Foreign governments step up anti-money laundering efforts. Yet, the impact on illicit financial flows is uncertain.

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Building a better working world

Global institutions are facing sustained pressure to their financial crime compliance programs as a result of recent anti-money laundering and sanctions actions by foreign regulators

Regulators outside of the United States over the past several years have steadily increased their pace of anti-money laundering (AML) actions, a trend that will apply pressure on global banks. Foreign regulators have expanded their efforts to include an emphasis on individual liability, greater transparency of company ownership, monetary penalties that have increased in frequency and value and have obtained new powers to punish anti-money laundering compliance failures. Our analysis found that this increased pressure across dozens of countries, including in global and regional financial hubs, is the result of governments reacting to reputational concerns, major illicit finance schemes that have been brought to public attention, new global anti-money laundering standards and economic sanctions considerations. In addition, the extraterritorial reach of regulators in the United States has encouraged foreign governments to take a more aggressive stance for lapses of anti-money laundering controls. Financial institutions' ability to identify exposure to ill-gotten funds and potentially nefarious customers will improve as they react to new supervisory demands and work to enhance internal controls. However, governments' anti-money laundering actions can cause unintended consequences, including the shifting of illicit financial flows to less-established and understood channels. Furthermore, as financial institutions improve their internal controls to identify illicit actors and increase reporting on suspect activities, some governments have not increased their capacity to make use of this new information. In light of this pressure, global banks need to consider how best to react and strengthen controls.

How are foreign regulators applying pressure to combat financial crimes?

The toolkit in use by foreign regulators to promote compliance with anti-money laundering rules and punish failures in combating illicit actors has expanded in scope over the past several years. Analysis of regulatory actions across multiple countries demonstrates several established approaches to anti-money laundering enforcement, most notably frequent civil monetary penalties. Foreign regulators are also pursuing a broader range of actions, including enforcement against bank personnel through fines and removal from positions, bans on new customer onboarding, revocation of banking charters, joint actions across multiple jurisdictions, implementation of economic sanctions authorities and a sustained push for greater insight into company ownership

Focus on individual liability

Throughout 2016 and 2017, financial institutions with anti-money laundering compliance deficiencies saw bank officials face financial penalties, public censure and bans. For example, a British regulator issued guidance in 2014 stressing the importance of compliance leaderships' attention to anti-money laundering control.[1] In late 2016, a separate British regulatory agency issued a fine against an AML compliance officer and prohibited him from further compliance activities at regulated financial institutions. In similar fashion, Swiss regulators are reportedly levying bans on bank executives in an effort to emphasize individual accountability for anti-money laundering requirements, according to an industry publication. Other similar bans or penalties against compliance officers have also occurred in Hong Kong, Latvia, New Zealand and Singapore. These actions signal a regulatory view that financial crimes compliance is the responsibility not only of a financial institution at the enterprise-level, but also of those in positions of authority to promote or deter effective protection from illicit activity.

Push for greater transparency

Foreign governments are continuously pushing for greater transparency of company ownership. The trend is the direct result of hundreds of law enforcement and media reports across dozens of countries demonstrating that illicit actors gain access to the financial system through opaque company structures and accounts in countries with poor beneficial ownership laws. The European Union's (EU) recently finalized Fourth Anti-Money Laundering Directive has called for far greater corporate transparency and information sharing of ownership data. The push extends beyond the EU's 28 members. Ukraine authorized a public database of company ownership, the British Virgin Islands introduced a platform for searching beneficial ownership information, Hong Kong is exploring a nonpublic registry of company ownership and control and regulators in Singapore, Japan, Australia and elsewhere are demanding that companies disclose natural person ownership. Recent data released by the Financial Action Task Force, an anti-money laundering and counter terrorist financing standard-setting body, highlighted room for continued improvement: more than 25 countries were at best partially compliant with company ownership transparency standards.[2]

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[1] Anti-money laundering guidance for money service businesses. Her Majesty's Revenue & Customs. 2014. http://webarchive.nationalarchives.gov.uk/20140206154027/http://www.hmrc.gov.uk/mlr/mlr_msb.pdf. Accessed February 2017.

[2] Consolidated assessment ratings. Financial Action Task Force, September 2017. http://www.fatf-gafi.org/publications/mutualevaluations/documents/assessment-ratings.html. Accessed September 2017.

