



EBA REPORT

ON COMPETENT AUTHORITIES' APPROACHES TO THE ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM SUPERVISION OF BANKS

EBA/Rep/2020/06

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Abbreviations

AML	Anti-money laundering
CFT	Countering the financing of terrorism
EBA	European Banking Authority
ESAs	European Supervisory Authorities
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
IMF	International Monetary Fund
ML/TF	Money laundering and terrorist financing
Moneyval	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
NRA	National Risk Assessment
SNRA	Supranational Risk Assessment

Executive Summary

This report summarises the findings from the first year of ongoing reviews, led by EBA staff with the support of a team of national anti-money laundering and countering the financing of terrorism (AML/CFT) experts, of all competent authorities that are responsible for the AML/CFT supervision of banks in the European Union (EU). Over the course of 2019, review teams reviewed seven competent authorities from five Member States and made recommendations tailored to each competent authority to support their AML/CFT efforts. Competent authorities that were not reviewed in 2019 will be assessed during the next evaluation rounds.

This report describes broadly how competent authorities in this year's sample apply the risk-based approach set out in international standards, Directive (EU) 2015/849 and the European Supervisory Authorities' joint AML/CFT guidelines. It focuses on these competent authorities' approaches to assessing the money laundering and terrorist financing (ML/TF) risks associated with banks under their supervision, and on how competent authorities are using these risk assessments to inform their supervisory practice. It also sets out how these AML/CFT competent authorities interact with their prudential counterparts to ensure a comprehensive approach to tackling ML/TF and safeguarding the integrity of the financial markets in their jurisdiction.

This report finds that all competent authorities in the EBA's sample had undertaken significant work to apply the risk-based approach to AML/CFT including in many cases a significant expansion of supervisory teams. AML/CFT supervisory staff in all competent authorities had a good, high-level understanding of international and EU AML/CFT standards and were committed to the fight against financial crime. Several competent authorities had made tackling ML/TF one of their key priorities and, in a number of cases, significant reforms were under way to strengthen their approach to the AML/CFT supervision of banks. Nevertheless, most competent authorities experienced challenges in operationalising the risk-based approach to AML/CFT.

Each competent authority experienced challenges that were unique to it. These challenges were related to the priority given to competent authorities' AML/CFT work, both inside the competent authority and at the level of government; the nature and size of their banking sectors; and the extent to which competent authorities had access to sufficient, and sufficiently skilled, AML/CFT staff.

There were, however, a number of challenges that were common to all competent authorities in this sample and that may be relevant to other competent authorities responsible for the AML/CFT supervision of financial institutions across the single market. These challenges included translating theoretical knowledge of ML/TF risks into supervisory practice and risk-based supervisory strategies; shifting from a focus on testing compliance with a prescriptive set of AML/CFT requirements to assessing whether banks' AML/CFT systems and controls are effective, and taking proportionate and sufficiently dissuasive corrective measures if they are not; and cooperating effectively with domestic and international stakeholders to draw on synergies and to position AML/CFT in the wider national and international supervisory frameworks.

As a result of these challenges, competent authorities' approaches to the AML/CFT supervision of banks were not always effective.

Based on these findings and as part of its new, broader mandate to lead, coordinate and monitor AML/CFT supervision efforts across the EU, the EBA will throughout 2020 continue its series of implementation reviews and provide support and training for all EU AML/CFT competent authorities to help them tackle key challenges identified in this report, in particular in relation to ML/TF risk assessments and effective AML/CFT supervisory practices. The EBA will review its AML/CFT guidelines with a view to providing further guidance in areas where weaknesses persist. EBA staff will also continue to follow up and work bilaterally with competent authorities to strengthen AML/CFT supervision in Europe and make sure that the EU's banking market is a hostile place for financial criminals.

1. Background and legal basis

1.1 Background

1. The EU has a comprehensive legal framework to tackle ML/TF. This framework is evolving in line with international AML/CFT standards.
2. There has, nevertheless, been a constant stream of high-profile ML/TF cases involving European banks. These scandals, together with findings by international AML/CFT assessment bodies that point to deficiencies in some competent authorities' approaches to the AML/CFT supervision of banks, have led to suggestions that competent authorities should do more to ensure that the EU's AML/CFT framework is implemented consistently and effectively.
3. In April 2018, the EBA therefore decided to review the effectiveness of national competent authorities' approaches to the AML/CFT supervision of banks, and to support individual competent authorities' AML/CFT efforts.
4. The legal basis for the EBA's implementation reviews is set out in Article 1, Article 8(1) and Article 29(1) and (2) of the EBA Regulation, which confers on the EBA a duty to ensure effective and consistent supervisory practices and contributes to the consistent and effective application of Union law, including in relation to AML/CFT. To this effect, the EBA can carry out peer reviews and investigate potential breaches of Union law, and it can take other measures such as staff-led implementation reviews to assess competent authorities' responses to particular compliance challenges.

