THE EU IS HOMING IN ON DIRTY MONEY

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Abstract

The EU is getting serious in the fight against dirty money. It is currently grappling with a huge legislative package in the domain of anti-money laundering (AML), a package that includes four proposals overall. Each needs to be carefully scrutinised to ensure that they bring real improvements. One of the most striking proposals is the creation of a new Anti-Money Laundering Agency (AMLA), to be operational by 2026. Many questions remain, however, on how it will ensure the better implementation of rules across the EU (and beyond) and guarantee closer cooperation between national competent authorities (NCAs) and financial intelligence units (FIUs), all envisioned within the European Commission's proposal. This CEPS Policy Insights paper discusses the four individual proposals and dives deep into the subsequent questions that they raise, such as whether a new agency is really the best solution. It concludes that the European Parliament and the Council of the EU definitely have their work cut out for them to ensure that a well-functioning structure for AML supervision is the true end result of this arduous legislative process.

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Anti-money laundering (AML) policies have been notoriously ineffective, but it is not guaranteed that the European Commission's plans will bring much change. Careful attention needs to be paid to the proposals currently being considered by the EU co-legislators to ensure they bring real improvement. More staffing and EU-wide coordination in AML is certainly a priority, but is a new agency the solution? The correct design and governance of the Anti-Money Laundering Authority (AMLA) is crucial for it to be effective, and the amendments to the existing laws should allow for truly risk-based and proportional AML policies. Different legal bases for judicial cooperation and strict data protection rules may form important impediments to such policies.

A huge legislative package in the domain of anti-money laundering (AML) is on the EU's co-legislators' agenda, with the Commission's July 2021 AML package. It comprises four proposals and a consultation: a proposal to create an 'Anti-Money Laundering Authority' (AMLA), amendments to the fifth AML directive and a new regulation to improve the application of the AML rules. It also published a consultation a week later on Public Private Partnerships (PPPs) in AML, and proposed an amendment to the Transfer of Funds Regulation, to include crypto-assets in AML scrutiny. This is all, suffice to say, a big upgrade in AML that requires close follow up to make it work.

This paper discusses the proposals and the subsequent questions they raise. We were largely inspired by our work in the context of a CEPS task force, that met over the course of 2020, but also by comments from experts and colleagues[1]. One huge problem that remains, however, in the domain of AML, is the lack of data that accurately shows the size of the problem, on which only very rough approximations currently exist. It is a pity that the Commission's impact assessment does not dive deeper into the different forms of money laundering and combatting the financing of terrorism (CFT).

AMLA, a new EU agency

With its proposal for an Anti-Money Laundering Authority (AMLA), the EU wants to get serious on tackling dirty money. The new agency, expected to be operational from 2026 onwards, aims to ensure the better implementation of rules and guarantee closer cooperation between national competent authorities (NCAs) and financial intelligence units (FIUs). AMLA should develop common methodologies for AML detection and will execute on-site inspections. It is expected to impose sanctions on blacklisted institutions ('obliged entities', Art. 6) for the non-respect of rules. But acting on money laundering itself, and penalising those behind it, will remain up to the Member States' national entities and judicial authorities. The focus will be mostly on financial institutions, much less on other types of entities.

The proposed AMLA is also intended to function as a pool of expertise and data for national authorities. It should facilitate the detection of illicit practices. The Commission is proposing that AMLA would assist FIUs in EU-wide risk detection coordination and support and through

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'joint analysis' of suspicious transaction reporting (STRs) and suspicious activity reports (SARs). AMLA would also operate FIU.net, the network of FIUs that was until recently managed by Europol. Finally, it would take over the AML/CFT database currently managed by the European Banking Authority (EBA).

Reading through the AMLA proposal, the similarity with the Single Supervisory Mechanism (SSM) for banks licensed in the Banking Union is apparent. AMLA will have joint supervisory teams, it will have a board comprised of the national supervisors, as well for AML or the FIUs, an executive board, and it will assist NCAs with common approaches, integrated analysis tools and joint templates. The similarity with the SSM goes further, as it will shortlist and directly supervise the riskiest cross-border institutions, to be assessed every three years. It will undertake peer reviews of national financial and non-financial supervisors.

Following its usual ways of working, the Commission is once more favouring 'agencification' as the best solution. But will another agency work, in an already very populated area of national, EU and international law? Will it help ensure consistency/coherency and effectiveness of EU action in line with better EU regulation guidelines/toolboxes (effectiveness, efficiency, coherency and fundamental rights). The AMLA operational structure thus raises many questions:

- The centralised structure of AMLA could, like the SSM, be useful to pool expertise, but the question can be raised over whether it is adapted to the specific nature of 'money laundering', which requires insights in the latest criminal practices and specialist knowledge of these milieus. Will AMLA manage to combine both, and adapt to different local customs and ways of doing things? The structure as proposed will give plenty of powers to the executive board, but Member States want more control for the board of supervisors, precisely due to their the link to local markets;
- Efficient interaction and cooperation between AMLA, the NCAs and, above all, FIUs is crucial. But is the structure and are the actors at national level sufficiently comparable to create what the European Commission envisages? Similar questions can be raised with regard to the ways in which AMLA will relate and cooperate with existing EU agencies such as Europol, Eurojust, the European Public Prosecutor Office (EPPO), etc.
- Being blacklisted as a 'selected obliged entity' by AMLA will be a significant 'vote of no-confidence' for any given institution, which could lead to credit agency downgrades and increases in funding costs. It will lead to higher operational costs and restructuring within banks and other financial institutions, and could give rise to adverse financial stability effects. What criteria will be used to identify risky financial institutions, and how the methodology would be set remains to be defined in implementing acts. The concept 'obliged entity' goes back to the fourth AML directive (2015/849), and covers a wide variety of entities that have to demonstrate that they have policies in place to control money laundering;

- **Selecting those 'obliged entities'** will require close cooperation with national supervisors and the SSM. But how will this cooperation work in practice, and how will data exchange be structured between both of them? How would *mutual trust* among relevant national and EU authorities be ensured?
- **The focus is by and large on regulated financial institutions**, it is much less developed for other actors in the field, or for newcomers. For non-financial institutions, it shall develop peer reviews of their supervisors, to the extent that they exist, or of the self-regulatory bodies. In case AMLA finds this insufficient, it would take all necessary steps to act on the breach of Union law, but this will be difficult to enact for such self-regulatory entities;
- The support and cooperation mechanism of **FIUs** is a worthy step, but will it work in practice? FIUs work in different institutional contexts at national level, where the EU does not necessarily have a firm grip. FIUs embody a complex multi-actor network of authorities with non-homogenous tasks and responsibilities across the EU Member States. Are the powers of AMLA sufficient to make it work, and will it get leeway on the issues resulting from the embedded diversity of the national and transnational actors involved?
- Cooperation amongst FIUs raises the question of **data protection and privacy**, which appears unresolved. This includes ensuring that personal data processing is limited to what is strictly necessary and proportionate, and a clear demarcation of the roles between AMLA and FIUs which will determine the applicable data protection rules and its supervision model. This includes privacy issues inherent to the proposed 'Public-Private Partnerships' (PPPs) model of information exchange, or those inherent to data exchange with third countries, including by Europol.
- **AMLA will need to be technology enabled**. At the heart of crime detection is the ability to collect and manage large quantities of data, and ensure independent checks and balances so that 'data' can become 'evidence' in criminal proceedings. AMLA should have the authority to standardise information flows, such as, for example, suspicious activity reports, and the ability to conduct advanced analytics so as to support FIUs and national supervisors. Who will carry out the research on these advanced analytics, and what will the guarantees be for ensuring the quality and legality of data collection and use? Will AMLA have enough capacity and the means to perform its tasks? A clear division of responsibilities between AMLA and the NCAs is required.
- Intelligence sharing, core to AML and CFT, requires solid legal foundations if happening at international level. The AMLA proposal is based on Article 114 TFEU, i.e. the harmonisation of laws to allow for the proper functioning of the internal market, but this may not be a sufficient base for data sharing in criminal cases. If the purpose/objective is to assist in the investigation of criminal offences, which may include the collection, storage, processing, analysis and exchange of information with third countries, then the question could be raised as to whether the relevant Treaty article applicable is Art. 87(2)(a) TFEU (i.e. police cooperation).

- The new entity will **only be operational by 2026**, which raises the question about what will happen until then. The EBA was clearly pushed aside ('cannot do it because of its governance structure, and cannot provide support to FIUs, (…) has no experience in direct supervision'). A well-organised transition between EBA and AMLA will be crucial. The role of and the cooperation with the ECB is not addressed by the proposal, whereas the SSM has a wealth of information on operational conduct and banking risks as part of its tasks.
- How will **international cooperation** be organised under AMLA? The role of third country banks in AML and cooperation with third country NCAs and FIUs is crucial to make AML work. Will the web of cooperation not become too complex, and will the speed of action and information transmission be affected? Clear structures will need to be elaborated by AMLA, but will the Member States accept the primacy of AMLA, or will AMLA create more overlaps?

An AML regulation

The draft regulation covers private operators and proposes to guarantee a harmonised application of AML rules across the EU, and towards third countries. Differences in the definition of money laundering in the Member States are a well-known problem. A regulation should ensure consistent application in the EU. An important element of the proposal is the tighter **customer due diligence measures**, including the formal requirement for rules for obliged entities to identify Ultimate Beneficial Owners (UBOs). The regulation also expands the list of obliged entities to include crypto-asset service providers but also other sectors, such as crowdfunding platforms. Obliged entities shall appoint one executive member of their board of directors responsible for AML implementation. Branches and subsidiaries of obliged entities located in third countries have to comply with the EU's AML rules, where the country will be subject to measures proportionate to the risk they pose, following the FATF rankings, or the Commission's own assessment. Third countries with significant strategic deficiencies in their AML regimes shall be designated as 'high-risk third countries' by the Commission, and enhanced due diligence measures will be applied to their obliged entities, or their licences will be withdrawn.

