

AML/CFT 4.0: Time for (a) change

8th Conference on the Banking Union

Thorsten Höche, 23rd September 2021, Frankfurt am Main



30 minutes on 30 years of AML/CFT legislation in the European Union

And why a basic change is needed



The Target

"Whereas money laundering has an evident influence on the rise of organized crime in general and drug trafficking in particular; whereas there is more and more awareness that combating money laundering is one of the most effective means of opposing this form of criminal activity, which constitutes a particular threat to Member States' societies (...)"

Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, Recital

The Concept



Developments

Excursion: Customer Due Diligence

Who are you?

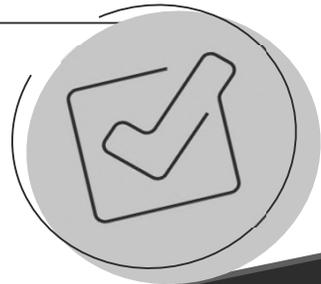
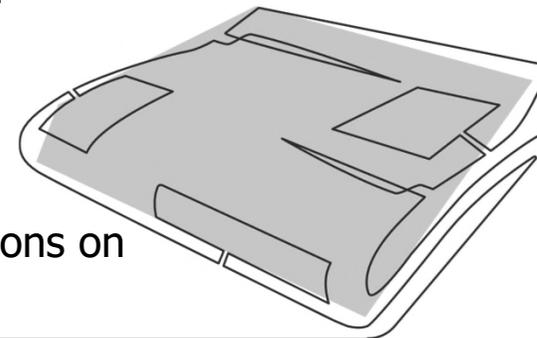
... and who stands behind you?

First AML Directive 91/308/EC, 10 June 1991

Article 3

1. Member States **shall ensure** that credit and financial institutions **require identification of their customers by means of supporting evidence** when entering into business relations, particularly when opening an account or savings accounts, or when offering safe custody facilities.

5. In the **event of doubt** as to whether the customers referred to in the above paragraphs are **acting on their own behalf**, or where it is certain that they are **not acting on their own behalf**, the credit and financial institutions shall take **reasonable measures** to obtain information as to the real identity of the persons on whose behalf those customers are acting.



Good old days (?)

Second AML Directive 2001/97 EC, 4 December 2001



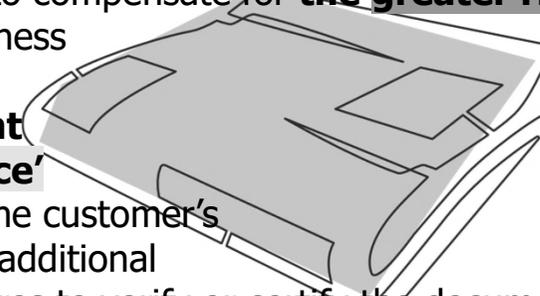
What's new:

- Non-face to face identification (lawyers etc)
- Enlargement personal scope
- First hints for RBA

1. Member States **shall ensure** that the institutions and persons subject to this Directive **require identification of their customers** by means of **supporting evidence** when entering into business relations, particularly, in the case of the institutions, when opening an account or savings accounts, or when offering safe custody facilities.

7. In the **event of doubt** as to whether the customers referred to in the above paragraphs are **acting on their own behalf**, or where it is certain that they are **not acting on their own behalf**, the institutions and persons subject to this Directive shall take **reasonable measures** to obtain information as to the real identity of the persons on whose behalf those customers are acting.

11. Member States shall, in any case, ensure that the institutions and persons subject to this Directive take specific and adequate measures necessary to compensate for **the greater risk of money laundering** which arises when establishing business relations or entering into a transaction with a customer who has **not been physically present for identification purposes ('non-face to face operations')**. Such measures shall ensure that the customer's identity is established, for example, by requiring additional documentary evidence, or supplementary measures to verify or certify the documents supplied, or confirmatory certification by an institution subject to this Directive, or by requiring that the first payment of the operations is carried out through an account opened in the customer's name with a credit institution subject to this Directive. The internal control procedures laid down in Article 11(1) shall take specific account of these measures.