1.2 Obligations of competent authorities

5. Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing aims, inter alia, to bring EU legislation in line with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation that the Financial Action Task Force (FATF), an international AML/CFT standard setter, adopted in 2012.
6. In line with the FATF's standards, Directive (EU) 2015/849 puts the risk-based approach at the centre of the EU's AML/CFT regime. It recognises that ML/TF risks can vary and that Member States, competent authorities, and credit and financial institutions within its scope have to take steps to identify and assess those risks with a view to deciding how best to manage them.
7. Article 48(10) of Directive (EU) 2015/849 requires the European Supervisory Authorities (ESAs) to issue guidelines to competent authorities on the characteristics of a risk-based

approach to AML/CFT supervision and the steps that competent authorities should take when conducting AML/CFT supervision on a risk-sensitive basis.¹ The aim is to create a common understanding of the risk-based approach to AML/CFT supervision and to establish consistent and effective supervisory practices across the EU. In these guidelines, which were issued in 2016, the ESAs characterised the risk-based approach to AML/CFT supervision as an ongoing and cyclical process that consists of four steps, namely the identification of ML/TF risk factors; the assessment of ML/TF risks; the allocation of AML/CFT supervisory resources based on the outcomes of this risk assessment, including decisions on the focus, depth, duration and frequency of onsite and offsite inspections, and on supervisory staffing needs; and the monitoring and review of both, the risk assessment and the underlying methodology. All competent authorities responsible for the AML/CFT supervision of banks indicated that they complied, or intended to comply, with these guidelines.

¹ Joint Guidelines on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis (The Risk-Based Supervision Guidelines)

2. Methodology

8. AML/CFT implementation reviews are staff-led, qualitative assessments of competent authorities' approaches to the AML/CFT supervision of banks. They are not a tick-box, compliance-based exercise and do not result in a score, a compliance rating, or a simple 'pass' or 'fail'. Instead, the purpose of these reviews is to identify areas for improvement and to support individual competent authorities' AML/CFT efforts.
9. Each implementation review is carried out in line with a written methodology and on the basis of a set of core questions that are sent to all competent authorities together with requests for documentary evidence. These are complemented with in-depth interviews during the onsite-visit part of the implementation review. The review takes into account the specific circumstances of each competent authority and Member State while focusing on:
 - a. competent authorities' approaches to assessing ML/TF risks;
 - b. competent authorities' approaches to supervising banks' risk-based approaches to AML/CFT, including supervisory follow-up and the imposition of dissuasive, effective and proportionate sanctions; and
 - c. domestic and international cooperation in relation to AML/CFT, including cooperation between AML/CFT and prudential competent authorities and the extent to which this cooperation supports competent authorities' work to ensure banks' safety and soundness and the integrity of the banking market.
10. Wherever possible, and to the extent that this is relevant, implementation review teams use information that competent authorities have prepared for international AML/CFT assessments, such as those led by the FATF, Moneyval or the International Monetary Fund (IMF) also for AML/CFT implementation review purposes; however, the conclusions of implementation reviews may differ from the conclusions of those assessment bodies. Each implementation review concludes with the review team, based on its findings, providing feedback and recommending specific actions to each competent authority.²
11. In 2019, members of EBA staff reviewed seven competent authorities from five Member States. They were supported by members of a network of AML/CFT experts from competent authorities, who were selected on the basis of their supervisory and policy skills and AML/CFT expertise at the start of this process.

² Given the ongoing nature of the reviews the report does not necessarily capture all feedback from all competent authorities on the review team's findings.

12. This report provides a summary of the main findings and recommendations, which will inform the next round of reviews in 2020.

3. Risk assessment

3.1 Findings

13. Directive (EU) 2015/849 requires competent authorities to have a clear understanding of the ML/TF risks that affect their sector. The ESAs' risk-based supervision guidelines specify that, to obtain a good understanding of ML/TF risks, competent authorities should consider ML/TF risks at the international, domestic, sectoral and institutional levels.

