

18-25 A Better European Architecture to Fight Money Laundering

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Major banks or financial institutions in more than 15 countries in the European Union have been hit in recent years by revelations involving violations of anti-money laundering (AML) laws. Many cases have involved staggering sums, with billions of dollars laundered through accounts at one single bank.¹ The steady drumbeat of scandal reached a

1. See annex A for a list of recent AML violations and related developments at EU banks.

crescendo in 2018 with the liquidation of ABLV Bank in Latvia, the reopening of criminal investigations into Danske Bank in Denmark and Estonia, and the imposition of the largest AML fine in European history against ING Bank in the Netherlands. Added together, these cases—large and small—have underlined the serious shortcomings of the European Union's AML regime.² Reports have pointed to a variety of bad actors as participants in these schemes, with linkages to organized crime, corruption, and North Korea among others. The common thread, though, seems to be the predominance of money originating in the former Soviet Union.

A major problem lies in the fact that AML supervision of banks and other firms rests largely with the national authorities of individual EU member states, in increasing tension with the legal framework for centralized prudential supervision³ within the euro area and the European single market. This division of responsibilities is susceptible to political influence and regulatory capture. The system depends heavily on small, lower-capacity jurisdictions to provide the first line of defense against illicit financial practices, encouraging illicit actors to seek out weak links. The result is an erosion of supervisory effectiveness in those member states where money launderers concentrate their activity, undermining the integrity of the entire European system.

Senior European financial policymakers have acknowledged this unsatisfactory reality. Andrea Enria, chairman of the European Banking Authority (EBA), has observed that “if you are in the [EU] single market, the strength of anti-money laundering controls can only be as high as the

2. Money laundering is the execution of a financial transaction involving the proceeds of a criminal act with the intent to conceal the origin of the funds. An AML regime is a set of rules requiring financial institutions or other entities to maintain controls and processes (an AML program) to detect and report such activity, to enable the government to discover, track, prevent, or punish it. See Reuter and Truman (2004) for a comprehensive and critical review of the US and global AML frameworks as they existed at that date.

3. Prudential supervision refers to oversight of the banking system to ensure its safety and soundness, including monitoring of capital ratios, lending practices, and governance.

weakest link.”⁴ Danièle Nouy, the top official for prudential supervision at the European Central Bank (ECB), has declared that it is “very embarrassing to depend on the United States to do the [AML] job. This has to change.... We need a European institution that is implementing in a thorough, deep, consistent fashion this [AML] legislation in the euro area.”⁵

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Compounding these weaknesses is an increasingly menacing linkage between illicit finance and security threats, not least the risk of interference by Russia and other non-EU countries in EU domestic matters. European policymakers have accordingly stepped up their calls for greater capacity to address such threats credibly and autonomously if need be, without depending on the United States.

This Policy Brief outlines a path forward for the fight against illicit finance with a stronger EU-level role in AML supervision. Among the possible options, this study recommends the creation of a European AML Authority that would supervise banks, other financial institutions, and nonfinancial firms for AML purposes. The new agency should have high standards of governance and independence, publish all of its decisions, and be empowered to impose sufficiently large fines to deter malpractice. It would also act as a catalyst for further harmonization of the AML legal regime across EU member states.

Even radical reform of the European Union’s AML supervisory architecture would not address all the illicit finance challenges facing Europe. AML policy is difficult and will remain so. Even so, a better supervisory architecture could make a material difference and significantly enhance the effectiveness of the European Union’s AML efforts.

4. Jim Brunsten, Caroline Binham, and Claire Jones, “Scandals expose weakness of EU’s dirty money fight, say watchdogs,” *Financial Times*, September 5, 2018.

5. Quoted from Ivan Camilleri, “Pilatus Bank incident ‘embarrassing,’ says European Central Bank supervisor,” *Times of Malta*, March 28, 2018, and from Deslandes and Magnus (2018).

EXISTING AML SUPERVISORY FRAMEWORK IN THE EUROPEAN UNION

The efforts of individual jurisdictions to combat money laundering rest on three pillars. The first pillar consists of administrative authorities, or AML supervisors, that examine supervised (“obliged”) entities for adherence to the jurisdiction’s AML regime and typically have the power to impose fines for noncompliance. The second pillar consists of financial intelligence units (FIUs), which collect, analyze, and disseminate the reporting that obliged entities submit under applicable AML program requirements.⁶ The third pillar consists of law enforcement agencies and the justice system, which investigate and prosecute individuals and entities that commit criminal violations related to money laundering.

The European Union first initiated AML legislation in the early 1990s, following AML developments in individual member states. To date, there have been five successive AML directives (AMLDs).⁷ AMLD4 has been in force since June 2015, with a deadline of June 26, 2017, for transposition by member states. The transposition deadline for most of AMLD5 is January 10, 2020. The successive AMLDs have generally followed, or even exceeded, recommendations set by the Financial Action Task Force (FATF), which sets AML standards at the global level.⁸ AMLDs have expanded the scope of obliged entities subject to AML supervision, tightened the definitions of suspicious activities and the processes to identify and report them, emphasized collecting ultimate beneficial ownership information and adopting risk-based approaches to compliance, and improved communication between relevant authorities.⁹

AML supervision in EU member states is conducted by a wide range of national authorities. The AML supervisor of a bank is generally but not always the same as its prudential

6. There is one FIU for each jurisdiction. They participate in a dedicated global body, the Egmont Group, formed in 1995 at a meeting in the eponymous building in Brussels. Egmont has 156 members and established a permanent secretariat in Toronto in 2008.

7. EU laws can be “directives,” framework laws that demand additional legislation (“transposition”) in each member state, or “regulations”—laws that are directly applicable in all member states with no need for national transposition.

8. The FATF was created at the G-7 Summit in 1989. Its permanent secretariat is hosted in Paris at the Organization for Economic Cooperation and Development (OECD).

9. The European Commission (EC 2018) observed, however, that even if the changes associated with the future implementation of AMLD5 are factored in, “cooperation between prudential authorities and AML supervisors is also largely dependent on the good faith and willingness of the relevant authorities.”

supervisor. In the United Kingdom, the AML supervisor is the Financial Conduct Authority, and in Malta, Poland, and Spain, the AML supervisor is the FIU, even though it may delegate certain tasks to the prudential supervisor.

