

Cooperation effectiveness between AML/CFT and prudential functions

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Financial Sector

1. AML cases emphasized a need for greater cooperation and convergence between AML and prudential functions

➤ **AML/CFT robust regulation is necessary but not sufficient to ensure an efficient AML/CFT framework**

- Some AML cases in Europe (where there is a common regulatory framework based on EU directives) showed nevertheless the **need to strengthen convergence and dialogue between supervisors** from different jurisdictions and different lines of supervision to improve financial system integrity ;
- Previous cases (eg “Panama Papers”) showed also the importance of group-wide international application of robust standards of supervision

➤ **Areas for enhancement of supervisory cooperation:**

- More fluent and organized exchange of information
- Implementation of a consistent approach to risk management for both prudential and ML/TF issues

2. Exchange of information between the AML and prudential functions (1/2)

- Within a banking group, the quality of the exchange of information for AML/CFT purposes is a way to improve the management of prudential risks: the same approach is valid at the level of supervisors.

- The legal backgrounds for cooperation and exchange of information between the AML and prudential functions:
 - **FATF Interpretative note of Reco 40 (§10 and §11)**
Extract from §10 : « Financial supervisors should cooperate with their foreign counterparts, regardless of their respective nature or status. Efficient cooperation between financial supervisors aims at facilitating effective AML/CFT supervision of financial institutions [...] »
 - **The FATF guidance “for a risk based-approach: effective supervision and enforcement by AML/CFT supervisors of the financial sector and law enforcement” (§14)**
« [...] prudential supervisors who are not the designated competent authority for AML/CFT supervision should be aware of the consequences and implications of their supervised institutions’ failures to adequately identify and manage ML/TF risks. Conversely, AML/CFT supervisors should understand how AML/CFT deficiencies may impact prudential supervision (e.g., impact on safety and soundness) [...] »

- The exchange of information between the AML and prudential functions, irrespective of organisational arrangements, is essential for an effective cooperation, at each stage of the authorization and supervisory processes:
 - Authorization/ Qualifying holding assessment/ Fit and proper test
 - Risk management/internal control assessment
 - Supervisory actions/ Enforcement / sanctions

2. Exchange of information between the AML and prudential functions (2/2)

➤ Examples of initiatives led to strengthen the cooperation and exchange of information between AML and prudential supervisors:

- **at the Basel Committee on Banking Supervision:**
 - Revision of Annex V of **BCBS Guidelines on Sound management of risks related to ML/FT** in order to **establish an effective cooperation and coordination mechanism** between the prudential and AML/CFT functions, regardless of the institutional setting
- **at the European level:**
 - **Revision of the Directive « CRD5 » :**
 - ML/TF risks shall be factored in relevant supervisory activities, including the supervisory evaluation and review process ;
 - Where a review gives the prudential supervisor reasonable grounds to suspect that ML/TF risk or if ML/TF is being/ has been committed or attempted ; or there is increased risk thereof, it should notify the EBA
 - **ESAs' draft supervisory guidelines** (being finalised) which set up AML/CFT colleges for firms operating on a cross-boarder basis, to which prudential supervisors will participate as observers
 - **Multilateral agreement on the practical modalities for exchange of information between the ECB and AML supervisors** signed on 10 January 2019

3. Convergence between prudential and AML-CFT functions (1/2)

- **Converging practices facilitate the dialogue between AML and prudential functions**

3-1 Existing bases of convergence in a challenging context

- **The principles applicable for prudential issues are also applicable in AML-CFT area:**
 - Common requirements for both functions (risk culture, governance, compliance, procedures, internal control and audit)
 - Some Basel Committee on Banking Supervision papers providing guidance should be applicable to both functions (ie effective banking supervision, internal audit function, sound management of operational risk, corporate governance or compliance and compliance function)
- **Challenging context should be taken into consideration:**
 - A global strengthening of the AML-CFT requirements
 - Difference of maturity between countries, functions, or practices and regulation
 - Variety of organizations regarding supervisory functions and international context

3. Convergence between prudential and AML-FT functions (2/2)

3-2 Improvement of existing concepts to insure an effective convergence

➤ The management of the risk in the heart of both functions:

AML-CFT approach as a reflection of the prudential approach:

- Framework: Risk mapping, implementation of mechanism of limits and control, risk measuring system
- Is a part of an advanced risk based approach. Too simple management of the ML-FT risk could easily lead to counterproductive measures such as derisking strategy

➤ Next steps for supervisors:

- Improve the management of the ML-FT risk and find a better way to factor ML-FT risk in prudential analysis;
- Insertion of a new Annex V to the BCBS Guidelines on Sound management of risks related to ML/FT to provide general components to be assessed by supervisors (ie the risks present in the target supervised entity linked to the entity's customers base, products and services and the geographical location in which the bank and its customers do business; the adequacy and effectiveness in implementation of the AML-CFT controls). Nevertheless as an holistic approach, it will need to be tailored by each supervisor.