3.1.1 International and national risk assessments

14. All competent authorities in this year's sample were aware of the need to address international and national risks in their assessments, but many found incorporating these risks in their supervisory risk assessments difficult.
15. The implementation review team found that:
 - a. All competent authorities had given some thought to incorporating the findings of the European Commission's supranational risk assessment (SNRA)³ in their approach. In many cases, the SNRA had influenced the choice of risk factors that competent authorities considered and, in some cases, competent authorities had given greater weight to risk factors that the SNRA had identified as particularly concerning. However, some competent authorities had incorporated the SNRA's findings without considering the extent to which these findings applied to their sector. In those cases, the focus on complying with the SNRA meant that risks specific to that Member State were missed.

In one case, a competent authority had assessed the ML/TF risk associated with electronic money in line with the Recommendations set out in the SNRA, even though staff told the review team that electronic money was not available in their Member State. The competent authority had not assessed ML/TF risks that were more relevant to banks in that Member State.

- b. All competent authorities acknowledged the need to take into account national ML/TF risk assessments (NRAs) that Member States are required to carry out in line with Article 7 of Directive (EU) 2015/849 in their supervisory ML/TF risk assessments. Where NRAs existed, the review team found that these were reflected in supervisory ML/TF risk assessments in only some cases; and where an NRA had not been drafted, or did not focus on the banking sector, competent authorities had not taken steps to identify and assess relevant risks themselves. This affected their understanding of the ML/TF risks to which banks in their jurisdiction were exposed.

³ European Commission (2019): Supranational risk assessment of the money laundering and terrorist financing risks affecting the Union

3.1.2 Sectoral risk assessments

16. Most competent authorities in this year's sample had not assessed the ML/TF risks associated with their banking sector, or had not done so comprehensively. As a result, competent authorities' views of the ML/TF risks affecting this sector, and of the ML/TF risks specific to different types of banks or sub-sectors, were often different from those of representatives of the banking sector.

In some cases, competent authorities considered that a sectoral risk assessment amounted to an aggregate score from their risk assessments of individual banks. They did not distinguish between types of banks or particular business models, such as private banks with a predominantly high net worth customer base and small savings banks with a predominantly local customer base.

17. An insufficient understanding of sectoral or sub-sectoral risks can affect competent authorities' ability to draw up a supervisory strategy focused on the areas of greatest risk. It also means that it could be more difficult for those competent authorities to critically assess banks' own risk assessments, and there was evidence to suggest that many competent authorities that had not assessed sectoral risks did not challenge banks' own ML/TF risk assessments either.

3.1.3 Risk assessments of individual banks

18. All competent authorities in this year's sample had taken steps to assess the ML/TF risks associated with individual banks but many were in the very early stages of developing or implementing their risk assessment methodology for the first time. Irrespective of the relative maturity of competent authorities' approaches to assessing ML/TF risks, there were challenges relating to the number and type of risk factors used to determine a risk rating. This meant that the risk rating was not always appropriate.
19. The implementation review team found that:
 - a. Most competent authorities used questionnaires that they sent to banks at regular intervals to obtain data to inform their ML/TF risk assessment of each bank. The frequency with which these questionnaires were sent to banks varied, with most competent authorities asking for annual returns and some asking for more frequent returns in respect of at least some data points.

Most competent authorities had not considered whether information to support their risk assessment had already been obtained by other domestic authorities or different teams within the same competent authority, for example prudential supervisors or the Financial Intelligence Unit (FIU), and whether it could be shared to prevent a situation from arising in which multiple competent authorities, or different departments within the same competent authority, request the same information from the same bank at different times and in different formats.

In some Member States, responsibility for the AML/CFT supervision of banks was shared between two competent authorities. In those Member States, each competent authority had developed its own risk assessment methodology. There was insufficient cooperation or coordination in respect of risk assessments, and neither competent authority had seen, or asked to obtain, the other's methodology.

In one case, one competent authority had yet to assess ML/TF risk for the first time. In another case, competent authorities had come to different conclusions regarding the ML/TF risk associated with the same banks; and responding to two questionnaires using different formats and timelines put a considerable resource burden on banks.

- b. Risk assessment methodologies were often complex, with sophisticated underlying mathematical formulae, a large number of data points and multiple assessment layers. However, the review team found that some competent authorities were at times unable to explain how individual risk factors were meaningful. The resulting risk assessment did not always correspond to the competent authority's AML/CFT experts' view, and in some cases, competent authorities therefore habitually resorted to manually correcting risk assessments and associated risk ratings.

The review team found one case where a competent authority required banks to provide data and information on more than 400 risk factors each year. The competent authority used only a quarter of all factors in its risk assessments because it found that its risk factors cancelled each other out.