Combined actions, new power granted to regulators

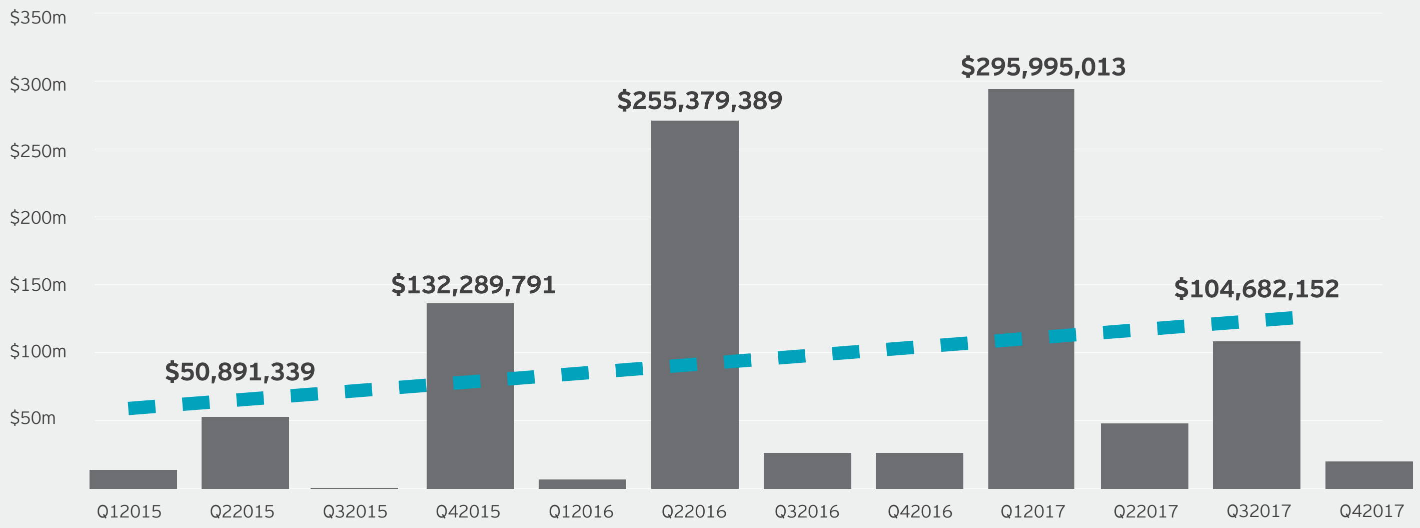
Recent actions also have underscored that foreign regulators are increasingly taking unique approaches to punishing financial crime compliance failures. For example, several jurisdictions have taken combined enforcement actions, including a joint Emirati-Dutch investigation and monetary fines against the private banking arm of a financial institution in late-2015. Similarly, Switzerland and Singapore's regulators issued coordinated fines against a bank for money laundering infractions, while Latvia issued a fine in 2017 based on information provided by the US government.[3] Other countries are amending laws to remove barriers to cross-border information sharing in order to strengthen their supervisory and regulatory frameworks, suggesting that joint actions may become more common.[4]

Separately, some foreign regulators have been granted new powers, expanding their scope of enforcement capabilities and reporting required of financial institutions. The United Kingdom established a new sanctions administrator with the ability to issue monetary penalties. Mexico, France and several other jurisdictions have enacted new anti-corruption measures that require enhanced reporting from regulated entities. A wide range of other new regulatory powers related to financial crime compliance are being globally implemented.

Increase in monetary penalties

Monetary penalties against local financial institutions have increased in frequency and value over the past three years. While foreign fines are modest as compared against those issued in the United States, a review of the previous 12 calendar quarters of data demonstrated a steady upward trend on a yearly basis. In a number of countries, recent monetary penalties are record setting, based on our research into publically available data. These fines are not exclusively being issued against large banks. Securities firms, money service businesses, foreign exchange houses and financial technology firms have all been assessed fines.

Value of non-US monetary penalties against banks for anti-money laundering issues



The overall value of monetary penalties issued by regulators outside of the United States against financial institutions has grown over the past three years. Since 2015, the aggregate value of fines related to financial crimes compliance issues has grown by about $100 million on an annual basis. In 2017, more than $450 million in fines were paid.[5]

[3] MAS directs BSI Bank to shut down in Singapore. Monetary Authority of Singapore, May 2016. http://www.mas.gov.sg/News-and-Publications/Media-Releases/2016/MAS-directs-BSI-Bank-to-shut-down-in-Singapore.aspx. Accessed August 2017.