Third AML Directive 2005/60/EC, 26 October 2005

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Plus
Art 11 simplified CDD
Art 13 ff enhanced
CDD

Identification

Art 8, paragr. 1. Customer due diligence measures shall comprise:

(a) **identifying the customer** and **verifying the customer's identity** on the basis of documents, data or information obtained from a reliable and independent source

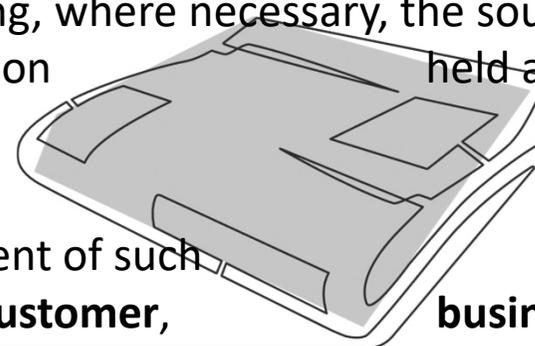
Additional CDD measures

(c) obtaining information on the purpose and intended nature of the business relationship

(d) conducting **ongoing monitoring of the business relationship** including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's or person's knowledge of the customer, the business and risk profile, including, where necessary, the source of funds and ensuring that the documents, data or information held are kept up-to-date.

2. The institutions and persons covered by this Directive shall apply each of the customer due diligence measures set out in paragraph 1, but may determine the extent of such measures on a **risk-sensitive basis** depending on the **type of customer, product or transaction, business relationship,** The institutions and persons covered by this Directive shall be able to demonstrate to the competent authorities mentioned in Article 37, including self-regulatory bodies, that the extent of the measures is **appropriate in view of the risks** of money laundering and terrorist financing.

What's new
"Complexity explosion I"
• Introduction of RBA
• Concept of UBO
• KYC develops to CDD



Third AML Directive, Part 2

Establishment of the ultimate beneficial owner

Definition of UBO

Art 3 paragr. 6: beneficial owner' means the **natural person(s)** who **ultimately owns or controls** the customer **and/or** the **natural person** on **whose behalf a transaction or activity** is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who **ultimately owns or controls a legal entity** through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of **25 % plus one share** shall be deemed sufficient to meet this criterion;

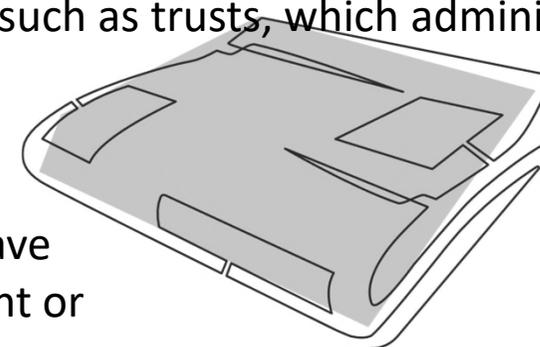
(ii) the natural person(s) who **otherwise exercises control** over the management of a legal entity:

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or

(ii) where the individuals that benefit from the legal arrangement or entity have been determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;

(iii) the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity; (...)



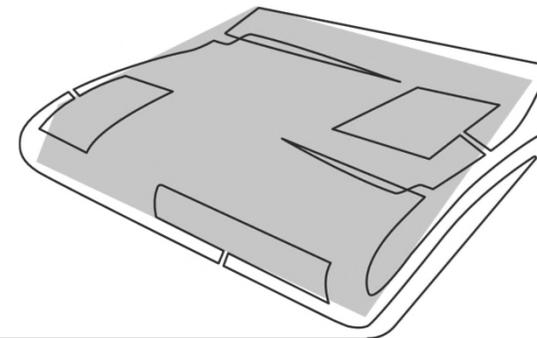
person(s) who
entity;
yet to be
entity is set up

Third AML Directive, Part 3

Establishment of the ultimate beneficial owner

CDD measures

Art 8 b) **identifying**, where applicable, **the beneficial owner** and **taking risk-based and adequate measures to verify his identity** so that the institution or person covered by this Directive is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, **taking risk-based and adequate measures to understand** the ownership and control structure of the customer;



Fourth AML Directive 2015/849/EC, 20 May 2015

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Plus
Art 15, 16 simplified CDD
Art 18-24 enhanced CDD

Identification

Art 13

paragr. 1 Customer due diligence measures shall comprise:

(a) **identifying the customer** and **verifying** the customer's identity on the **basis of documents, data or information** obtained from a **reliable and independent source**