European Supervisory Authorities (ESAs)

Three European Supervisory Authorities (ESAs) were established in 2011 to help coordinate financial regulation and foster supervisory convergence at the EU level: the European Banking Authority (EBA) in London (which will soon move to Paris because of Brexit), the European Insurance and Occupational Pensions Authority (EIOPA) in Frankfurt, and the European Securities and Markets Authority (ESMA) in Paris.¹⁰

The ESAs may investigate cases of “breaches of Union law” in their respective sectors and even override the decisions of national authorities in some circumstances. However, such investigations typically only happen after a large-scale prudential or AML supervisory failure and not more proactively, which is why the EBA has described its breach-of-Union-law powers as “a rather blunt tool” (European Parliament 2018a).¹¹ The EBA’s first-ever finding of breach of Union law for AML matters was reported in its July 2018 recommendation to the Maltese FIU following the case of Pilatus Bank (EBA 2018). Ongoing investigations are underway at the time of writing in Denmark, Estonia, and Latvia. The EIOPA and ESMA have similar mandates to foster supervisory convergence in their respective nonbank sectors.

The Joint Committee that facilitates coordination among the three ESAs has an AML subcommittee, known as AMLC. The geographic scope of the ESAs’ authority is the entire European single market, including the 28 EU member states¹² and other members of the European Economic Area (EEA).

10. Contrary to what their name suggests, the ESAs currently do not have direct supervisory authority over financial firms for either prudential or AML purposes. The ESMA alone has direct conduct-of-business supervisory authority over some limited categories of financial firms, such as credit rating agencies or trade repositories.

11. European Parliament, “Public Hearing: Combat of Money Laundering in the EU Banking System,” Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3), [verbatim report](#), April 28, 2018.

12. Whether the United Kingdom will remain in the single market after its planned exit from the European Union in March 2019, and if so, for how long, is not known at the time of writing.

Banking Union

In the euro area, the prudential supervision of banks has been pooled at the supranational level within the ECB since November 2014, as part of a broader policy integration project known as banking union.¹³ In this new framework, known as the Single Supervisory Mechanism (SSM), the ECB works with all participating countries’ prudential supervisory authorities (National Competent Authorities, or NCAs). The ECB makes all supervisory decisions directly for the most systemically significant banks, including all those with more than €30 billion in total assets. For the smaller ones, the NCAs are in charge of many supervisory tasks, but the most important authorizations, such as those on banking licenses and significant changes of ownership, are made centrally by the ECB. The banking union is currently limited to the 19 euro area countries, but it might expand in the future through the process of “close cooperation” that allows non-euro area member states to join the banking union voluntarily.¹⁴

Recent Policy Developments

In May 2018, the European Commission initiated joint work on AML reform with the ECB and the three ESAs.¹⁵ The first outcome of this work was a reflection paper sent to member states in late August 2018. This paper has not been made public by the EU institutions, but its text was posted online by a member of the European Parliament.¹⁶

On September 12, 2018, in his yearly State of the European Union address, European Commission President Jean-Claude Juncker announced new measures to reinforce the effectiveness of AML enforcement, and on the same day the European Commission published proposals for corresponding legislative amendments (EC 2018). If adopted, these amendments would, among other things, confer additional authority on the EBA to request that national

13. See Schoenmaker and Véron (2016) for a description and early assessment of the ECB-led prudential supervision.

14. At the time of writing, several non-euro countries including Bulgaria, Denmark, and Sweden were at various stages of considering close cooperation.

15. The European Commission’s letter of May 8, 2018 establishing this work process refers to “a number of high profile incidents in recent months” as motivation for the endeavor. It was published by *Politico* and is available at https://www.politico.eu/wp-content/uploads/2018/05/Letter-to-SSM-EBA-EIOPA-and-ESMA_signed.pdf.

16. “Reflection paper on possible elements of a Roadmap for seamless cooperation between Anti Money Laundering and Prudential Supervisors in the European Union,” August 31, 2018, available at https://sven-giegold.de/wp-content/uploads/2018/09/COM-Reflection-paper-on-elements-of-a-Roadmap-for-seamless-cooperation_Sept-2018.pdf.

AML supervisors investigate potential breaches and consider actions, and, in extreme cases of noncompliance by the national authority, impose some direct decisions (though not fines) on individual firms. The amendments would also empower the EBA to carry out periodic independent reviews of AML issues and risk assessment exercises and to collect data on AML supervision in the European Union. Unlike existing EBA competencies, this new authority would extend beyond the banking sector to other categories of supervised financial firms. This would effectively deprive EIOPA and ESMA of their existing AML roles, and as a consequence, the AMLC would be integrated into the EBA. At the time of writing, the likelihood that these amendments will be adopted before the end of the current EU parliamentary term in the spring of 2019 is hard to assess.

European AML Enforcement in Practice

AML enforcement in the European Union is extremely heterogeneous, and disclosure practices vary considerably from one national authority to another. For example, AML fines have so far either been entirely anonymized or not published at all in Denmark, Germany, and Spain. In France, Sweden, and the United Kingdom, by contrast, fines are published and their subjects identified in most or all cases. Even in the latter circumstance, the publication format has often made it difficult to understand the exact nature of the violations and the punitive or deterrent impact of a given fine. In principle, Article 60 of AMLD4 mandates that member states publish most decisions, including the identity of the affected person or entity and the nature of the breach, but it is not clear that all member states comply with this requirement, and the June 2017 deadline for transposition is too recent for a firm assessment. From discussions with practitioners conducted for this paper, the UK Financial Conduct Authority appears to have a reputation for imposing higher fines for AML violations than most other national authorities, even though fines are often much higher still in the United States.¹⁷ Italy and Germany impose lower fines for AML violations, whereas France is somewhere in between.

Recent AML cases for which some information is publicly available are summarized in annex A. Many of

these events occurred in smaller euro area countries, where resources for supervisory oversight are typically constrained. There are two important caveats, though, that suggest caution about causality in that observation. First, major money laundering incidents at EU banks have not been limited to smaller jurisdictions and have also occurred in major financial centers such as London. Second, it is intrinsically hard to ascertain whether more publicized cases of prominent money laundering reflect a greater frequency of money laundering in a given jurisdiction, or, conversely, a greater willingness on the part of the jurisdiction's authorities to root out problems and tackle illicit activity—or both.