- c. Most competent authorities used the same set of risk factors for all banks and, in some cases, for all financial institutions. The review team found that competent authorities, when choosing risk factors, had not considered distinguishing between different types of banks or different types of financial institutions more generally. In many cases, this appeared to result in a situation where competent authorities assessed all banks as presenting the same level of ML/TF risk.
- d. Most competent authorities allocated different weights to individual risk factors, but the review team found that some competent authorities were unable to explain the rationale underlying these differences in weighting. In other cases, significant weight was given to prudential risk factors, which meant that smaller banks were unlikely to be classified as presenting a high ML/TF risk irrespective of their business model or customer base.
- e. Most competent authorities combined an assessment of inherent risks and the quality of banks' controls to obtain each bank's residual risk profile. The way that

competent authorities computed this risk profile meant that they were often unable to establish whether a bank's ML/TF risk rating resulted from, for example, a high level of inherent ML/TF risk and effective AML/CFT controls, or a moderate level of ML/TF risk and ineffective AML/CFT controls. This hampered their ability to target supervisory action effectively.

- f. Most competent authorities relied on banks' own assessments of the adequacy of their AML/CFT systems and controls. Less thought appeared to have been given to whether banks' self-assessment was reliable, and most competent authorities that used this approach had not put in place controls to systematically identify where the outcomes of banks' self-assessments were different from the competent authority's own view.

3.2 Recommendations

20. The ESAs' risk-based supervision guidelines require competent authorities to assess the ML/TF risks associated with individual institutions or 'clusters' of individual institutions that share the same characteristics. They also require competent authorities to have a good understanding of sectoral risks, and domestic and international risks to the extent that these are relevant to their sector. They do not prescribe in detail how competent authorities should obtain the information necessary to perform these assessments, or how competent authorities should assess the risks; but they are clear that a risk assessment is above all a tool to inform AML/CFT supervision, and it is important that competent authorities take steps to ensure that their risk assessment methodology delivers on this point.
21. The EBA considers that assessing ML/TF risks does not have to be complex to be meaningful and effective. Instead, a good risk assessment at each level can also be achieved through a considered combination of carefully chosen risk factors and information sources, and a methodology for assessing ML/TF risks that can be easily understood and applied by all concerned.
22. To address the points raised above and to the extent that this was relevant in each case, the implementation review team recommended that:
 - a. Competent authorities, as a matter of priority, carry out a sectoral ML/TF risk assessment and consider carrying out a sub-sectoral ML/TF risk assessment where the banking sector is large or diverse. As part of this, competent authorities should remain alert to domestic and foreign ML/TF risk factors that are particularly relevant for their sector and reflect these risk factors in the sectoral ML/TF risk assessment as appropriate. Where competent authorities could access the results of sectoral ML/TF risk assessments from other sources, for example the NRA, the review team recommended that they assess whether this is sufficient to meet their information needs and complement sectoral assessments as necessary.

- b. Competent authorities carefully review their approach to assessing the ML/TF risks associated with individual banks and their sector to ensure that the risk factors used to assess ML/TF risks are meaningful and relevant to a particular sector or sub-sector, and to individual banks. As part of this, where competent authorities decide to weigh risk factors differently, the review team recommended that they should ensure that weightings are well founded and understood, and consider whether to use weighting to reflect the impact of specific risk factors on particular types or categories of bank.
- c. Competent authorities consider the frequency of information requests and the number of indicators requested, to ensure efficiency for both competent authorities and banks. Some risk factors are unlikely to change considerably over a short period of time; and a careful selection of key risk indicators that are likely to remain stable over time may be preferable to frequent changes in the nature and type of data requested or gathering large amounts of less relevant data. As part of this, the review team recommended that competent authorities consider ensuring that any information requests to banks are proportionate and focused on what is necessary for informing the competent authority's risk assessment, and consider strategically whether reliable information could be obtained from other sources, for example prudential supervisors or the FIU.
- d. Competent authorities ensure the right balance between quantitative and qualitative data to carry out a meaningful risk assessment. Quantitative data can be an important starting point but should be combined with information on the quality of AML/CFT controls from supervisory findings, including from prudential inspections where available. It can also be combined with information that banks themselves provided, as long as this is accompanied by consistency and veracity checks.

In one case, a competent authority had recently developed a risk assessment methodology that relied on a small number of quantitative risk indicators to assess the inherent risk associated with each bank. To compute an overall risk profile, the competent authority intended to supplement this quantitative assessment with qualitative information it held on the adequacy of the bank's AML/CFT systems and controls.

