

JOINT POSITION PAPER BY THE MINISTERS OF FINANCE OF FRANCE, GERMANY, ITALY, LATVIA, THE NETHERLANDS AND SPAIN

TOWARDS A EUROPEAN SUPERVISORY MECHANISM FOR ML/FT

1. Introduction

It should be ensured at a European level that supervision aimed at preventing the use of financial institutions for money laundering and terrorist financing (ML/FT supervision) is of a high quality throughout the European Union. Money laundering scandals in various EU Member States have affected the integrity and reputation of the European financial sector. Differences in ML/FT regulation and supervision between Member States are undesirable. This calls for a harmonized European regulatory framework and supervisory mechanism for ML/FT.

2. The need for a European ML/FT supervisor

2.1 The issue at hand

Money laundering and terrorist financing are often cross-border issues. At the same time, European passporting allows financial institutions to serve the entire internal market from a single Member State¹. As a result, shortcomings in ML/FT supervision in one Member State can affect other Member States.

ML/FT supervision of financial institutions is organized at a national level. Accordingly, international cooperation and exchange of information between supervisors is often complex, undermining the effectiveness of supervision over cross-border institutions and activities. In addition, information exchange between ML/FT supervisors and prudential supervisors (which is partially organized at a European level) is unnecessarily complicated, while such exchange is vital to identifying and addressing ML/FT risks. Although the recent amendments to AML and CRD legislative frameworks aim at clarifying the architecture of this information sharing and are likely to produce improvements in this field, such efforts seem not be decisive.

Also, in its present form, supervision is affected by other issues. Resources and attention for ML/FT supervision are sometimes limited, while ML/FT enforcement decisions may conflict with prudential and other interests. Where large financial interests are at stake, there is a risk of national ML/FT supervisors being influenced directly or indirectly by supervised institutions or interest groups (i.e. capture). As ML/FT supervision is organized at a national level, without an affective coordination at EU level, it could offer arbitrage opportunities and create a un-level playing field. This brings about the risk that precisely those financial institutions and Member States that are uncovering money laundering and terrorist financing are also the ones suffering reputational damage. Lastly, European norms are implemented in different ways in the Member States because rules in ML/FT-field are not uniform (minimum harmonization).

2.2 European ML/FT supervision mechanism as the solution

¹ Notwithstanding the fact that the supervisor of the host Member State supervises branch offices

Organizing an ML/FT supervision function at a European level enables a consistent and effective approach to addressing the problems described above. Firstly, it enables a better exchange of information between supervisors, making it easier to exercise adequate supervision on cross-border institutions and activities. Secondly, investing in supervisory resources at the EU level will ML/FT help those member states to improve their knowledge and expertise, with resources being deployed where ML/FT risks are most significant. Thirdly, supervisory independence will be strengthened as a further layer of supervision will be placed at a greater distance from local institutions and interest groups. Lastly, a European ML/FT supervision layer with pooled human resources will help create a level playing field, as supervisory practices will be more uniform.

This new supervision function should operate based on a set of harmonized, directly applicable rules. A European supervisory function should only enter into force either simultaneously with an AML regulation or subsequent to such a regulation in order to ensure that any supervisory function of an EU body has a sound and enforceable legal basis. With regards to the financial sector, the core aspects of the provisions which are currently included in AML directives, should be converted to regulations in order to prevent any regulatory gap enabled by minimum harmonization directives. Thus, it should be guaranteed that national obligations with regards to, for instance, to customer due diligence and record keeping requirements are the same in every member state. Indeed, harmonization promotes uniformity in both the explanation of rules as in the execution of and supervision on those rules; harmonized rules and regulations reduce the risk of competence and interpretation disputes between (national) supervisors. By contrast, other subjects deeply embedded in the national frameworks should remain regulated by a directive.

3. Desired design of supervision

3.1 Scope

The European ML/FT supervision mechanism should cover the entire internal market and all financial sector operators². The European regulatory framework for these institutions has to a large extent already been harmonized. There is emerging consensus that further harmonization also in ML/FT requirements at least for this sector will be an important priority. Moreover, *financial sector operators* typically engage in many cross-border activities and fulfil an important gatekeeper role in terms of money laundering and terrorist financing. Entities outside this scope will remain solely subject to national ML/FT supervision, such as civil-law notaries and trust or company service providers (TCSPs). With a view to the gatekeeper role of the financial sector, the European ML/FT supervision mechanism may over the years develop into a knowledge hub that also can provide important input for ML/FT mechanisms in other sectors.

3.2 A European ML/FT supervisory mechanism, featuring a European central supervisor cooperating with national supervisory authorities

The European ML/FT supervisory mechanism should be arranged on the basis of a system with national ML/FT supervisors complemented with a European supervisor. However, the European supervisor would be *primus inter pares* with its own instruments for intervention and the authority to act in cases where the deficiencies of the national supervisors became apparent.