[4] The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action. International Monetary Fund, June 2016. https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf. Accessed September 2017.

[5] Data gathered by EY in 2017 and 2018 using open-source search engines and foreign regulators' websites. Information available upon request.

Select counter-financial crimes actions outside of the United States, 2016–2017

United Kingdom: AML compliance officer fined and barred from future positions with regulated financial institutions; new office focused on administering and enforcing sanctions established and given power to issue monetary penalties

Canada: New economic sanctions programs announced against human rights abusers

Denmark: Financial regulator reported a local bank to law enforcement agencies for investigation over suspicious flow of funds passed, fines issued against bank board member for money laundering issues

Scotland: New beneficial ownership regulations passed, with a particular focus on local shell companies

Brussels: Fourth Anti-Money Laundering Directive, after years of planning and implementation, enters into force, expanding reporting requirements, definition of politically exposed persons and AML obligations for foreign subsidiaries

Latvia: License of local bank revoked for "egregious" money laundering violation, new individual liability law passed, fine issued against bank board member for money laundering issues

Ukraine: Government authorizes sharing of beneficial ownership data with international consortium, making the information public

South Korea: AML laws expanded to require reporting by lawyers, accountants, realtors and other non-finance professionals

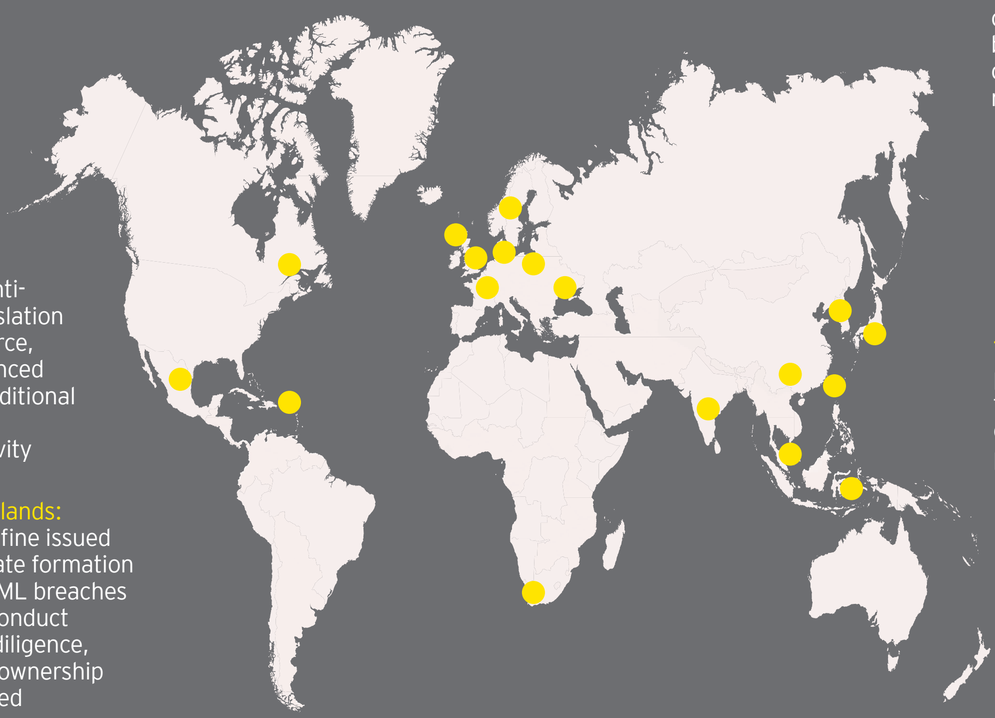
Japan: Electronic currencies, including bitcoin, fall under scope of anti-money laundering regulations

China: New regulations passed requiring enhanced reporting of cross-border funds transfers, prohibition of certain virtual currency activity

Taiwan: New regulations passed, removing monetary threshold for consideration of money laundering prosecution

Mexico: New anti-corruption legislation entered into force, requiring enhanced training and additional reporting on suspicious activity

British Virgin Islands: Record-setting fine issued against corporate formation agent due to AML breaches and failure to conduct customer due diligence, new beneficial ownership legislation signed



Philippines: New regulations introduced, expanding government's ability to prosecute money laundering and regulate casinos

France: New anti-corruption law enacted, requiring implementation of compliance programs and increased reporting

South Africa: Anti-money laundering fines issued against local and foreign-registered banks, AML legislation strengthened

India: Financial institution barred from investment activity stemming from enhanced enforcement of money laundering

Singapore: Licenses of two banks shut down for money laundering breaches

Reputational concerns and global expectations driving a more aggressive approach to financial crimes compliance

A confluence of factors has driven foreign governments to strengthen domestic anti-money laundering laws and pursue more assertive enforcement of noncompliance with those standards, based upon our analysis of media reporting, regulatory information, international organization reporting and our industry experience.