OPTIONS TO IMPROVE THE EU FRAMEWORK

Given the difficulty of observing and quantifying money laundering, it is not self-evident that malpractice has actually become more widespread in Europe in recent years. It is also possible that tolerance of money laundering has decreased in the face of heightened awareness, possibly spurred by such factors as: an assertive US stance, as illustrated by the recent ABLV case; a perceived erosion of alignment between EU and US interests, paralleled by the rising perception that Europe needs to develop its own security further; a greater sensitivity of the European Union and many of its member states to risks emanating from Russia; improvements brought about by the implementation of AMLD4; and the emergence of dedicated European authorities with a mandate to oversee banking practices, first the EBA in 2011 and especially the SSM in 2014. The last of these might have reduced overall European tolerance of supervisory failures, in contrast to an earlier era in which all relevant authorities were national and many were inclined to defend national banking champions.

Irrespective of whether the problem is growing or not, however, it is evident that recent AML supervision in the European Union has been embarrassingly ineffective and that deep reform is needed. The core problem is one of supervisory incentives and architecture. The coexistence of an integrated, enforceable single financial market policy with the national structures of AML supervision means that AML supervisory weakness in any one EU/EEA member state leads to that country becoming attractive for money launderers who can then use it to access the entire single market. This, in turn, creates a constituency in the country against strong AML enforcement, bringing together the criminals and their representatives, an array of service providers, and potentially also government authorities that have failed in their past AML supervisory duties. If sufficiently large, this aggregate constituency might weigh on national political processes and outcomes, even in cases that stop short of

17. Very recently, the Dutch central bank has also moved to impose large fines as documented in annex A. Article 59 of AMLD4 raised and harmonized the maximum amount of AML fines to “at least €5 million or 10 percent of the total annual turnover” of the affected entity. As with the mandate to publish decisions, however, it is too soon to assess the extent to which this new legislation has fostered convergence of actual behavior of national AML supervisors.

outright government capture. The resulting pressures further weaken the AML supervisory framework. In sum, the combination of the EU/EEA single market and national AML supervision generates national vicious circles, which tend to be self-perpetuating rather than self-correcting.¹⁸

In this “AML vicious circle” analytical framework, money laundering and AML violations end up being asymmetrically distributed in the European Union. Some member states become weak links from which clients can be served throughout the entire single market, for those activities for which a passporting regime exists. Not all member states need be weak links for money launderers to achieve their objectives. As long as at least one weak link exists, the entire AML system is at risk of failure. A corollary

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is that even if some EU member states have highly effective AML frameworks, it does not disprove the assessment that the AML problem is systemic and a matter of EU supervisory architecture. Furthermore, it is not enough to eliminate a weak link—even if the vicious circle is broken in one member state, it is likely to reappear in another. Also, not all weak-link countries need be smaller member states. While insufficient administrative capacity may be a more acute problem in very small countries, undue influence from certain special interests or other forms of institutional failure can affect larger countries as well. The variety of patterns of deficiencies in AML regimes in the European Union are illustrated in annex A.

To be sure, in theory national AML authorities in the other member states can monitor transactions originating in the weak-link countries and should be able to spot suspicious activity. In practice, national authorities must prioritize undercapacity constraints and operate within a dense web of relationships and interdependencies. Furthermore,

within the banking union, any national authority’s AML supervisory failure potentially compromises the integrity of the entire prudential supervisory framework (and of the licensing, qualifying holdings, and fit-and-proper review processes) to the extent that the latter relies on AML assessments conducted by NCAs, as the case of ABLV and others have shown. Moreover, the likely future development of financial technology and new business models for financial intermediation and services that are inherently cross-border is likely to exacerbate the tension between the single market framework and national AML supervision.

Addressing the AML Vicious Circle: Two-Tier versus Unitary Architecture

To deal with the European Union’s core AML supervisory problem, the incentives of AML supervisors should be aligned with the objective of effectively enforcing the AML framework and fighting money laundering throughout the entire single market. Breaking the vicious circle thus requires increasing EU-level supervision significantly beyond the limited oversight that already exists.

To do so, the European Union faces a choice between two models. In an enhanced two-tier architecture that builds on the present situation, the ultimate responsibility for AML supervision of individual firms would remain at the national level, but an EU authority would be empowered to oversee national AML supervisors (“supervisor of supervisors”).¹⁹ In a unitary architecture, a European agency would have ultimate AML supervisory responsibility for firms, though this responsibility might be exercised through a network that involves national agencies and other European-level bodies.

The distinction between a two-tier and a unitary architecture has become a familiar one in matters of European financial supervision over the past decade. Until 2010, financial supervision was entirely national. In 2011, the creation of the three ESAs established a two-tier architecture, encompassing prudential, conduct-of-business, and AML supervision of financial firms. The SSM, implemented in 2014, is an almost pure unitary system.²⁰ In a different area, the European Commission’s Directorate-General for Competition embodies a unitary architecture

18. Panicos Demetriades, a former governor of the Central Bank of Cyprus, gave a vivid description of this vicious circle: “The ‘political pressure’ on supervisors in small EU states with large offshore sectors, such as Cyprus, Estonia, Latvia, and Malta ‘is so great that it’s very hard for them to do the right thing,’ Demetriades said.” Quoted in Andrew Rettman, “Cyprus: Russia’s EU weak link?” *EUobserver*, September 25, 2018.

19. A two-tier architecture might also entail technical assistance from the central hub to the member states that need help improving their national frameworks.

