential supervisors.

5. Improving coordination and exchange of information

- 5.1 We note that the 4AMLD and 5AMLD¹⁹ already provide for channels for the exchange of information between AML/CTF supervisors,²⁰ for example via the EU FIU Platform²¹ and FIU.Net²².
- 5.2 However, a Commission document²³ published in June 2017 identified important obstacles²⁴ which currently hinder the exchange of information including, for example, differences in the size, powers and organisation of AML/CTF authorities and non-standardised reporting formats. There is therefore clearly still much room for improvement in this respect.
- 5.3 The Commission has proposed a means of improving the information flow between AML/CTF and prudential supervisors. But it is not clear that the Commission has clearly set out a means of improving information flow between national AML/CTF supervisors. This is an important area which should not be overlooked, and we believe that this should fall within scope of the EBA's responsibilities.
- 5.4 We note that the Commission proposes that the EBA should become a data hub on AML supervision and should be able to collect all the necessary information and data pertaining to AML issues, from AML as well as prudential supervisory authorities, which should include confidential data relating to specific money laundering cases". We believe that it is important that information on suspicious transactions is shared routinely across AML/CTF supervisors (including typologies and more general information on strategy etc). In addition, consideration should be given to the sharing of information at an earlier stage (e.g. early notification of concerns on individuals or a firm). The sharing of information in this way may require new or improved information channels and it would be necessary to ensure that they are compliant with data protection rules²⁵ (although as noted above the Commission is proposing changes to the CRD to waive confidentiality rules in relation to the sharing of AML data).

6. Additional points:

- 6.1 We would encourage the Commission to investigate the development of utilities for KYC purposes. This would allow companies acting on behalf of financial institutions to collect KYC information from clients. We understand that KYC requirements vary across the EU and that there may be important data protection considerations involved. However, if these challenges can be overcome, we understand that this could greatly improve the efficiency of the on-boarding process for

¹⁹ The 5AMLD allows FIUs to request information from an 'obliged entity' without the need for a prior STR, FIUs can have access to information in MS centralised bank and payment account registers and central data retrieval systems.

²⁰ In particular, the 5AMLD requires Member States to set up a cooperation framework within six months of the Directive coming into force.

²¹ Specifically referred to in the 4AMLD, it is an expert group comprising Member State representatives providing a forum for the exchange of information and views across Member States.

²² Specifically referred to in the 4AMLD as the recommended channel of communication between FIUs.

²³ Available [here](#).

²⁴ The obstacles are:

- Differences in the size, powers and organisation of AML/CTF authorities.
- Differences in the types of information sources available to AML/CTF authorities.
- Lack of strategic and organisational analysis within AML/CTF authorities.
- Data protection, security and confidentiality rules.

²⁵ The General Data Protection Regulation (GDPR) (available [here](#)) which came into force on 25 May 2018.

financial institutions. We note also the work of the Commission eID and KYC expert group²⁶ and would hope that this could produce EU-wide digital ID and KYC standards.

- 6.2 We encourage the Commission to investigate the development of greater collaboration (in particular, information sharing) between financial institutions and law enforcement agencies. This would entail, for example, a regime encouraging the disclosure of information by financial institutions to public authorities. We understand that new technology may be developed providing a platform for secure collaboration. Data protection concerns would of course need to be considered carefully, as well as protection of the industry disclosers from litigation.
- 6.3 Also, if the industry is better able to play its part in AML and CTF, it needs feedback from the regulators as to what they are looking for. Estimates vary, but we have heard it suggested that as many as 90% of STRs are not useful to FIUs. That is because MLROs report everything that might be suspicious, for fear of enforcement action and personal liability if they omit something that the regulator views as important. If they were: (a) told what to look for; (b) encouraged to focus their monitoring and surveillance accordingly; and, (c) not enforced against when they miss something by reason of having targeted their resources accordingly, the quality and usefulness of STRs would improve dramatically.
- 6.4 We understand that in the longer-term, consideration may be given to transforming the AMLD into a Regulation. We would welcome further consideration of this approach. Certainly, AML/CTF is a good example where the use of a Regulation rather than a Directive could lead to a harmonised AML/CTF framework for Member States resulting in administrative efficiencies, cost savings and more effective prevention of crime.
- 6.5 We welcome the comments made by Andrea Enria, Chairman of the EBA, at the ECON public hearing in the European Parliament on 8 October, suggesting the possibility of conferring specific AML supervisory tasks to a new dedicated EU-wide agency. This idea has the support of some parties in the Parliament. This would be a significant task requiring significant resource and it is likely to take time to implement. But it may deal with the issue of the significant ML/TF risk in sectors outside financial services, which we mention at paragraph 2.9 above. Therefore, this longer-term option should remain on the table. In the interim, we do hope that the EBA will manage to ensure that AML/CTF rules are implemented consistently across the EU.

7. Conclusion

- 7.1 We hope our ideas, set out above, are seen as helpful. We look forward to working with the relevant authorities and other stakeholders as the Commission's, Council's, Parliament's and the ESAs' work in this critical area develops.

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²⁶ Commission expert group on electronic identification and remote Know-Your-Customer processes (see [here](#)).