Additional CDD measures

(c) assessing and, as appropriate, obtaining information on the **purpose and intended nature** of the **business relationship**

(d) conducting **ongoing monitoring of the business relationship** including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the obliged entity's knowledge of the customer, the business and risk profile, including where necessary the source of funds

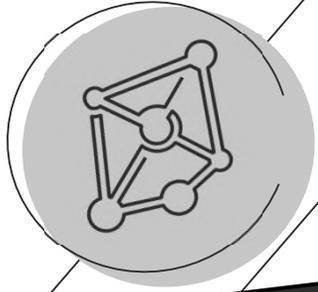
the documents, data or information held are kept

When performing the measures referred to in of the first subparagraph, obliged entities shall also person purporting to act on behalf of the customer is so identify and verify the identity of that person.

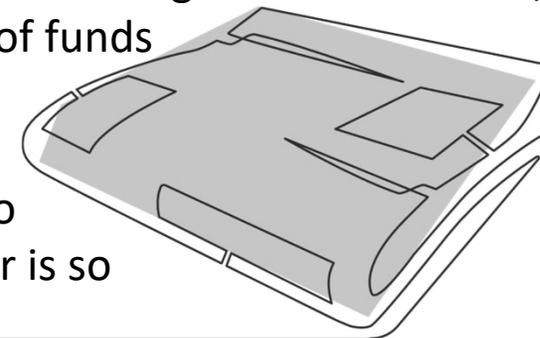
and ensuring that up-to-date.

points (a) and (b) verify that any authorised and

2. Member States shall ensure that obliged entities apply each of the customer due diligence requirements laid down in paragraph 1. However, obliged entities may determine the **extent of such measures** on a **risk-sensitive basis**.



What's new
"Complexity explosion 2"
• Specific rules on trusts
• Implementation UBO registers



Fourth AML Directive, Part 2

Establishment of the ultimate beneficial owner

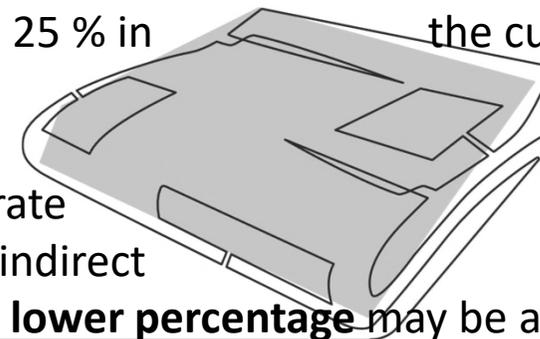
Definition of UBO

Art 3 paragr. 6: 'beneficial owner' means any **natural person(s)** who **ultimately owns** or **controls** the **customer** and/or the natural person(s) on whose behalf a transaction or activity is being conducted and includes at least:

(a) in the case of **corporate entities**:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in that entity, including through bearer shareholdings, or through control via other means, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Union law or subject to equivalent international standards which ensure adequate transparency of ownership information

A shareholding of **25 % plus one share** or an ownership interest of more than 25 % in a natural person shall be an indication of direct ownership. A shareholding of one share or an ownership interest of more than 25 % in the customer held by a natural person, or by multiple corporate entities, which is under the control of a natural person(s), or by multiple corporate entities which are under the control of the same natural person(s), shall be an indication of indirect



the customer held by a natural person, or by multiple corporate entities, which are under the control of the same natural person(s), shall be an indication of indirect ownership.

This applies without prejudice to the right of **Member States** to **decide** that a **lower percentage** may be an indication of ownership or control. Control through other means may be determined, inter alia, in accordance with the criteria in Article 22(1) to (5) of Directive 2013/34/EU of the European Parliament and of the Council;

Fourth AML Directive, Part 3

Establishment of the ultimate beneficial owner

Definition of UBO

Art 3 paragr. 6 ff:

(ii) if, after having exhausted all possible means and provided there are no grounds for suspicion, no person under point (i) is identified, or if there is any doubt that the person(s) identified are the beneficial owner(s), the natural person(s) who hold the position of senior managing official(s), the obliged entities shall keep records of the actions taken in order to identify the beneficial ownership under point (i) and this point;

(b) in the **case of trusts**

(i) the settlor;