The advantage of this approach was that the risk assessment was not dependent on banks' own assessments of the extent to which their AML/CFT systems and controls were adequate and sufficiently effective to manage ML/TF risks; however, the competent authority had yet to fully implement this risk assessment.

In another case, a competent authority systematically reviewed whether information supplied by banks was consistent with the competent authority's AML/CFT and prudential knowledge of the bank, and challenged banks as necessary.

- e. In line with the risk-based supervision guidelines, competent authorities review whether ML/TF risk assessments adequately inform competent authorities' understanding of ML/TF risks and support the effective targeting of supervisory resources to those areas where the risk of ML/TF is greatest. Manually adjusting

automated risk scores is important to ensure that relevant information, such as negative inspection findings or adverse media reports, can be incorporated into risk assessments in a timely manner; however, routine adjustments of automated risk scores that are not foreseen could suggest a problem with the methodology underpinning the calculation of the risk score.

4. AML/CFT supervision

23. Directive (EU) 2015/849 requires competent authorities to monitor effectively, and to take the measures necessary to ensure, compliance with this directive. As part of this, it requires competent authorities to adjust the frequency and intensity of onsite and offsite supervision to reflect the outcomes of their ML/TF risks assessments. Step 3 of the ESAs' risk-based supervision guidelines further clarifies that competent authorities should ensure that staff with direct or indirect AML/CFT responsibilities are suitably qualified and trained to exercise sound judgement, with a view to challenging effectively banks' AML/CFT policies and procedures should they give rise to concern.
24. Furthermore, Directive (EU) 2015/849 requires sanctions and other supervisory measures to be effective, proportionate and dissuasive. The FATF's guidance on effective supervision and enforcement confirms that, to be effective, corrective measures and sanctions should be proportionate to the breach; change the behaviour of the offending bank and its peers; deter non-compliance; and eliminate financial gain.

4.1 Findings

25. Most competent authorities in this year's sample were engaging in comprehensive reforms of their approach to the AML/CFT supervision of banks. In most cases, this involved a significant increase in AML/CFT supervisory resources, a restructuring of internal processes to allow a greater focus on AML/CFT supervision and fundamental changes to competent authorities' onsite and offsite supervision methodologies to accommodate the risk-based approach.
26. Challenges persisted in translating competent authorities' ML/TF risk assessments into supervisory strategies and inspection plans, and many competent authorities found the move from testing compliance with a prescribed set of AML/CFT requirements to also assessing the effectiveness of a bank's AML/CFT policies and procedures very difficult.
27. The implementation review team found that:
 - a. In respect of their approach to the AML/CFT supervision of banks,
 - i. Some competent authorities had put in place an AML/CFT supervision strategy for the banking sector, but this strategy did not always reflect the outcomes of the competent authority's ML/TF risk assessments, set out how the competent authority intended to tackle the ML/TF risks it had identified or explain how the competent authority intended to ensure adequate, risk-based AML/CFT supervision of all banks in its sector. In other cases, competent authorities had no strategy in place. As a result, in

some Member States, some banks had never been supervised for AML/CFT purposes in line with their ML/TF risk profile, or at all.

In a number of cases, the review team found that competent authorities had never carried out an AML/CFT inspection of a considerable section of their banking sector on the basis that this section was made up of small cooperative banks with a predominantly local customer base. They had not considered that many of these banks were exposed to increased terrorist financing risk as a result of servicing customers who are asylum seekers from high-risk jurisdictions and territories. Some banks told the review team that they felt ill-equipped to tackle this challenge alone.

- ii. Most competent authorities had attempted to adjust their approach to AML/CFT supervision in line with the requirements of Directive (EU) 2015/849 and the ESAs' risk-based supervision guidelines, and some competent authorities had given at least some thought to adjusting the frequency, intensity and intrusiveness of AML/CFT supervision on a risk-sensitive basis. Where different types of inspection existed, only a minority of competent authorities used these effectively or strategically and most competent authorities carried out full-scope onsite inspections instead, irrespective of different levels of ML/TF risk. This meant that most competent authorities were unable to make the best use of often limited supervisory resources and that, in many cases, the population of actively supervised banks was very small.
- iii. Most competent authorities had put in place a supervisory manual to guide their inspection process and to ensure a consistent approach. In some cases, the level of detail contained in these manuals made it difficult for supervisors to adjust their approach in line with the ML/TF risks they had identified during inspections, and inspection reports suggested that there was a risk that systemic AML/CFT compliance failures were being missed or not being recorded.

In a number of cases, the review team found that, to assess whether banks had assessed ML/TF risk in line with the requirements set out in Directive (EU) 2015/849, competent authorities merely checked that banks had carried out a risk assessment. They did not consider themselves competent to assess whether that risk assessment was sufficiently comprehensive or made sense.