The **risk-based approach** is most important in the scope of the regulation. It says that 'obliged entities shall take appropriate measures, proportionate to their nature and size, to identify and assess the risks of money laundering and terrorist financing', but the customer due diligence requirements have become much stricter. So will they be effectively risk-based? Is there sufficient flexibility for tailor-made approaches or will there be even more box-ticking as a result of the new rules? In case of the latter, it will result in even more paperwork and bottlenecks at the level of FIUs, and AMLA, in dealing with thousands of false positives.

The sixth AML directive (AMLDVI)

The draft directive, or the sixth update of the original 1991 AML directive, is addressed to the supervisory authorities and FIUs. It provides a harmonised list of the **22 predicate offenses that constitute money laundering, including certain tax crimes, environmental crime and cyber-crime, which should facilitate the work of AMLA**. It extends criminal liability and introduces tougher punishments. The draft intends to bring about a greater level of convergence in the practices of supervisors and FIUs, and in the cooperation among NCAs. The powers and structures of supervisors are to be harmonised.

The draft sets a **legal basis for the FIU.net** system, and thereby aims to overcome the 'suspension' of the network by the European Data Protection Supervisor (EDPS) that occurred in 2019. Whether this will be enough to overcome privacy and data protection concerns remains to be seen. This is particularly so with regard to the proposed model focus on a 'risk-based approach', the lawfulness of the envisaged FIUs 'access rights' and the lack of clarity in relation to the categories of data which will be processed. The EDPS has also underlined that the envisaged extensive data access by FIUs is in conflict with the administrative (as opposed to criminal investigation) nature of FIUs and the EU's proportionality principle. Regarding the **non-financial sector, the duty of oversight** by a public authority, or self-regulatory bodies that act as supervisors, is introduced. But this raises big conflict of interest issues for the latter entities, apart from the general lack of European coordination in the oversight of the non-financial sector.

What Scope for PPPs in AML

The European Commission also issued a consultation on Public Private Partnerships (PPPs) in AML supervision, an issue that for some is missing in the proposals, but that is at the same time underestimated in the policy problems it raises. PPPs at national level raise issues of competence, data secrecy and bias, and open competition, which are amplified at European and international level. PPPs first require a structure for cooperation among private sector entities, which can then lead to cooperation with the public sector, taking the respective roles of both into account.

It is obvious, however, that the private sector, and certainly the financial sector, is at the forefront in detecting money laundering and can share much intelligence with the public sector. Both can share intelligence on threats and risks, they can develop structures for information sharing and facilitate the adoption of new tools and technologies. But are the resources sufficient in the FIUs to act upon this? And how are privacy and bias concerns handled?

Summing up

Setting out a well-functioning structure for AML supervision is quintessential. In view of the complexity of the tasks in AML supervision, and the entities involved, this will not be easy. The analogy with the SSM masks the huge difference in the supervisory tasks: AML detection is a bottom-up process, examining a variety of ever-changing practices, involving several entities. Unlike the SSM, it will be impossible to create a one stop shop for AML supervision, as it will always involve home affairs and judicial authorities, and several already existing EU agencies. Hence there will, at least for the foreseeable future, be a complex structure at EU level, which will need to demonstrate its expected effectiveness, its coherency and fundamental rights impacts in line with EU Better Regulation guidelines.

At international level, while AMLA could be seen as a step forward to facilitate more effective interaction and coordination, this all will depend on how good the new structure will work at EU level. AMLA will need to demonstrate its added value to gather consistent and high-quality data from FIUs and national supervisors, and its capacity to interpret and act upon these data. And it will need to apply the AML regulation across borders in an extraterritorial way. It is clear within the SSM from, for example, the status of third country banks, how difficult this is, as different practices are in place in different countries as regards the tolerance for money laundering, data protection and secrecy. As Table 1 below highlights, a complex international structure for cooperation amongst supervisors already exists. AMLA will not replace the role of the NCAs in these entities, creating further overlaps that may generate inefficiencies, incoherence and fundamental rights' protection concerns. These are issues the European Parliament and the Council of the EU will need to assess in their own reading and interpretation of the proposals put in front of them.

Table 1. AML: The supervisory structure today

	Global	EU – Europe	Member states
Regulatory policy	FATF	EU institutions Moneyval	National institutions
Supervision	Basel Committee/FSB	ECB/EBA/ESAs/EDPS (AMLA)	Central bank, FSA, specialised supervisor
Investigation	Egmont Group	Europol/FIU.net	FIU
Enforcement	UN/International Courts	CJEU/EPPO/Eurojust	Public prosecutors, Courts
Private sector/ NGO	Wolfsberg Group International NGOs Transparency International		TMNL National NGOs
PPPs		EFIPPP	JMLIT, SAMLIT, AMLC, etc.

Source: CEPS AML task force report 2021.