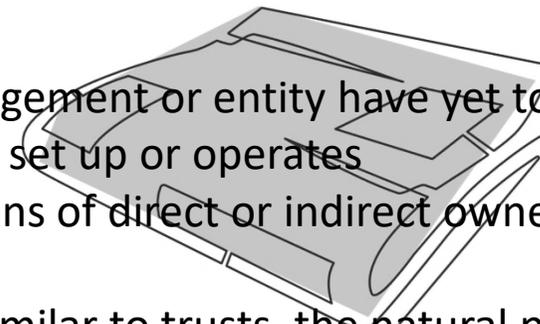
(ii) the trustee(s);

(iii) the protector, if any;

(iv) the beneficiaries, or where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates

(v) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means;

(c) in the case of legal entities such as foundations, and legal arrangements similar to trusts, the natural person(s) holding equivalent or similar positions to those referred to in point (b)



Fourth AML Directive, Part 4

Establishment of the ultimate beneficial owner

CDD on UOB - Art 13 paragr. 1

(b) **identifying the beneficial owner** and taking **reasonable measures to verify** that person's identity so that the obliged entity is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts, companies, foundations and similar legal arrangements, taking reasonable measures to understand the ownership and control structure of the customer;

Paragr. 2

Member States shall ensure that obliged entities apply each of the customer due diligence requirements laid down in paragraph 1. However, obliged entities may determine the **extent** of such measures on **a risk-sensitive basis**

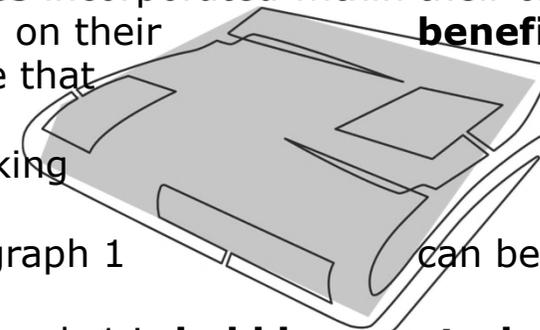
Art 30, 31: Implementation of UBO registers

Art 30

paragr. 1 Member States shall ensure that **corporate and other legal entities** incorporated within their territory are **required to obtain and hold adequate, accurate and current information** on their **beneficial ownership**, including the details of the beneficial interests held. Member States shall ensure that those entities are required to **provide**, in addition to information about their legal owner, **information** on the beneficial owner to **obliged entities** when the obliged entities are taking customer due diligence measures in accordance with Chapter II.

paragr. 2 Member States shall require that the information referred to in paragraph 1 can be accessed in a timely manner by competent authorities and FIUs.

paragr. 3 Member States shall ensure that the information referred to in paragraph 1 is **held in a central register** in each Member State, for example a commercial register, companies register as referred to in Article 3 of Directive 2009/101/EC of the European Parliament and of the Council, or a public register. Member States shall notify to the Commission the characteristics of those national mechanisms. The information on beneficial ownership contained in that database may be collected in accordance with national systems



Fourth AML Directive, Part 5

Art 30, 31: Implementation of UBO registers

Art 30 paragr 4

Member States shall require that the information held in the central register referred to in paragraph 3 is adequate, accurate and current.

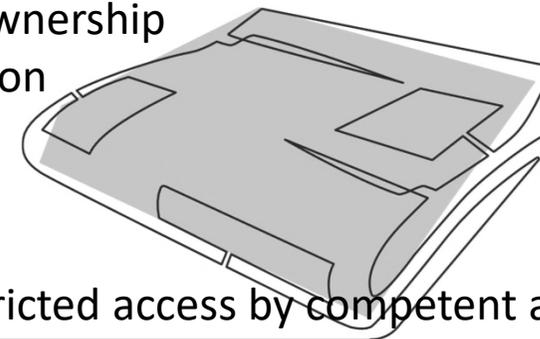
paragr. 5

Member States shall ensure that the information on the beneficial ownership is accessible in all cases to

- (a) competent authorities and FIUs, without any restriction;
- (b) obliged entities, within the framework of customer due diligence in accordance with Chapter II;
- (c) any person or organisation that can demonstrate a legitimate interest

The persons or organisations referred to in point (c) shall access at least the name, the month and year of birth, the nationality and the country of residence of the beneficial owner as well as the nature and extent of the beneficial interest held.