In practice, most competent authorities carried out narrow compliance checks, such as checking whether the bank had obtained an up-to-date copy of a beneficial owner's passport or whether a risk assessment existed. They did not assess the quality of banks' AML/CFT policies and procedures, or consider whether repeated AML/CFT breaches could be symptoms of underlying deep-seated AML/CFT compliance failures or systemic issues such as internal control weaknesses or governance failures.

- iv. Most competent authorities had recently hired, or were in the process of hiring, additional AML/CFT staff. In many cases, a skills shortage meant that AML/CFT supervision staff were either new to supervision or new to AML/CFT. This, combined with a lack of strategic AML/CFT and supervision training plans in many competent authorities and in some cases an apparent lack of support from senior management for strengthening the competent authority's AML/CFT work, affected these authorities' ability to effectively supervise banks' risk-based approaches.
 - v. In many competent authorities, staff from prudential supervision teams that were not members of the AML/CFT team were relied upon to alert AML/CFT experts to areas with a higher level of ML/TF risk but had not been trained to spot those risks. In some cases, this had contributed to the competent authority failing to intervene in good time before ML/TF risks had crystallised or granting authorisation despite proposed AML/CFT systems being inadequate or despite serious questions remaining over a proposed qualifying shareholder's fitness and propriety.
 - vi. In a number of cases, the review team observed that information flows between AML/CFT supervisors and prudential supervisors were based on close personal relationships between staff. No formal structure had been put in place, which the review team pointed out had the potential to create issues in the future as staff turn over or the organisation grows.
- b. In respect of their engagement with banks,
- i. A number of competent authorities had considered strategically how to reach out to the banking sector. They had developed comprehensive suites of communication tools, including guidance, circular letters, frequently asked questions and podcasts, that they used to disseminate information to specific target groups.

In one case, the competent authority was of the view that the sector was not currently in a position to effectively identify and manage ML/TF risks. It had therefore decided to opt for a more prescriptive approach to the risk-based approach until it was satisfied that the sector's understanding and experience of the new approach had matured. The review team agreed with this approach in principle, but noted that the competent authority did not have in place a strategy to gradually reduce the level of prescription. There was little room for the banking sector to develop a mature understanding of ML/TF risks and, consequently, for banks to develop the ability to identify, assess and mitigate ML/TF risks.

Notwithstanding this, many competent authorities had yet to set clear, regulatory expectations of banks' management of ML/TF risks. Banks in those Member States told the review team that they were not always clear about what was expected of them. In other cases, where regulatory guidance had been issued, the review team noted that this was overly

prescriptive and not conducive to supporting effective ML/TF risk management by banks.

- c. In respect of their approaches to sanctions,
 - i. Some competent authorities had thought strategically about the best use of different supervisory tools to achieve consistent and effective outcomes. However, in most cases, and taking into account that most sanctions were imposed under the old regime based on Directive 2005/60/EC, sanctions were not proportionate, effective or dissuasive. For example, many competent authorities had developed a sanctions tool that determined fixed fines for specific breaches of AML/CFT obligations by a bank. These fines were usually very low, and several minor breaches therefore triggered multiple fines of the same low level. Banks in these Member States told the review team that they factored these fines in as a cost of doing business, and there was an associated risk, which had crystallised in some cases, that sanctions for breaches that had not been listed in the sanctions tool could not be imposed.

The review team found a number of cases where banks had failed to take remedial action following the imposition of significant fines for serious AML/CFT breaches. In several cases, banks continued to be in breach of the same legal provision many years after a fine had first been imposed but were not challenged by the respective competent authority.

- ii. Most competent authorities had put in place different strategies for follow-up, to ensure that banks had addressed previously identified AML/CFT shortcomings, and some competent authorities had systems in place to ensure that follow-up was commensurate with the nature of the breach. However, many competent authorities afforded little priority to following up on banks' remedial actions and this undermined the effectiveness of competent authorities' remedial efforts.

4.2 Recommendations

- 28. To address the points raised above and to the extent that this was relevant in each case, the implementation review team recommended that:
 - a. In respect of their approach to the AML/CFT supervision of banks,
 - i. Competent authorities put in place an overall supervisory strategy that sets clear objectives and ensures that banks that have been assessed, by competent authorities, as medium-low or low risk from an AML/CFT perspective are included in their supervisory strategy and inspection plan.