20. Even for the smaller euro area banks, the ECB, not NCAs, is the ultimate decision maker for bank licensing and other key authorization procedures, implying that it is much more than a mere “supervisor of supervisors.”

for the enforcement of competition policy in the European Union.²¹

Given the experience of the SSM, and taking into account the differences between prudential and AML supervision, a well-designed unitary architecture for AML supervision would be a practical proposition, as would a reinforced two-tier model such as the one that the European Commission proposed in mid-September 2018 (EC 2018). To be sure, current AML legislation in the European Union is less harmonized than many other areas of financial legislation, including the bank capital requirements that the SSM enforces. But a European-level authority in charge of enforcing poorly harmonized national law is not an unprec-

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edented situation; one example is the ECB's fit-and-proper vetting of senior executives of the euro area's significant banks. Furthermore, the experience of the SSM suggests that the establishment of a unitary European supervisory mandate can spur the development of policy expertise towards further regulatory harmonization. There is in principle no legal obstacle to a European agency imposing fines or other restrictions on individual firms, as illustrated by the existing practice of the SSM.²² In sum, the establishment of a unitary architecture need not await the creation of a single rulebook for AML supervision; indeed, it can be expected to vastly accelerate its emergence.²³

A unitary architecture would entail a significantly simpler system, essentially eliminating problems of information sharing between AML supervisors and allocation of tasks between home and host authorities. The reduced

risk of confusion of responsibilities would be positive for the legitimacy, accountability, and effectiveness of the supervisory system. The reduced administrative friction between different supervisory authorities would decrease overall operating costs and the risk of errors and omissions; the efficiency of the system would be further enhanced by economies of scale, e.g. in terms of specialist expertise and skills. If implemented with the division of operational tasks between the national and European levels properly articulated, a unitary system would not entail a loss of local knowledge or communication with supervised entities, national law enforcement agencies, or national FIUs. As Nouy has repeatedly argued in describing the SSM's supervision of euro area banks, such arrangements provide "the best of both worlds: the experience of national supervisors, while also keeping some distance from individual banks" and the related risks of political interference.²⁴ Once in place, a unitary architecture also reduces political conflict between European and national authorities, a problem endemic in any two-tier system.

Based on SSM experience since 2014, the supervisory effectiveness of a European agency under a unitary architecture should be significantly greater than that of the weaker member states' AML supervisors, and not necessarily less than the best current national practice. Conversely, in a two-tier system, even with forceful capacity at the hub, weak links will inevitably remain. As such, even to the extent that an effective two-tier system may be able to spot malpractice, a unitary system is bound to do so at an earlier stage and to be more proactive in taking action. For similar reasons, a unitary system would be more resilient than a two-tier system against the possibility of erosion of the rule of law in a given member state, even though it would cover only AML supervision and not the FIU and law enforcement pillars of the AML framework.

A unitary system would also greatly enhance and facilitate the European AML supervisor's cooperation and information sharing with its counterparts in other jurisdictions, first and foremost the United States. While this would not deprive the US government of its ability to act unilaterally, e.g. by wielding its authority under Section 311 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct

21. The competition directorate-general, in turn, has delegated back to national competition authorities the handling of cases that lack a European dimension.

22. The ability of EU agencies such as the ESAs to make decisions that are binding on individual firms has been established by the jurisprudence of the Court of Justice of the European Union, including the *Meroni* judgment of June 13, 1958 (case 9-56) and the *short-selling* judgment of January 22, 2014 (case C-270/12).

23. There is no compelling case for introducing in AML supervision a divide similar to that in the SSM between larger and smaller banks. This is because the most significant and complex AML breaches often occur in comparatively small firms. Therefore, the EU principle of proportionality does not apply to AML supervision in the same way as it does to prudential supervision.

24. As paraphrased, for example, in the Council of the European Union's partial summary record of the meeting of the ECON Committee of the European Parliament held in Brussels on November 3-4, 2014, available at <http://data.consilium.europa.eu/doc/document/ST-15376-2014-INIT/en/pdf>.

Terrorism (USA PATRIOT) Act,²⁵ it would likely help ensure that the use of such instruments would remain selective, as it appears to have been so far. At the global level, a unitary European architecture would reduce the complexity of the Financial Action Task Force's processes, as fewer European participants would need to be directly involved.

Conversely, the main advantage of a two-tier architecture is the more incremental nature of the change compared to the status quo. But to be effective, the central agency will need to have unfettered access to information and strong enforcement capabilities, powers which ultimately raise political challenges similar to those inherent in a unitary system.²⁶ On balance, a unitary architecture for AML supervision in the European Union is feasible, simpler than a two-tier system, likely to be significantly more effective, and compliant with the principle of subsidiarity.

There are parallels between the AML vicious circle and the bank-sovereign vicious circle that ultimately led to the establishment of Europe's banking union. In both cases, the coexistence of the single market and euro area frameworks with national banking supervision (respectively prudential and AML) led to perverse incentives for national authorities and ultimately to pervasive supervisory and crisis-management failures.²⁷ In both cases, the attempted solution was a two-tier architecture. The EBA was created in 2011 in the midst of Europe's decade-long banking system crisis, which was ultimately resolved thanks to the creation of the SSM. Unlike the earlier institutional mismatch in the prudential space, Europe's AML problem should be comprehensively tackled before it grows to a critical systemic dimension.

Which Agency at the Hub?

If the European Union decides to move toward a unitary architecture to combat money laundering, then one or several European agencies needs to be empowered to that effect. The European AML supervisor(s) may be an existing or new agency, or different agencies for different categories

25. This authority, which the Treasury Department has delegated to its Financial Crimes Enforcement Network (FinCEN) unit, enables the US government to target administratively foreign financial institutions that it determines are "of primary money laundering concern" (an undefined term). It can condition, restrict, or cut off those institutions' access to the US financial system, including prohibiting the provision of US correspondent accounts, effectively ending their ability to make international payments cleared in dollars.

26. The European Commission's proposal of September 12, 2018 (EC 2018) stopped well short of that objective.

27. Véron develops this analysis for prudential supervision in "Banking Nationalism and the European Crisis," [speech](#) at the European Private Equity and Venture Capital Association (EVCA) Annual Symposium in Istanbul, June 2013.

of obliged entities. The following analysis explores the main advantages and shortcomings of seven different options:

- the ECB as single AML supervisor of euro area banks, in addition to its existing role as prudential supervisor;
- each ESA for its respective area: EBA for banks, EIOPA for insurers, and ESMA for other financial firms;
- EBA for all financial firms or even all obliged entities;²⁸
- ESMA for all financial firms or even all obliged entities;
- a joint venture of the three ESAs, building on the existing AMLC;
- a dedicated new agency, which may be referred to as the European AML Authority or EAMLA;²⁹ and
- a dedicated new agency with authority over only a subset of member states, established through a process of enhanced cooperation.

