

PREVENTING AND COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM. POSSIBLE IMPROVEMENT SOLUTIONS

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***Abstract.** The European authorities are paying more attention to money laundering and terrorism financing which affect the integrity and the stability of the financial system as a whole. Therefore we have to think of cooperation between the prudential supervision system and the AML/CET supervision system as a prerequisite to ensure that the credit institutions rigorously observe the prudential regulations and the law in force.*

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Recent cases of involvement of some crediting institution from the European Union in money laundering made the national and European authorities pay more attention to this phenomenon affecting the integrity and stability of the financial system as a whole.

The voluntary liquidation of the Latvian ABLV Bank¹, a credit institution under the prudential supervision of the European Central Bank and AML supervision by the Financial Market Authority (FMA), qualified as a bank of systemic importance in Latvia, following the non-observance of the regulations in matter of preventing and combating money laundering and the international sanctions reveals, in my opinion, the fact that there is a

¹ [http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614496/IPOLIDA\(2018\)614496
EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614496/IPOLIDA(2018)614496_EN.pdf)

risk to financial stability and to the operation of a credit institution and, implicitly, to the stability of the financial system.

Although the determinants are specific to the risk of money laundering, the effects are associated to events causing an impact at the level of the prudential risks, such as: operational risk, reputational risk, liquidity risk or even credit risk. Thus we may conclude that a bank unable to manage the risk of money laundering and terrorism financing faces also a prudential risk. When a bank is of systemic importance, this effect may expand to the national system, which might affect financial stability.

Considering the above-mentioned, we may assume that the cooperation between the systems of prudential supervision and those of preventing and combating money laundering and terrorism financing is a prerequisite to ensure that the credit institution rigorously observe the prudential regulations and the laws in force.

The separation of the supervision concerning the prevention and combating of money laundering and terrorism financing from the prudential supervision took place during the financial crisis and soon after that. Under some jurisdictions, this process was based on centralized AML/CFT supervision for all categories of reporting entities.

In the countries where such competence was attributed to traditional prudential supervisors, the process was gradual, in a context that revealed a need for more specialisation in this specific field implying rather analyses at the transaction level than a macro approach, based on relevant indicators, the so-called supervisor's "traffic lights". The purpose was to avoid its secondary position in relation to the prudential supervision, because after the financial crisis there was a need for more regulation and prudential supervision, concentration on elements considered decisive for the financial crisis stir-up, evolution and extent, which required more resources for prudential supervision.

In general, the evolution of the banking regulation was sinuous over time, and often it consisted in emotional response to some events and later in some changes to rebalance them; this was reflected within the regulations and in the regulation-deregulation sequence.

After the crisis, this emotional mark started to fade under the impact of the requirements for adopting a regulatory framework for strategic objectives, as defined through complex analyses of options, effects and costs, in the context of globalisation and the need for an easier trade.

The cooperation between the supervision authorities seems necessary to harmonize practices and objectives which might reduce reactive regulation but not to fully eliminate it, since the regulation process is, besides the technical component, a decision taken at the political level in response to social expectations and economic developments.

Of course, the direction changes in the regulation plan are followed by repositioning in the implementation and supervision domains.

As for recent investigations into claims of vulnerability to money laundering of credit institutions of the EU member states, a study² published on the European Parliament website shows that, on one hand, there are common risks to the involved credit institutions that can be found in the process of monitoring some prudential indicators, but which were not suitable and sufficient to reveal the non-observance of the regulations for preventing and combating money laundering and, on the other hand, that once the scandal of this non-observance burst, the prudential indicators deteriorated rapidly.

The impact of the failure of the AML/CTF systems in some member countries to prevent the involvement of some financial institutions in laundering tens or even hundreds of billions requires the identification of the causes of this failure and solutions to ensure better management of future risks.

In this context, the discussion agenda should include the issue of supervision because it seems that the present supervisors did not have all necessary instruments for a previous identification of vulnerabilities, although suspicious operations had been carried out for many years and in large amounts. It is true that the velocity and complexity of the operations, the utilisation of increasingly laborious schemes for hiding the illicit character of the funds involved, especially by the so-called trade-based money laundering implying the justification of the suspicious transactions by legitimizing commercial documents, hinder the identification of the criminal typologies.

Obviously, major changes in the regulation framework require the adjustment of the compliance supervision systems, all the more so as attempts are made to take the initiative in order to anticipate the risks, to identify vulnerabilities and to find corrective solutions before being

² [http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614496/IPOLIDA\(2018\)614496EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614496/IPOLIDA(2018)614496EN.pdf)

confronted with severe consequences. In this respect, a steady checking cannot be any longer a suitable instrument and a risk-based approach is considered for the identification or even the anticipation of the elements/factors favouring the non-observance of the regulations or amplifying the consequences of such non-observance and the focus of the supervisor's actions and resources on these elements. Actually, the present failures and limitations are not transparently shown as there is no organisation using a common evaluation methodology to make comments on comparable data, except for a few criteria for supervising financial institutions within the country evaluations in accordance with methodology for the Financial Action Task Force (FATF).