- ii. Competent authorities put more emphasis on assessing the adequacy and effectiveness of banks' wider AML/CFT systems and controls, and on identifying the root causes of repeated or systemic AML/CFT breaches, rather than focusing solely on banks' compliance with a prescribed set of processes and procedures.
- iii. Competent authorities consider alternating comprehensive, full-scope AML/CFT reviews with shorter, more targeted reviews to test the effectiveness of specific aspects of a bank's AML/CFT policies and procedures. Examples of more targeted, smaller-scale reviews include thematic reviews, i.e. onsite or offsite reviews of a cross-section of banks that focus on one specific aspect of these banks' AML/CFT systems and controls, and that can help competent authorities gain a better understanding of the way specific ML/TF risks are managed by a particular sector or sub-sector.
- iv. Competent authorities ensure that AML/CFT supervisors have appropriate knowledge and understanding of the risk-based approach to AML/CFT and are trained to exercise sound judgement in line with the principles set out in the ESAs' risk-based supervision guidelines. As part of this, and to support the assessment of the extent to which a bank's systems and controls are effective, the review team recommended that AML/CFT supervisors be equipped and able to assess why a particular breach, or series of breaches, occurred and whether this was a deliberate act, accidental oversight or indicative of wider internal system and control shortcomings.
- v. Competent authorities put in place measures to ensure that AML/CFT and prudential supervisors exchange relevant information systematically, proactively and in a timely fashion, including, where necessary, while an inspection is still under way.

One competent authority had developed an AML/CFT 'ID sheet' for each bank that prudential supervisors could use to obtain a good overview of the ML/TF risks that were relevant to their areas of interest.

- vi. Competent authorities ensure that staff who are relied upon to identify ML/TF risks for escalation to AML/CFT experts during authorisations, qualifying holdings, and fitness and propriety processes, as well as ongoing prudential supervision, receive specific training in identifying those risks.
- b. In respect of their engagement with banks,

- i. Competent authorities think strategically about the use of different communication and guidance tools, for example by putting in place a communications strategy that sets out how competent authorities will communicate with banks and the sector, and which tools they will use to achieve different outcomes.

In one case, a competent authority had given line supervisors ultimate responsibility for overseeing all aspects of a bank's compliance. This meant that they were able to consider prudential and AML/CFT issues in the context of the bank's overall compliance framework.

- ii. Competent authorities make use of the full range of supervisory tools, including guidance to set regulatory expectations, to provide explanatory detail of the types of systems and controls competent authorities expect to see, and on the steps banks can take to reduce their ML/TF risks. Such guidance could include examples of good and poor practices that competent authorities might have observed during onsite inspections that could help banks assess the adequacy of their own AML/CFT systems and controls, and identify remedial actions where necessary.
- c. In respect of their approach to sanctions,
 - a. Competent authorities ensure that corrective measures and sanctions are proportionate to the breach, change the behaviour of the offending bank and its peers, and deter non-compliance. This means applying a wider range of supervisory measures to rectify AML/CFT controls deficiencies than is currently being applied by most competent authorities.

One competent authority used its sanctions tools innovatively by imposing significant fines under the Capital Requirements Directive for AML/CFT system and control shortcomings in cases in which AML/CFT sanction possibilities were not commensurate with the nature or scale of the breach.

- b. Where a breach is particularly serious, competent authorities consider providing meaningful information to the sector about the breach, for example by publishing a detailed analysis of the breach, the system and control shortcomings that allowed the breach to occur and the measures that the bank had to apply, or is expected to apply, to remedy those shortcomings. This is so that banks can understand what went wrong and why it went wrong, and what action they need to take to prevent similar shortcomings from arising again.
- c. Competent authorities ensure appropriate follow-up in a way that is commensurate with the nature and type of the breach to satisfy themselves that banks have corrected any shortcomings identified and improved the effectiveness of their AML/CFT policies and procedures.

5. Cooperation

29. Directive (EU) 2015/849 is clear that cooperation between competent authorities at home and across borders is an integral component of an effective approach to AML/CFT supervision.

5.1 Findings

30. Most competent authorities in this year's sample expressed a general willingness to cooperate and welcomed the ESAs' forthcoming AML/CFT colleges guidelines⁴, but not all had yet taken concrete steps to reach out to other competent authorities at home or abroad.