Option 7 is only a fallback option in case all others lead to political deadlock. This is unlikely to be the case, however, since Options 2-6 can be implemented through EU single market legislation (on the basis of Article 114 of the Treaty on the Functioning of the European Union, or TFEU), which only requires approval by a qualified majority of EU member states.³⁰

Option 1, using the ECB as a single AML supervisor of euro area banks, has immediate appeal given the generally solid performance of the ECB as a banking supervisor. But it also has several drawbacks. Like Option 7, it does not cover the entire single market, leaving space for a continued AML vicious circle affecting countries outside the banking union area. This is a concern in any case, and particularly if, as appears possible at the time of writing, the United Kingdom remains in the European single market for an undetermined period of time following its planned exit from the European

28. This option is hinted at as a long-term outcome by the European Commission Communication of September 12, 2018 (EC 2018). However, the European Commission's legislative proposal of the same day stops short of Option 3, since it entails a two-tier and not a unitary architecture for AML supervision.

29. A variant of Option 6, which is not explored further here, might be the creation of a dedicated new European Commission directorate-general, modelled on the existing framework for competition policy under the competition directorate-general, which would take over the AML supervisory mandate directly. This would not be functionally very different from a new EU agency, but it would entail a different framework for governance, accountability, and funding.

30. In the European Union, "qualified majority" refers to a specific supermajority of member states defined in the EU treaties. Under the currently applicable Lisbon Treaty, it implies approval by at least 55 percent of member states (16 out of 28) representing at least 65 percent of the EU population.

Union in late March 2019.³¹ Option 1 could also run into legal difficulties.³² Furthermore, adding the AML task to the ECB's already heavy burden of responsibilities might centralize too much authority in a single institution, given the comparatively fragile framework for general-purpose executive authority and democratic scrutiny at the European level.

Options 2, 3, 4, and 5 all build on the existing structures of the three ESAs. Option 2, employing each ESA for its respective area, is the most straightforward but has the drawback of entrenching fragmented AML supervision along sectoral lines. The drawbacks of such sectoral fragmentation will likely become increasingly significant, as future financial technologies may blur the boundaries between subsectors of finance and correspondingly open new avenues for regulatory arbitrage.

Option 3, relying on the EBA, might be justified by the fact that publicly identified AML failures have been particularly prominent in the European banking sector, and that the EBA has been so far the most active of the three ESAs in the AML field.³³ But the EBA does not otherwise have experience with, or a mandate for, direct supervision, and it is unlikely to gain such authority in the future. Moreover, the members of the EBA's Board of Supervisors are designated by national prudential supervisory authorities, not all of which have AML duties, creating a potential governance misalignment. Having the EBA supervise firms other than banks may create further awkward mismatches.

By contrast, ESMA (Option 4) has existing direct supervisory experience and is likely to gain more in the future (e.g., over central counterparties). It also has more

experience with cross-sectoral oversight.³⁴ Option 5 (a joint venture of all three ESAs) has the advantage of being cross-sectoral but may suffer from too much complexity and a deficit of accountability in the corresponding governance arrangements.

The obvious drawback of Option 6 (EAMLA) is that a new agency would further complicate the EU financial regulatory landscape. But it would provide a straightforward and cross-sectoral solution to the specific challenge of AML supervision. It could also learn from the early experiences of the three ESAs and other European bodies, including the SSM. The EAMLA could thus adopt an optimized governance and funding framework from the outset. This model would have further potential advantages from the standpoint of the "twin-peaks" vision—in which prudential and conduct-of-business supervision are separate—as it would be separated from the prudential concerns of the ESAs and the SSM. A separate agency might also be preferable in terms of ring-fencing sensitive information about potentially criminal activity.

An Initial Blueprint for an EAMLA

The creation of a new European AML Authority (Option 6) emerges as the best response to the current challenges of AML supervision in the European Union. EU leaders' current heightened awareness of AML challenges justifies an overhaul of the European Union's AML supervisory architecture without delay. While enacting new legislation within the current European Parliament term (ending in May 2019) does not appear realistic, leaders could in principle decide to proceed immediately with a mandate for the next European Commission to propose legislation accordingly in the second half of 2019.

If so, one could realistically envisage supervisory authority transferring to the EAMLA starting around late 2022, allowing for one year's legislative debate and two years for institutional buildup and recruitment, which is significantly more than was the case for the ESAs or the SSM. The transfer could itself be gradual to allow the new agency to absorb lessons from early experience, e.g. starting with banks in 2022 and subsequently adding other categories of obliged entities. Before 2022, the existing two-tier archi-

31. If the United Kingdom leaves the single market, it will be treated as a third country for AML purposes, as is currently the case with Switzerland.

32. Option 1 would presumably be based on Article 127(6) TFEU, like the SSM, raising challenges of both procedure (unanimity) and legal robustness. It is not clear that the reference in Article 127(6) TFEU to "specific tasks [...] concerning policies relating to [...] prudential supervision" can be understood as including AML supervision in addition to the prudential supervisory tasks already conferred on the ECB by the SSM regulation. It is also not clear that the ECB could be granted an AML supervisory mandate under another treaty article, e.g. Article 114 TFEU. Article 127(6) also specifically refers to "credit institutions and other financial institutions with the exception of insurance undertakings," so the sectoral scope beyond banks would be correspondingly limited.

33. The EBA's existing capacity and experience should not be exaggerated, however, since the August 2018 discussion paper states that its entire staff for AML tasks is fewer than two full-time equivalents.

34. Furthermore, there is a scenario in which the ESMA could acquire some supervisory responsibilities in the future over banks and insurers, if the European Union adopts a "twin-peaks" vision for the long-term evolution of its general financial supervisory architecture, i.e. a separation of prudential oversight from conduct-of-business supervision (Schoenmaker and Véron 2018). A "twin peaks" financial supervisory framework asserts that prudential supervision should be separated from supervision of conduct.

ture would remain in place, possibly with the limited enhancement proposed by the European Commission on September 12, 2018.

The governance of the EAMLA should take into account the experience of the ESAs, of the SSM, and of the Single Resolution Board that was established in 2015–16 to manage banking crises in the euro area. It should rely on a compact collective decision-making board of fewer than 10 members, including the agency’s chair.³⁵ All members of

The creation of a new European AML Authority emerges as the best response to the current challenges of AML supervision in the European Union.

that board should be individually vetted by the European Parliament, thus creating legitimacy and accountability. The agency’s funding should be through a levy directly collected from supervised entities, similar to the funding of the SSM.