Extraterritorial reach of US laws and regulatory action: The impact of enforcement actions taken by regulators in the United States against foreign, global banks often reverberates back to the home countries of those institutions due to the size, scope, and extraterritorial reach of the action. This extraterritorial reach often leads foreign regulators to themselves take direct enforcement actions. After the US Treasury Department identified banks in Cyprus and Andorra as "primary money laundering concerns," regulators in both countries took actions against those institutions.[6] Separately, after a Taiwanese bank was fined for lax money laundering controls by US authorities, the Government of Taiwan overhauled aspects of the financial crimes compliance legislation. [7, 8]

Reaction to recent money laundering schemes: Some governments are pursuing a stronger posture due to information about illicit flows passing through local banks. The scale and scope of those flows in some countries has garnered negative political attention or various other forms of criticism that have contributed to reputational harm. For example, after the leak of the "Panama Papers" in 2015, which highlighted the use of local companies in the British Virgin Islands and elsewhere to mask true beneficial ownership, the British Virgin Island government's anti-money laundering enforcement spiked in the months after the allegations surfaced.[9] This reputational harm has manifested itself in the form of "de-risking," a reference to banks cutting-off or significantly decreasing exposure to certain classes of customers or products. For some countries, the push for a more aggressive action against money laundering is an attempt to counteract de-risking by promoting strong financial crimes compliance practices.

Enhanced global money laundering standards: The Financial Action Task Force is increasingly focused on measuring the effectiveness of governments' anti-money laundering and counter-terrorist financing regulatory frameworks. The organization is shifting focus from whether or not member states' anti-money laundering programs include critical features, to instead focusing on the effectiveness of those programs. In recent mutual evaluations, the method used by the organization to publically deliver evaluations to member states, commonly include language on effectiveness (for example, "[the government] has a sound and substantially effective regime … but could do more to obtain money laundering and terrorist financing convictions" from a 2017 evaluation).[10] As the Financial Action Task Force emphasizes effectiveness of anti-money laundering programs, it has led regulatory agencies to issue civil monetary penalties and a range of other actions cited above.

Focus on money laundering enforcement a first step in stemming illicit financial flows

The growth in global attention to and enforcement against money laundering may over time increase the "cost of doing business" for nefarious actors as financial institutions are better equipped to understand their exposure to customers, product usage, and transactions that may be used to move ill-gotten gains. However, this impact will be difficult to quantify and may have a negative consequence as less-regulated jurisdictions and financial instruments garner the attention of money launderers and other illicit actors.

The operations of illicit actors are disrupted through two principal channels: actions taken by financial institutions to protect themselves from serving as channels of money laundering and governmental actions — usually driven by law enforcement — to arrest or otherwise restrict illicit actors. The increased action by foreign regulators is likely to strengthen the ability and resolve of banks to interdict illicit activity in the form of enhanced due diligence on new and existing customers, financial intelligence analysis, better sanctions screening and improved monitoring of suspicious activity.

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[6] Andorra takes over BPA bank on US money laundering concerns. Reuters, March 2015. https://www.reuters.com/article/andorra-bpa/update-2-andorra-takes-over-bpa-bank-on-u-s-money-laundering-concerns-idUSL5N0WC51020150310. Accessed February 2018.

[7] Taiwan implements new anti-money laundering system. Executive Yuan, Republic of China. http://english.ey.gov.tw/News_Hot_Topic.aspx?n=B6FFA41BADC7639C&sms=0FCE5ECB990F95A2. Accessed August 2017.

[8] Mega Bank case could hit anti-money laundering rating. China Post, August 25, 2016. http://www.chinapost.com.tw/taiwan/business/2016/08/25/476512/mega-bank.htm. Accessed August 2017.

[9] British Virgin Islands: Have They Cleaned Up Since the Panama Papers? Transparency International, October 2016. https://www.transparency.org/news/feature/british_virgin_islands_have_they_cleaned_up_since_the_panama_papers. Accessed September 2017.