For the purposes of this paragraph, access to the information on beneficial ownership in accordance with data protection rules and may be subject to online registration payment of a fee. The fees charged for obtaining the information shall not exceed the administrative costs thereof



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paragr 6

The central register referred to in paragraph 3 shall ensure timely and unrestricted access by competent authorities and FIUs, without alerting the entity concerned. It shall also allow timely access by obliged entities when taking customer due diligence measures.

paragr. 7

Member States shall ensure that competent authorities and FIUs are able to provide the information referred to in paragraphs 1 and 3 to the competent authorities and to the FIUs of other Member States in a timely manner.

Fourth AML Directive, Part 6

Art 30, 31: Implementation of UBO registers

Art 30 paragr. 8

Member States shall require that obliged entities do not rely exclusively on the central register referred to in paragraph 3 to fulfil their customer due diligence requirements in accordance with Chapter II. Those requirements shall be fulfilled by using a risk-based approach

paragr. 9

Member States may provide for an exemption to the access referred to in points (b) and (c) of paragraph 5 to all or part of the information on the beneficial ownership on a case-by-case basis in exceptional circumstances, where such access would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence or intimidation, or where the beneficial owner is a minor or otherwise incapable. Exemptions granted pursuant to this paragraph shall not apply to the credit institutions and financial institutions, and to obliged entities referred to in point (3)(b) of Article 2(1) that are public officials.

paragr. 10

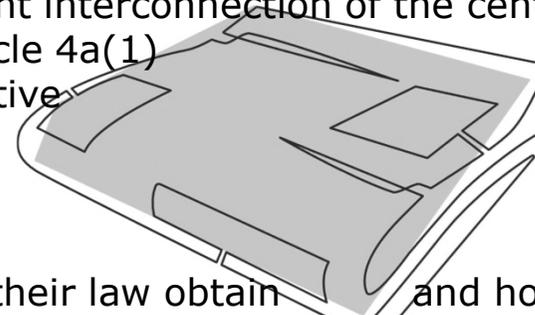
By 26 June 2019, the Commission shall submit a report to the European Parliament and to the Council assessing the conditions and the technical specifications and procedures for ensuring the safe and efficient interconnection of the central registers referred to in paragraph 3 via the European central platform established by Article 4a(1) of Directive 2009/101/EC. Where appropriate, that report shall be accompanied by a legislative proposal.

Art 31

paragr. 1

Member States shall require that trustees of any express trust governed under their law obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust. That information shall include the identity of:

- (a) the settlor;
- (b) the trustee(s);
- (c) the protector (if any);



Fourth AML Directive, Part 7

Art 30, 31: Implementation of UBO registers

Art 31 ff

paragr. 1 ff.

- (d) the beneficiaries or class of beneficiaries; and
- (e) any other natural person exercising effective control over the trust.

paragr. 2

Member States shall ensure that trustees disclose their status and provide the information referred to in paragraph 1 to obliged entities in a timely manner where, as a trustee, the trustee forms a business relationship or carries out an occasional transaction above the thresholds set out in points (b), (c) and (d) of Article 11.

paragr. 3

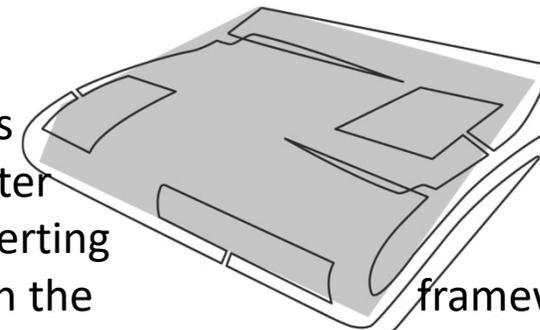
Member States shall require that the information referred to in paragraph 1 can be accessed in a timely manner by competent authorities and FIUs

paragr. 4

Member States shall require that the information referred to in paragraph 1 is held in a central register when the trust generates tax consequences. The central register shall ensure timely and unrestricted access by competent authorities and FIUs, without alerting the parties to the trust concerned. It may also allow timely access by obliged entities, within the framework of customer due diligence in accordance with Chapter II. Member States shall notify to the Commission the characteristics of those national mechanisms.

paragr. 5

Member States shall require that the information held in the central register referred to in paragraph 4 is adequate, accurate and up-to-date.



