IMPROVING ECONOMIC POLICY

bruegel

A Better AML Supervisory Architecture for the European Union

Joshua Kirschenbaum
Senior Fellow, German Marshall Fund / Alliance for Securing Democracy (Washington DC)

Nicolas Véron
Senior Fellow, Bruegel (Brussels) and
Peterson Institute for International Economics (Washington DC)

Discussion at Bruegel – 15 October 2018

Calls for Reform

Several large-scale money laundering cases involving Cyprus, Denmark, Estonia, Latvia, Malta, Netherlands, UK

- Often billions of dollars through a single bank
- Frequently tied to Russia/CIS
- Enforcement by national regulators and law enforcement inconsistent
  - Fines often low, details often non-public
  - Lack of high-profile prosecutions

- Emerging recognition that illicit finance is a national security issue

"It's very embarrassing to depend on the United States to do the [AML] job. This has to change […] We need a European institution that is implementing in a thorough, deep, consistent fashion this [AML] legislation in the euro area [...] We need to change the situation. It's not sustainable to stay in that situation."

Danièle Nouy, ECON Committee hearing, 26 March 2018

"Until there is political will to create a centralized European body for dealing with money laundering, the international McMafia will continue to find plenty of ways to funnel its illicit billions through the pipework of the European financial system."

Financial Times editorial, 5 July 2018

3 Pillars of AML Policy

- AML Supervision
  - Emphasis on processes (AML Program)
  - For banks, AML supervisor often same authority as prudential

- Coordination and information-sharing
  - One Financial Intelligence Unit (FIU) in every jurisdiction
  - Wide diversity of FIU types, coordinated through Egmont Group
  - Lack of coordination among AML supervisors

- Law enforcement
  - Criminal investigations, prosecutions, asset seizures
  - Police, prosecutors, judges
  - Distinction between AML program violations and criminal money laundering

- Our focus is on AML Supervision – primarily, but not only, of banks

AML in European Union

- EU law harmonization
  - Minimal, successive directives
  - AMLD5 enacted, not yet transposed (public beneficial ownership registries, bank account registers)
  - AMLD4 (beneficial ownership registries) in effect, uneven transposition

- AML is responsibility of member states' national competent authorities
- Highly heterogeneous national frameworks
- AML supervision carried out by host, not home, supervisors
- ECB does licensing, qualifying holdings, fit and proper within euro area
- ESAs have limited oversight role
- All of these elements introduce frictions

AML in the United States

- Central role of FinCEN = AML Supervisor + FIU
- FinCEN issues regulations and guidance and has ability to impose fines
- But delegation of examination authority to "Federal Functional Regulators," which leads to fragmentation:
  - Banking regulators including Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve
  - Other regulators include Securities and Exchange Commission, Commodity Futures Trading Comission and their respective self-regulatory organizations (FINRA and NFA)
  - Money services businesses have no federal functional regulator
  - Emphasis on robust enforcement and large fines by FinCEN, federal regulators, and Justice Department

Supervisory Architecture & Incentives: “AML Vicious Circle”

- Single market + national AML supervision
  - Concentration of [layering] activity into certain member states
  - Fosters powerful domestic economic and political interests
  - Vicious circle, especially in small countries
  - Passporting to entire EU from any member state
- Reputational damage for the ECB, potential political conflict with EC/EBA
- “Whack-a-mole” effect: addressing one weak link may only displace the activity
- Relies on smallest, lowest-capacity jurisdictions as first line of defense; cannot harness economies of scale

Unitary vs. Two-Tier Architecture

- Greater supervisory integration needed

- Two models
  - Two-tier: NCAs supervise, checked by European agency
  - Unitary: European agency supervises, and may delegate to NCAs
  - Unitary architecture preferable for AML

- Options for European agency
  - Pros/cons of each option may differ if two-tier vs unitary

Seven Options for European Hub

1. SSM (for banking union area countries)
2. Each ESA for its respective scope (e.g. EBA for banks only)
3. EBA for all [financial] firms
4. ESMA for all [financial] firms
5. Joint venture of the 3 ESAs, building on existing Committee
6. Fourth ESA: “EAMLA”
7. Enhanced cooperation (subset of member states)

- Preferred option is EAMLA
  - Proactive, resolves home/host issues, cross-sectoral, tailored governance, specific AML culture (center of excellence)
  - Downside: one more EU-level agency
  - But AML is worth it