[10] Ireland's measures to combat money laundering and the financing of terrorism and proliferation. Financial Action Task Force, September 2017. http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-ireland-2017.html. Access September 2017.

As those controls are enhanced, it will almost certainly result in more information sharing with governmental agencies through suspicious activity reporting and other channels. Unfortunately, many of those tip-offs will remain uninvestigated. A report by the European Union's law enforcement arm noted that about 90% of suspicious transaction reports are uninvestigated by law enforcement or regulatory agencies in the 28-member bloc.[11] Other governments have few, if any, successful money laundering convictions or forfeiture of ill-gotten gains. Increased capacity to identify illicit actors on the part of banks is not always being met with an analogous increase in resources by governments.

Furthermore, as anti-money laundering regulations grow in strength in certain jurisdictions, it may encourage illicit actors to seek less-regulated channels to move and park ill-gotten gain. The US Government's most recent money laundering risk assessment summarized this trend, noting "criminals use every feasible money laundering method," and that "different money laundering methods ... are alternated in response to actions taken by law enforcement and financial supervisors."[12] Some major international banks have reported experiencing closing accounts for suspect customers, only to have those individuals and companies continue to expose the bank to risk through accounts with other institutions, handicapping their ability to act.

What should financial institutions be doing?

Financial institutions often face competing, overlapping and at times contradictory pressure at the hands of regulators. A more aggressive push for financial crimes compliance across different jurisdictions will further reinforce this pressure. Planning ahead and strengthening existing controls will position banks to respond.

Inventory of regulations: As foreign regulators gain new authorities and expand their unwritten expectations, financial institutions should create inventories of those requirements and expectations across operating jurisdictions. Established governance processes can help institutions update this inventory on an ongoing basis. For example, company ownership is becoming increasingly transparent in a growing number of countries, and regulators expect banks to collect ownership information to certain thresholds. But, there is no single Know Your Customer standard. Tracking potentially disparate requirements should be followed by a determination of the appropriate information collection standards to address regulatory requirements. The purpose of the inventory is to identify gaps in current controls and identify potential efficiencies.

Financial intelligence: As noted above, illicit actors may seek less-regulated channels to move and park ill-gotten gains, if activities in one jurisdiction are restricted. Developing or bolstering financial intelligence teams — especially those that merge open-source intelligence, transaction reviews and engagement with third parties, including law enforcement — can help proactively assess how a financial institution's risk may change as illicit actors seek greater opacity in their activity. The work of financial intelligence teams should be incorporated into trainings, customer risk rating, transaction screening operations and the development of new transaction monitoring scenarios, among other controls.

Cost efficiencies: New regulatory attention often leads financial institutions to increase spending to remediate and enhance financial crime compliance controls. As regulatory concerns aggregate, cost overruns may quickly become a major concern. Various new tools and processes are ever more effective in helping realize cost efficiencies in compliance programs, including around streamlining risk assessments, automating customer risk rating, minimizing repetitive customer due diligence information collection and closing false positive transaction monitoring and sanctions screening alerts using robotics tools. Cost efficiencies in one compliance process can free up resources to reinvest in other needs.

Information sharing: Financial institutions sit on a wealth of useful information that can improve financial crime compliance controls, especially when all business lines, branches and subsidiaries across a global enterprise are considered. They should understand what information can be shared across borders, subject to data privacy laws. Information sharing could include customer beneficial ownership data, sanctions screening issues and violations, screening list entries, transaction monitoring scenarios, lessons learned from regulatory engagement, escalations about money laundering or sanctions risk factors, among others. Effective information sharing can speed up how quickly and effectively a large bank can use new information learned in one part of an enterprise to strengthen the financial crime controls elsewhere.

The heightened focus from foreign regulators will create challenges around tracking illicit flows, regulatory requirements, cost increases and the need to better share information across borders. This trend calls for continued vigilance and clever solutions on the part of global financial institutions to not fall behind or be caught off-guard.

[11] From Suspicious to Action: Converting financial intelligence into greater operational impact. Europol, 2017. https://www.europol.europa.eu/publications-documents/suspicion-to-action-converting-financial-intelligence-greater-operational-impact. Accessed September 2017.

[12] National Money Laundering Risk Assessment. US Department of the Treasury, 2015. https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/National%20Money%20Laundering%20Risk%20Assessment%20%E2%80%93%2006-12-2015.pdf. Accessed September 2017.

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