The steady-state size of EAMLA staff would depend on how much of its supervisory work is delegated to other bodies—other EU agencies such as the SSM (for banks), or national AML supervisors, or both. The EAMLA would need staff for policy work and rule drafting, similarly to the ESAs.³⁶ For supervisory work, the EAMLA could rely on hybrid teams of its own staff and those of other supervisors for both regular and targeted examinations. Even so, to be effective, the EAMLA could easily need a staff of several hundred, especially if, as might be desirable, it is granted AML supervisory authority over all categories of obliged entities including nonfinancial entities.

Conclusion: Focus on AML Supervisory Integration First

Getting the supervisory architecture right is the current central challenge of AML policy in the European Union, but it is not the only one. The content of applicable AML legislation might also be ripe for improvement. But the fact that AMLD5 was very recently enacted and is not yet trans-

posed, let alone enforced, suggests policy discussions should follow a more delayed timetable. Given that experience, it makes sense to create a European AML supervisor ahead of any attempt at, for example, an AML Regulation (AMLR) that would move EU law in that area closer to the vision of a single rulebook.³⁷ The SSM experience argues in favor of such sequencing.

Similarly, supervisory integration should help increase the size and consistency of AML fines and ensure the transparent publication of individual AML decisions. The European Union should aim to impose fines with a genuinely dissuasive impact and should expect detailed public announcements of all individual decisions containing the name of the subject entity, the nature of the alleged AML violations, and the size of the penalty.

Whether the FIU pillar of Europe’s AML regime should also undergo supranational integration in the future is an open question. The creation of an EU-level FIU was recommended in a 2016 report (EU FIUs’ Platform 2016); it was also considered but ultimately rejected in the European Parliament discussion of AMLD5³⁸ and more recently recommended by Latvia’s finance minister, among others.³⁹ Since the most notable recent AML cases in the European Union have tended to be concentrated in the banking sector and linked to failures of AML supervision, AML supervisory integration appears more urgent than a European FIU. Establishing an EU FIU also appears comparatively more challenging from both political and technical perspectives, given how the activities of FIUs are embedded in member states’ specific arrangements for criminal justice, law enforcement, and intelligence gathering and analysis. If the creation of a European AML Authority is undertaken and succeeds, then the case for a European FIU might become more realistic than it is now.

35. A larger body could be set up with every member state represented, but only for consultative purposes in the process of drafting new rules, not for individual supervisory decisions.

36. Under the *Meroni* and *short-selling* jurisprudence, the EAMLA is unlikely to be empowered as an autonomous rule-maker (beyond the issuance of non-binding opinions, guidelines, and recommendations) but would draft binding technical standards for approval by the European Commission.

37. An AMLR may or may not be needed to achieve maximum harmonization, which can also be pursued through directives. Correspondingly, it is possible that the optimal steady state includes a combination of regulation(s) and directive(s), as is currently the case for the EU bank capital requirements legislation. No indepth investigation of the corresponding tradeoffs has been done in the preparation of this paper.

38. Sven Giegold, “Won and Lost: Details of the Compromise on the European Anti-Money Laundering Directive,” [blog](#) post, December 15, 2017.

39. “Latvian Finance Minister Dana Reizniece-Ozola called for ‘the creation of a financial intelligence unit at the EU level as the scope of combating money laundering and terrorism financing goes far beyond the supervision of the financial sector.’” Quoted in Alexander Weber, “Money-Laundering Scandals Prompt EU Rethink on Policing Banks,” *Bloomberg*, October 2, 2018.

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ANNEX A SELECTED BANK-RELATED ANTI-MONEY LAUNDERING (AML) DEVELOPMENTS IN THE EUROPEAN UNION

Austria (covered by the Single Supervisory Mechanism—SSM)

In 2018, Austria's Financial Market Authority fined [Raiffeisen Bank](#) €2.7 million for AML violations, including beneficial ownership and customer due diligence failures. The Financial Market Authority also fined Hypo Vorarlberg Bank €414,000 for AML violations that year.

Cyprus (SSM)

In 2018, the Central Bank of Cyprus (CBC) imposed a €715,000 fine on the [Cyprus Development Bank](#) for AML violations. Also in 2018, the CBC issued a circular previewing forthcoming regulations that will restrict the holding of accounts for shell companies.¹ Similar fines were imposed in 2017 and 2016 against [RCB Bank](#) and [Hellenic Bank](#). In 2014–15, the CBC initiated resolution and liquidation proceedings for FBME Bank and revoked its branch license.² FBME had been the subject of a US Treasury Department action under Section 311 of the PATRIOT Act in 2014.³

Czechia (non-SSM)

In 2016, the Czech National Bank revoked the license of [ERB Bank](#), which it found lacked a functioning AML system.

Denmark (non-SSM)

In 2018, Danish prosecutors announced a new probe into Danske Bank after the bank's publication of an internal report that disclosed that over €200 billion in transactions flowed through its Estonian branch over a nine-year period, of which at least 40 percent was potentially suspicious. The Danish Financial Supervisory Authority (FSA) also announced a new investigation, and the bank's CEO resigned.⁴ In September 2018, at the European Commission's [request](#),⁵ the European Banking Authority (EBA) started a breach-of-Union-law preliminary enquiry into AML supervision of Danske Bank in Denmark and Estonia. In 2017, Danish prosecutors had fined the bank DKK 12.5 million following the receipt of a 2015 referral from the FSA.

Estonia (SSM)

In 2018, prosecutors opened a criminal investigation into alleged illicit activity at the Estonian branch of Danske Bank.⁶ In September 2018, the EBA started a breach-of-Union-law enquiry into AML supervision of Danske Bank in Denmark and Estonia (see Denmark above). Also in 2018, the Estonian FSA announced that the European Central Bank had withdrawn the license of [Versobank](#) at its request.⁷

1. Elias Hazou, "Under the US cosh? The crackdown on money laundering," *Cyprus Mail*, June 30, 2018. See also Joshua Kirschenbaum, "The Other 'Cyprus Problem,'" German Marshall Fund Alliance for Securing Democracy [blog](#), July 5, 2018.

2. FBME in Cyprus was a branch of FBME Bank Ltd, headquartered in Tanzania, but it conducted the bulk of the consolidated group's activity.

3. Announcements available on the respective websites of [FinCEN](#), of the [CBC](#), and of the [District Court](#).

4. Danish FSA [memorandum](#) and [internal report](#), both available on Danske Bank's website. See also Teis Jensen, "Under fire Danske bank faces fresh money laundering inquiry," *Reuters*, September 20, 2018; Stine Jacobsen and Jacob Gronholt-Perdersen, "Denmark to investigate Danske Bank over money laundering allegations," *Reuters*, August 6, 2018; and Danske Bank's own [announcement](#) of the 2017 fine.