The Special Committee Report on Organized Crime, Corruption and Money Laundering, submitted in 2013 – already revealing the changes in the fields under consideration, the transnational character favoured by free movement, the expansion and diversification of the fields of action of over 3,600 organized crime groups in the European Union³ – was a serious warning and the later terrorist attacks of the so-called Islamic State were reasons for tougher regulations concerning new fields such as the virtual coin, the transparency of the e-coin. Such actions cannot produce the expected outcome without an effective supervision.

One of the options for solving this problem could be the re-integration of the AML/CTF component into the prudential supervision so that both components can use for evaluation information and conclusions concerning the aspects of common interest, such as the internal governance, the internal control system or the risk profile of the banks.

But some papers, such as *The Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy. Final Report*⁴ on advantages and disadvantages of the supervision models, point out – in relation to the *external* model, i.e. when the prudential supervisor supervises also the enforcement of the provisions concerning the money laundering prevention and combating – the advantage of understanding the specific features of the supervised entity, of the related processes and

³ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2013-0307+0+DOC+XML+VO//EN>

⁴ [http://www2.econ.uu.nl/users/unger/ecoleffiles/Final%20ECOLEF%20report%20\(digital%20version\).pdf](http://www2.econ.uu.nl/users/unger/ecoleffiles/Final%20ECOLEF%20report%20(digital%20version).pdf)

products, but the prudential supervision of the AML/CTF component could mean less attention to the latter.

Therefore, the best solution might be not a return to the previous model but it might be the integration of the two components into the same institution to ensure better cooperation and exchange of information without restrictions, breaks or delays in order to take advantage of the dual exchange of information or even to request, whenever necessary, punctual inspections at the level where distortions, vulnerabilities or risk factors were detected.

At present, the prudential and AML/CFT supervision, as per the websites of various European institutions, is the following⁵:

| No. | EU member state | The AML supervision for the credit institutions | The prudential supervision authority for the credit institutions |
|------------|------------------------|--|--|
| 1 | Austria | Financial Market Authority (FMA) | Financial Market Authority (FMA) |
| 2 | Belgium | Financial Services and Markets Authority (FSMA) | Banque Nationale de Belgique |
| 3 | Bulgaria | Bulgarian National Bank (BNB) | Bulgarian National Bank (BNB) |
| 4 | Croatia | Croatian National Bank (HNB) | Croatian National Bank (HNB) |
| 5 | Cyprus | Central Bank of Cyprus (CBC) | Central Bank of Cyprus (CBC) |
| 6 | Czech Rep. | Czech National Bank (CNB) | Czech National Bank (CNB) |
| 7 | Denmark | Finanstilsynet (Danish FSA) | Finanstilsynet (Danish FSA) |
| 8 | Estonia | Finantsinspektion (Estonian FSA) | Finantsinspektion (Estonian FSA) |
| 9 | Finland | Finanssivalvonta (Finnish FSA) | Finanssivalvonta (Finnish FSA) |
| 10 | France | Autorité de Contrôle Prudential et de Résolution (ACPR) under the Banque de France | Autorité de Contrôle Prudential et de Résolution (ACPR) under the Banque de France |
| 11 | Germany | Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) | Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) |
| 12 | Greece | Bank of Greece | Bank of Greece |
| 13 | Hungary | Hungarian National Bank (MNB) | Hungarian National Bank (MNB) |
| 14 | Ireland | Central Bank of Ireland (CBI) | Central Bank of Ireland (CBI) |
| 15 | Italy | Bank of Italy and Ministry of Finance | Bank of Italy |

⁵ Source: Websites of the National Supervisory Authorities, <https://www.anti-moneylaundering.org>