31. The implementation review team found that:

- a. All competent authorities confirmed to the review team that there were no legal obstacles preventing them from cooperating with other competent authorities or agencies in their Member State.
- b. Some competent authorities had established, or participated in, structures for cooperation between domestic AML/CFT authorities, including competent authorities, law enforcement agencies, FIUs and government agencies. Through these structures, competent authorities exchanged high-level views on risks and developed strategies at a national level, e.g. their national risk assessments. However, these structures were almost never used to discuss or address ML/TF risks or specific concerns that competent authorities, the FIU or law enforcement agencies had about a particular bank under their supervision.
- c. In most cases, irrespective of the existence of formal cooperation structures, cooperation was based in practice on informal personal exchanges between staff of competent authorities and other domestic agencies, including the FIU. The review team observed some instances where a breakdown in personal relationships negatively affected the extent to which cooperation was possible or effective.
- d. Some competent authorities had experience of international cooperation but most had not yet taken concrete steps to put in place an international cooperation strategy. Where international cooperation was observed by the review team, it was often limited to ad hoc exchanges of findings from inspections. In some cases, the review team found that information that would have been relevant to other

⁴ These guidelines were published in December 2019 as Joint guidelines (JC 2019 81) on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (the AML/CFT Colleges Guidelines)

competent authorities was not shared, and competent authorities failed to consider whether other competent authorities held information that could have supported their own ML/TF risk assessments and made their AML/CFT supervision more effective and targeted. In one case, a competent authority had begun to reach out to its regional counterparts to share information and good practices.

- e. Most competent authorities were aware of colleges of prudential supervisors and noted that AML/CFT concerns were sometimes discussed within these colleges, but most competent authorities had not been asked to contribute or participate.

5.2 Recommendations

32. To address the points raised above and to the extent that this was relevant in each case, the review team recommended that:

- a. Competent authorities put in place and implement a comprehensive international supervisory cooperation strategy to obtain as full a view as possible of the ML/TF risks to which banks that are established on their territory are exposed. As a starting point, competent authorities should look to the ESAs' joint guidelines on supervisory cooperation for inspiration on implementing an effective approach to supervisory cooperation.⁵
- b. Domestically,
 - i. Competent authorities work closely with other competent authorities as well as wider stakeholders within the Member State where necessary to ensure a consistent and effective approach to the AML/CFT supervision of banks on their territory, in particular if responsibility for the AML/CFT supervision of banks is shared between a number of different competent authorities.
 - ii. Competent authorities consider formalising some of these arrangements where necessary.

⁵ Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions — The AML/CFT Colleges Guidelines (<https://eba.europa.eu/esas-transform-way-competent-authorities-cooperate-each-other-amlcft-matters>).

6. Conclusions and next steps

33. This report finds that all competent authorities in this year's sample had worked hard to apply the risk-based approach to AML/CFT. In many cases, AML/CFT supervision teams were being expanded and expert AML/CFT supervisory staff in all competent authorities had a good, high-level understanding of international and European AML/CFT standards and were committed to the fight against financial crime. Several competent authorities had made tackling ML/TF one of their key priorities and, in a number of cases, significant reforms were under way to strengthen their approach to the AML/CFT supervision of banks. Nevertheless, most competent authorities found operationalising the risk-based approach to AML/CFT difficult.
34. Each competent authority experienced challenges that were unique to it. These challenges were related to the priority given to the competent authority's AML/CFT work, both inside the competent authority and at the level of government; the nature and size of their banking sector; and the extent to which the competent authority had access to sufficient, and sufficiently skilled, AML/CFT staff.
35. There were, however, a number of challenges that were common to all competent authorities in this sample and that may be relevant to other AML/CFT competent authorities across the single market. These challenges included translating theoretical knowledge of ML/TF risks into supervisory practice and risk-based supervisory strategies; shifting from a focus on testing compliance with a prescriptive set of AML/CFT requirements to a focus on assessing whether banks' AML/CFT systems and controls are effective, and taking proportionate and sufficiently dissuasive corrective measures if they are not; and cooperating effectively with domestic and international stakeholders to draw on synergies and to position AML/CFT in the wider national and international supervisory frameworks.
36. As a result of these challenges, competent authorities' approaches to the AML/CFT supervision of banks were not always effective or as effective as they could have been.
37. Based on these findings and as part of its new, broader mandate to lead, coordinate and monitor AML/CFT supervision efforts across the EU, the EBA will throughout 2020 continue its series of implementation reviews and provide training for EU AML/CFT competent authorities to help them tackle key challenges identified in this report, in particular in relation to ML/TF risk assessments and effective AML/CFT supervisory practices. The EBA will also review its risk-based supervision guidelines with a view to providing further guidance in areas where weaknesses persist. EBA staff will also continue to follow up and work bilaterally with competent authorities to strengthen AML/CFT supervision in Europe and make sure that the EU's banking market is a hostile place for financial criminals.



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