5. Tiina Astola, Director-General for Justice and Consumers, European Commission, "Request to investigate a possible breach of Union law under Article 17 of Regulation (EU) No 1093/2010," [letter](#) to Andrea Enria, chairman of the European Banking Authority, September 21, 2018.

6. Teis Jensen, "Estonia to investigate Danske Bank over money laundering allegations," *Reuters*, July 31, 2018.

7. See also Joshua Kirschenbaum, "Estonian Regulators and European Central Bank Move Forcefully Against Russian Money Laundering," German Marshall Fund Alliance for Securing Democracy [blog](#), March 30, 2018.

France (SSM)

In 2017 and 2018, the *Autorité de Contrôle Prudential et de Résolution* (ACPR) fined [two entities](#) of the Crédit Mutuel group a total of €2.5 million, a [member bank](#) of the Crédit Agricole group €2 million, [Société Générale](#) €5 million, and [BNP Paribas](#) €10 million for AML violations, including failures related to the filing of suspicious transaction reports and the detection of suspicious activity.

Germany (SSM)

Germany's Federal Financial Supervisory Authority (BaFin) does not publish individual sanction decisions. According to press reports, BaFin fined Deutsche Bank €40 million for AML violations in 2015.⁸

Hungary (non-SSM)

In 2018, the Hungarian National Bank [fined](#) MagNet Bank 47 million forint for a variety of shortcomings including AML violations. The 2018 penalty followed a [2014 AML fine](#) against MagNet. Also in 2018, the Hungarian National Bank [imposed](#) an AML fine of 9.5 million forint against MKB Bank, which followed a [2016 fine](#) for a variety of violations including those related to AML.

Ireland (SSM)

In 2017, the Central Bank of Ireland fined the [Bank of Ireland](#) €3.1 million for AML violations, including the failure to file suspicious transaction reports.

Latvia (SSM)⁹

In 2016, the Financial and Capital Markets Commission (FCMC) imposed an AML fine against [ABLV](#), and in 2018 ABLV was the subject of an [action](#) by the US Treasury Department under Section 311 of the PATRIOT Act and was subsequently liquidated. Then, at the European Commission's [request](#), the EBA started a breach-of-Union-law preliminary enquiry into AML supervision of ABLV. In 2017, the FCMC fined five banks—Baltikums Bank, Privatbank, Regional Investment Bank, Norvik Bank, and Rietumu Bank—for AML violations including violations related to activity involving North Korea.¹⁰ On the recommendation of the FCMC, the ECB in 2016 withdrew the license of [Trasta Komerbanka](#) on the grounds of capital adequacy problems and AML violations.

Luxembourg (SSM)

In 2017, the *Commission de Surveillance du Secteur Financier* fined DNB Luxembourg SA, Nordea Bank SA, and local operations of Crédit Agricole and Novo Banco for AML violations.¹¹

Malta (SSM)

In 2018, the ECB [withdrew the license](#) of Pilatus Bank upon the recommendation of Malta's FSA. The EBA conducted a preliminary enquiry into the Pilatus case under its breach-of-Union-law authority and found *"general and systematic shortcomings in the FIAU's application of AMLD3"* (EBA 2018).

Netherlands (SSM)

In 2018, the Netherlands Public Prosecution Service fined ING €775 million for money laundering violations that facilitated illicit activity including bribery in Uzbekistan. The Dutch National Bank said in a letter to the finance minister that other

8. See Arno Schuetze and Jonathan Gould, "Bafin fines Deutsche Bank for anti-money laundering flaws: source," *Reuters*, June 24, 2016.

9. A detailed analysis of recent AML-related developments in Latvia is provided in Kirschenbaum (2018).

10. Announcements available on FCMC's website: "FCMC and ABLV Bank, AS signed administrative agreement, applying fine to Bank and issuing reprimand to board member," [press release](#), May 26, 2016; and "FCMC in collaboration with U.S. law enforcement authorities identifies weaknesses and imposes monetary fines on three banks," [press release](#), June 27, 2017.

11. See Martine Huberty, "Panama Papers: Fines for 9 Financial Institutions," *Delano*, December 21, 2017.

Dutch banks might also have inadequate AML controls.¹² In 2017, the Fiscal Information and Investigation Service raided Amsterdam Trade Bank as part of an investigation into the bank's failure to comply with suspicious activity reporting and customer due diligence obligations.¹³

Portugal (SSM)

In 2016, the EBA liaised with the Bank of Portugal regarding its implementation of the qualifying holdings approval process in two instances in which a politically exposed Angolan purchased stakes in Banco BIC and the Bank of the Philippine Islands (BPI).¹⁴

Spain (SSM)

In 2017, prosecutors started an investigation into suspected money laundering through the Madrid branch of the Industrial and Commercial Bank of China's Luxembourg subsidiary.¹⁵ In 2016, the Supreme Court upheld a €1 million AML fine against Banco Santander imposed by Spain's government in 2015.¹⁶

Sweden (non-SSM)

In 2015, the Swedish FSA imposed AML fines against [Nordea](#) and [Handelsbanken](#) of SEK 50 million and SEK 35 million, respectively. Both banks were found to have committed violations related to nonresident customers, politically exposed persons, private banking, and correspondent banking.¹⁷

United Kingdom (non-SSM)

In 2017, the UK Financial Conduct Authority (FCA) fined [Deutsche Bank](#) £163 million for AML violations related to \$10 billion in securities "mirror trades."¹⁸ In 2015, the FCA fined [Barclays](#) £72 million for inadequate AML controls related to a high-value transaction for politically exposed persons. The head of the UK National Crime Agency declared that "many hundreds of billions of pounds of criminal money is almost certainly laundered through UK banks and their subsidiaries each year."¹⁹

12. See Joshua Kirschenbaum, "Europe Needs Money Laundering Penalties That Hurt," German Marshall Fund Alliance for Securing Democracy [blog](#), September 12, 2018; and Bart Meijer, "Dutch banks too lax on money laundering: central bank," *Reuters*, September 25, 2018.

13. See Aleya Begum Lønsetteig, "Amsterdam Trade Bank under new money laundering investigation," *Global Trade Review*, December 20, 2017.