| No. | EU member state | The AML supervision for the credit institutions | The prudential supervision authority for the credit institutions |
|------------|------------------------|--|---|
| 16 | Latvia | Financial and Capital Markets Commission (FCMC) | Financial and Capital Markets Commission (FCMC) |
| 17 | Lithuania | Bank of Lithuania | Bank of Lithuania |
| 18 | Luxembourg | Commission de Surveillance du Secteur Financier (CSSF) | Commission de Surveillance du Secteur Financier (CSSF) |
| 19 | Malta | FIAU and Malta Financial Services Authority (MFSA) | Malta Financial Services Authority (MFSA) |
| 20 | Netherlands | Dutch National Bank (DNB) | Dutch National Bank (DNB) |
| 21 | Poland | Financial Supervisory Authority | Financial Supervisory Authority |
| 22 | Portugal | Bank of Portugal | Bank of Portugal |
| 23 | Romania | National Bank of Romania (BNR) | National Bank of Romania (BNR) |
| 24 | Slovakia | National Bank of Slovakia | National Bank of Slovakia |
| 25 | Slovenia | Bank of Slovenia | Bank of Slovenia |
| 26 | Spain | SEPBLAC, in cooperation with the Bank of Spain | Bank of Spain |
| 27 | Sweden | Finansinspektionen (Swedish FSA) | Finansinspektionen (Swedish FSA) |
| 28 | United Kingdom | Financial Conduct Authority (FCA) | The Prudential Regulation Authority |

The above table shows that, in general, the model used in the European Union assigns to one institution both the prudential supervision and the AML/CFT supervision. Also, most of the Central Banks supervise the money laundering prevention and combating in order to ensure the integrity and the stability of the banking system.

We may infer that as regards the internal governance the intensification of the cooperation of the two banking supervision activities is feasible and realizable at a low cost. But from a functional point of view, I think there is a problem regarding the quantification of the impact of the ML/FT risk on a credit institution, especially when it comes to the need of internal capital, within the Internal Adequacy Assessment Policy (ICAAP).

Therefore, there is a close link between the ML/FT risk and the operational risk. The ML/FT risk may be considered a component of the operational risk because the risk determinants are elements related to the way some operational processes take place, to the efficiency and fiability of

the IT systems, to the quality and quantity of the resources provided for the knowledge of the customers and transaction monitoring. At the same time, the way of interpreting the legal provisions in matter of AML/CFT exposes the bank to the legal risk, which, in turn, is a component of the operational risk.

The ML/FT risk causes a major exposure of the bank to the reputational risk (see the case of the Latvian ABLV Bank). In fact, it is about an increasing lack of confidence in the integrity and viability of a credit institution. Quite often, this evolution causes emotional response from the customers, consisting in money withdrawals that further cause liquidity crises and endanger a bank's financial stability or even its future operation.

The ML/FT risk may also impact on the credit risk when a bank in exposed (offers loans) to a customer who, after being monitored, is found as being involved in transactions suspected to be of the money laundering type. Also, a customer may request credit products to be further used for complex operations to hide the illicit origin of the funds. In general, when a bank or an AML/CFT supervision authority identifies doubtful operations, the loans may become non-performing ones.

All the above-mentioned elements reveal – in my opinion – that the information exchange between the AML/CFT supervision authority and the prudential supervision authority is an essential condition for the assessment of how a bank covers the exposure to financial and operational risk with provisions (expected loss) or with internal capital (unexpected loss). At the same time, the information exchange and increasing cooperation could be the first step of a scheduled process of integration of the two sides of the banking supervision.

Besides this micro construction, the jurisdiction or the national segment of the financial market, the cross-border character of the ML/FT schemes requires a broad approach to the activity of the financial institution on the Single Market.

Therefore, after the adoption of a unitary regulation framework we should gradually start the integration of the AML supervision procedures existing in the member states by mean of guidebooks and assessments harmonized at the EU level and after achieving this purpose and creating permanent information transmission channels and databases it is possible to complete the institutional integration of the off-site supervision at the EU level. I exclude the on-site supervision component that should be further

carried out by the national supervision authorities, owing to their higher response capacity and better understanding of the local economic environment.

The gradual transition of the off-site supervision competence would allow for the information centralisation, integration effectiveness, while the administrative changes would not have a major (even temporary) negative impact on the quality of supervision. This macro vision concerning the vulnerabilities, the procedures, the risk management, the customer typology and, especially, the financial flow would allow us to detect, follow and stop more effectively the complex financial circuits used to launder money made by evasion, corruption, smuggling and other illegal actions.

Equally important, the off-site supervision transition from the national level to the European level could diminish or even eliminate the politicians' indirect involvement.

Also, there would be symmetry with the prudential banking supervision integrated with the European Central Bank.

Of course, the member countries should conclude an agreement on this matter, while a good impact study revealing the advantages of this approach could stimulate the compliance process in order to consolidate the supervision in the ML/FT prevention and combating field.

The fastest way to establish a new institutional architecture at this level could be assigning such duties to one of the existing European institutions, such as the European Central Bank or the European Banking Authority.

An initial obstacle could be the existence of many supervision models in the member countries, especially where the AML supervision is not assigned to the central banks or to the financial supervision authorities that are not included in the regulation area of the above-mentioned European institutions.

Anyhow, it is obvious that we need a single supervision of the loan providers operating on the single financial market so that the borders open to free movement of capital should not facilitate the movement of funds resulted from illegal activities.

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