² Financial sector operators are all financial institutions under the scope of the regulations governing the formation of the European supervisory authorities (ESAs) and the anti-money laundering directive, and which were recently brought under the EBA's ML/FT mandate. The ESAs are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

Establishing a central supervisor that can supersede national supervisors and can independently conduct supervision is necessary to ensure consistent and effective European ML/FT supervision. In order to conduct effective supervision and monitor the supervision by participating national ML/FT supervisors, the central European supervisor must have accurate and up to date information on the ML/FT risks in the common market, each member states and the f financial institution active in these markets. It should also have a good knowledge of the activity led by the national ML/FT supervisor (such as inspections programs, risk mapping of obliged entities, list of imposed sanctions). It must furthermore have sufficient inspectors fully available with expertise in their field. With such provisions, this European supervisor should be able to conduct its supervisory tasks in an independent and autonomous manner, coordinating with the national supervisors. In accordance with a risk-based approach, the European supervisor, having performed a thorough risk assessment in cooperation with the national supervisors, would concentrate its direct supervision, resources and efforts on the riskiest institutions as well as on the member states and areas where national supervision is apparently insufficient or inappropriate. The central European supervisor should be financed inside the MFF ceilings.

National ML/FT supervisors would also remain an essential relay with other national authorities. Combating money laundering and terrorist financing requires close cooperation with authorities that are organized at the national level, such as law enforcement authorities, financial intelligence units (FIUs) and supervisors for non-financial institutions. The European ML/FT supervisor must be able to share relevant information with national law enforcement authorities if there are indications of criminal offences.

3.3 Division of tasks between the European central supervisor and national ML/FT supervisors

The EU central supervisor should be mainly focused on high risk financial institutions or where the national supervision has been apparently insufficient or inappropriate. The EU central supervisor should be informed on the national authorities' inspection program and could decide, where appropriate, to participate in these inspections along with national supervisors. The European central supervisor should be able, where high risks are apparent and national supervision is otherwise apparently insufficient or inappropriate to directly supervise financial institutions. The European supervisor should monitor the quality of supervision by national ML/FT supervisors in order to timely identify high risks or insufficient or inappropriate supervision. The central European supervisor should work on a risk-based approach, taking into account cross-border aspects among other things. Where the EU central supervisor identifies high risks and material supervisory deficiencies, supervision of institutions will be performed by Joint supervisory teams (JSTs) comprising both staff from the central supervisor as well as staff from national ML/FT supervisors. Where necessary (because national supervisory action proves to be insufficient or inappropriate to properly address risks and deficiencies) and after informing the national supervisor, the central European supervisor should have the power to direct specific instructions to national authorities in respect of individual institutions, and ultimately, to bring such individual institutions under its direct supervision. National competent authorities should be able in any case to request the intervention of the EU supervisor.

Inspection programs should be designed with regard to the ML/FT risk profile of each financial sector operator on the basis of objective criteria. Relevant criteria, as a starting point, for establishing the risk profile could emanate from two sources of information. Firstly, the European supervisor would rely both on the inspection programs and risk mappings of national supervisors which would be communicated to the central European supervisor as well as on a the qualitative opinion on the reliability of national supervision taken from results of peer reviews (currently released by the EBA). Secondly, further possible objective criteria for the design of inspection programs should be explored

with the aim for higher convergence in adequacy and intensity of risk-based approach in ML/FT supervision within the EU and at the level of EU central supervisor.

When deemed insufficient to conclude on which operators to inspect, the European level of supervision could supplement this analysis with information which include type of product, service, transaction or delivery channel, the type (including origin) of customers and geographical risk factors.

3.4 Establishing a new European ML/FT supervisory function

All options for a functional and sustainable institution architecture of ML/FT have to be considered.

The EBA option would be coherent with the recent amendments to the ESFS regulations. Further legislative changes would be needed to give a clear and strong mandate to the EBA to exercise direct supervision, and to amend its governance in order to guarantee the required level of independence – for instance through a specific supra-national executive AML/TF committee exempted from the one-country one-vote rationale and distinct from the current EBA governance for prudential supervision.³

The option of a new and dedicated ML/FT supervisory body should also be further explored. It could be endowed from the outset with the task to exercise direct supervision as well as with a corresponding, ML/FT specific governance, in accordance with primary EU law. Such an institution could gradually evolve and take over also ML/FT support functions outside the supervision of financial sector operators.

When establishing this new layer of supervision, it is important to ensure that this European ML/FT supervisor:

- i. monitors compliance with a set of **harmonized rules**;
- ii. **fosters convergence of supervisory practices**, including by exercising risk assessments and peer reviews;
- iii. exercises its supervision **together with national ML/FT supervisors**;
- iv. receives a clear and strong mandate to direct specific instructions to national authorities in respect of any financial institution and to exercise **direct supervision** of the financial institutions where national supervision is apparently insufficient or inappropriate;
- v. **monitors** the direct supervision by the national ML/FT supervisors of the other financial institutions;
- vi. is empowered to take legally binding **decisions vis-à-vis individual financial institutions**, while the latter must have access to **legal remedies**;
- vii. is able to exercise its supervisory tasks **independently**;
- viii. is **autonomous** in terms of its governance and finances;
- ix. is **transparent** about its supervisory activities;
- x. is audited by the **European Court of Auditors**;
- xi. **cooperates**, among others, with national (prudential) supervisors, the ESAs and the ECB.

³ The recently adopted proposal (part of the EFSF review) insufficiently changes the EBA's governance to guarantee the required level of independence and the supervising tools build on application of the AML directive and the implementing national law are not sufficiently effective.