14. See EBA [letter](#) to Ana Gomes, Member of the European Parliament, December 16, 2016.

15. See Angus Berwick, David Lague, and Jesús Aguado, "Spain probes ICBC's European unit over money laundering," *Reuters*, September 11, 2017.

16. See Paul Day and Angus Berwick, "Banco Santander fined 1 mln euros for failing to stop money laundering," *Reuters*, November 28, 2016; and Reyes Rincón, "Multa de un millón de euros al Santander porque Banesto incumplió la ley contra el blanqueo," *El País*, November 28, 2016.

17. See also Jonathan Boyd, "Swedish regulator fines, Nordea, Handelsbanken for AML failures," *Investment Europe*, May 19, 2015.

18. Given the absence of disclosure by BaFin, it is impossible to know if this case is related to the German case also referred to in this annex.

19. Keith Bristow, "Transnational organized crime as a national security threat," [speech](#) at George Washington University, January 2015.

Annex B Anti-money laundering (AML) supervisors for banks and financial intelligence units (FIUs) in EU and EEA countries

Country	AML supervisor for banks	Financial Intelligence Unit*	Financial Intelligence Unit setup
Austria	Financial Market Authority (FMA)	Austrian FIU (A-FIU)	Division of the Federal Police Force (Bundeskriminalamt)
Belgium	Financial Services and Markets Authority (FSMA)	Belgian Financial Intelligence Processing Unit (CTIF-CFI)	Agency supervised by the Ministries of Justice and Finance
Bulgaria	Bulgarian National Bank (BNB)	Financial Intelligence Directorate, State Agency for National Security (FID-SANS)	Directorate within the national counterintelligence agency (SANS)
Croatia	Croatian National Bank (HNB)	Anti-Money Laundering Office (AMLO)	Independent unit within the Ministry of Finance
Cyprus	Central Bank of Cyprus (CBC)	Unit for Combating Money Laundering (MOKAS)	Unit within the independent Law Office of the Republic
Czechia	Czech National Bank (CNB)	Financial Analytical Unit (FAU-CR)	Independent unit of the Ministry of Finance
Denmark	Finanstilsynet (Danish FSA)	Money Laundering Secretariat (FIU Denmark)	Unit of the Prosecution Service
Estonia	Finantsinspektsioon (Estonian FSA)	FIU Estonia (Money Laundering Information Bureau / MLIB)	Independent unit of the Police and Border Guard Board
Finland	Finanssivalvonta (Finnish FSA)	FIU (RAP)	Unit of the National Bureau of Investigation, part of the national police
France	Autorité de Contrôle Prudential et de Résolution (ACPR) under the Banque de France	Intelligence Processing and Action against Illicit Financial Networks Unit (TRACFIN)	Intelligence unit under the Ministry of Finance
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	FIU Germany	Unit of the Customs Service, part of the Ministry of Finance
Greece	Bank of Greece	Hellenic FIU	Unit of the Hellenic Anti-Money Laundering Authority (HAMLA)
Hungary	Hungarian National Bank (MNB)	Hungarian FIU (HFIU)	Unit of the National Tax and Customs Administration
Iceland	Fjármálaeftirlitið (Icelandic FSA)	FIU Iceland (FIU-ICE)	Unit within the National Police
Ireland	Central Bank of Ireland (CBI)	Bureau of Fraud Investigation (MLIU)	Unit of the Garda National Economic Crime Bureau, part of the national police
Italy	Bank of Italy	FIU of Italy (UIF)	Independent unit hosted by the Bank of Italy
Latvia	Financial and Capital Markets Commission (FCMC)	Office for Prevention of Laundering of Proceeds derived from Criminal Activity (Control Service) (KD)	Independent authority under the supervision of the Prosecutor's Office
Liechtenstein	Financial Market Authority (FMA)	FIU Liechtenstein (EFFI)	Independent administrative agency
Lithuania	Bank of Lithuania	Financial Crime Information Service (FCIS)	Service under the Ministry of the Interior
Luxembourg	Commission de Surveillance du Secteur Financier	FIU (CRF)	Unit of the Economic and Financial Prosecution Service under the Ministry of Justice
Malta	Financial Intelligence Analysis Unit (FIAU)	FIAU	Independent agency
Netherlands	Dutch National Bank (DNB)	FIU Netherlands (FIU-NL)	Independent agency
Norway	Finanstilsynet (Norwegian FSA)	FIU Norway (EFE)	Police specialist agency and prosecutor body
Poland	General Inspector of Financial Information (GIFI)	GIFI	Unit of the Ministry of Finance
Portugal	Bank of Portugal	FIU Portugal (UIF-Portugal)	Department within the Criminal Police
Romania	National Bank of Romania (BNR)	National Office for Prevention and Control of Money Laundering (ONPCSB)	Independent government agency

(table continues)

Annex B Anti-money laundering (AML) supervisors for banks and financial intelligence units (FIUs) in EU and EEA countries (continued)

Country	AML supervisor for banks	Financial Intelligence Unit*	Financial Intelligence Unit setup
Slovakia	National Bank of Slovakia	FIU of the National Crime Agency (FSJ)	Unit of the Ministry of the Interior
Slovenia	Bank of Slovenia	Office for Money Laundering Prevention (OMLP)	Unit of the Ministry of Finance
Spain	Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC)	SEPBLAC	Unit of the Commission for the Prevention of Money Laundering and Monetary Offences (CPBCIM) under the Ministry of Economic Affairs
Sweden	Finansinspektionen (Swedish FSA)	FIU Sweden	Unit of the Swedish Police Authority
United Kingdom	Financial Conduct Authority (FCA)	UK FIU (National Crime Agency, NCA)	Unit of the National Crime Agency, a national law enforcement agency
Gibraltar	Financial Services Commission (FSC)	Gibraltar FIU (GCID-GFIU)	Unit of the Coordinating Centre for Criminal Intelligence and Drugs

EEA = European Economic Area

* As listed by the Egmont Group.

Note: Gibraltar is included in the list above because of its inclusion in the Internal Market. FSA refers to Financial Supervisory Authorities in Nordic countries and Estonia.

Sources: Websites of the Egmont Group, the Anti-Money Laundering Forum (<https://www.anti-moneylaundering.org/>), and selected national agencies, consulted on September 2, 2018.