held in a
shall ensure
the parties to
framework of customer

Fourth AML Directive, Part 8

Art 30, 31: Implementation of UBO registers

Art 31 ff

paragr. 6

Member States shall ensure that obliged entities do not rely exclusively on the central register referred to in paragraph 4 to fulfil their customer due diligence requirements as laid down in Chapter II. Those requirements shall be fulfilled by using a risk-based approach.

paragr. 7

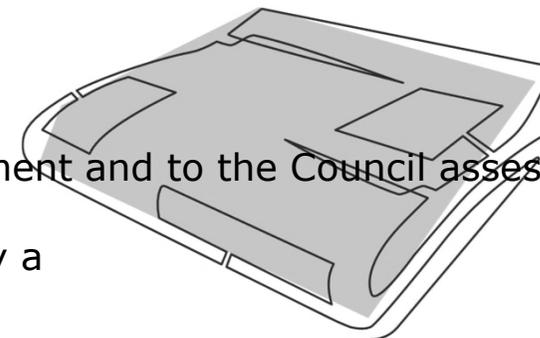
Member States shall ensure that competent authorities and FIUs are able to provide the information referred to in paragraphs 1 and 4 to the competent authorities and to the FIUs of other Member States in a timely manner.

paragr. 8

Member States shall ensure that the measures provided for in this Article apply to other types of legal arrangements having a structure or functions similar to trusts.

paragr. 9

By 26 June 2019, the Commission shall submit a report to the European Parliament and to the Council assessing the conditions and the technical specifications and procedures for ensuring safe and efficient of the central registers. Where appropriate, that report shall be accompanied by a proposal.



interconnection
legislative

Fifth AML Directive 2018/849, 30 May 2018

Plus

Art 15, 16 simplified CDD
Art 18-24 (new: Art 18a,
20a) enhanced CDD

Identification

Art 13 paragr. 1

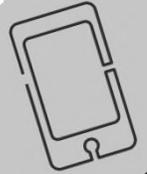
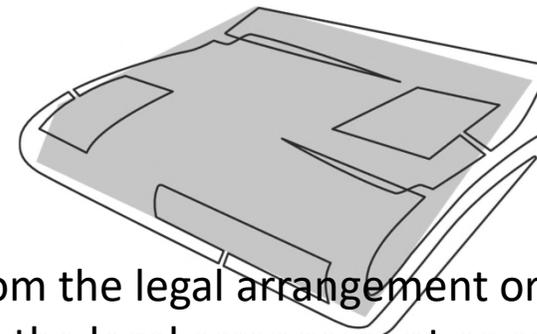
(a) identifying the customer and verifying the customer's identity on the basis of documents, data or information obtained from a reliable and independent source, including, where available, **electronic identification means**, relevant trust services as set out in **Regulation (EU) No 910/2014** of the European Parliament and of the Council or **any other secure, remote or electronic identification process regulated, recognised, approved or accepted by the relevant national authorities**

Identification of UBO

Art 3 paragr. 6

(b) in the case of trusts, all following persons:

- (i) the settlor(s);
- (ii) the trustee(s);
- (iii) the protector(s), if any;
- (iv) the beneficiaries or where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
- (v) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means;

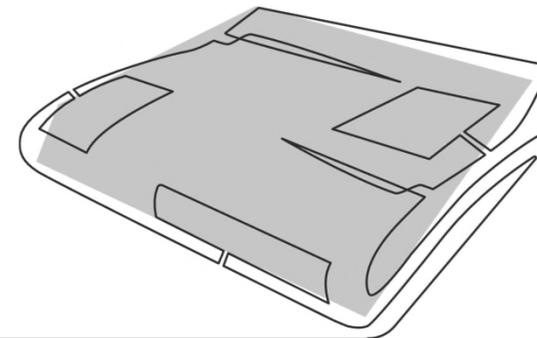


What's new

- Stricter rules on high risk countries
- Recognition of electronic identification

Fifth AML Directive, Part 2

In addition far-reaching amendments of Art 30, 31 on the UBO register and supplementing implementing acts



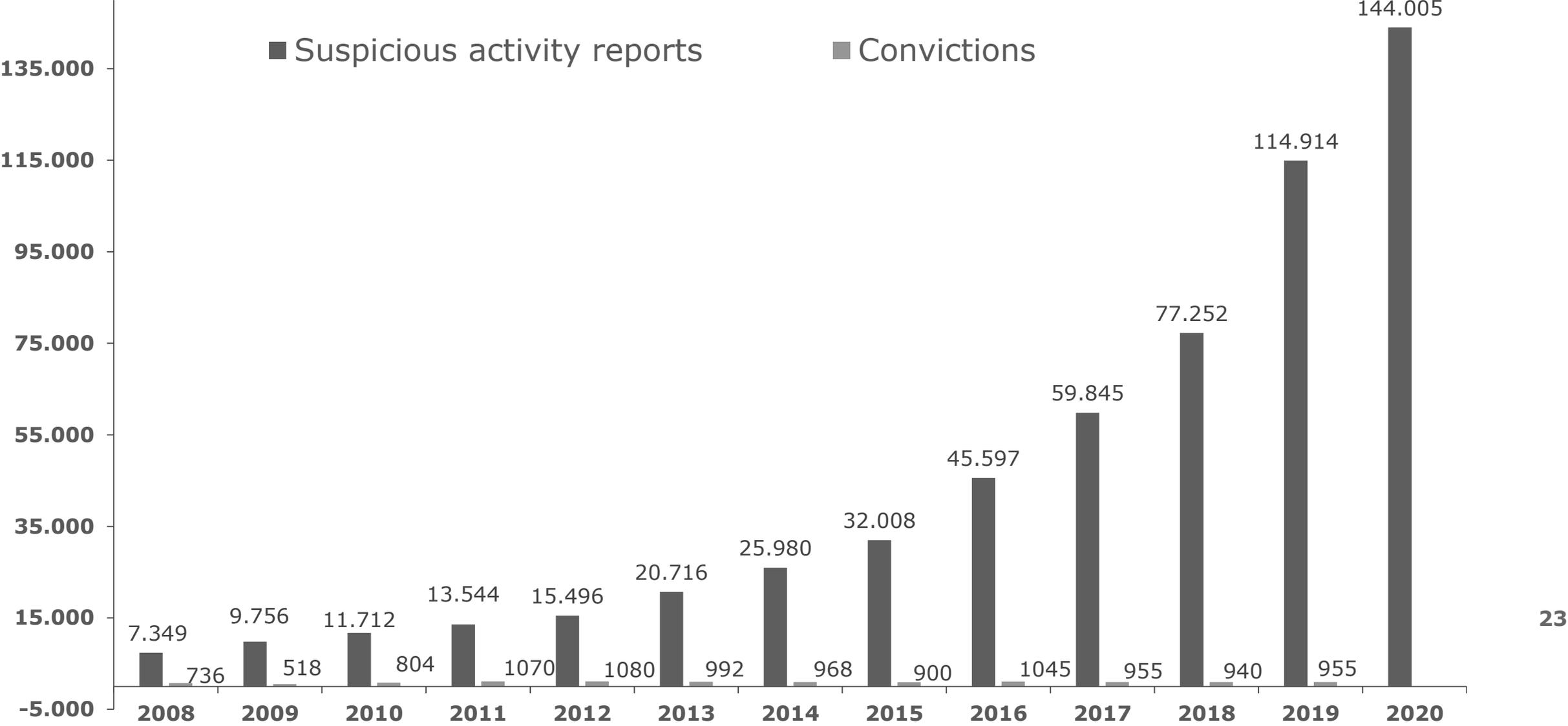
Results



Statistics

- Worldwide estimated amount of money being laundered per year: Between **715 Bill. and 1,87 Trill. €** (2-5% of global GDP)
United Nations Office on Drugs and Crime, Source: Europol-Website, Crime Areas & Trends
- Estimation in and for Germany: **> 100 bill. €**
Bussmann, Geldwäscheprävention im Markt, 2018, p. 6
- The total projected cost of financial crime compliance across key global markets is estimated at **180.9 bill. \$**, of which **136.5 bill. \$** in Europe
LexisNexis Risk Solutions – The True Cost of Anti-Money Laundering Compliance, Global Report, March 2020. According to the report, compliance costs in Europe are highest in **the UK (\$49.5 billion)**, followed by **Germany (\$47.5 billion)**, **France (\$21.0 billion)**, **Italy (\$15.8 billion)** and the **Netherlands (\$2.7 billion)**.

SARs and Convictions of Money Laundering, Section 261 Penal Code (StGB) in Germany



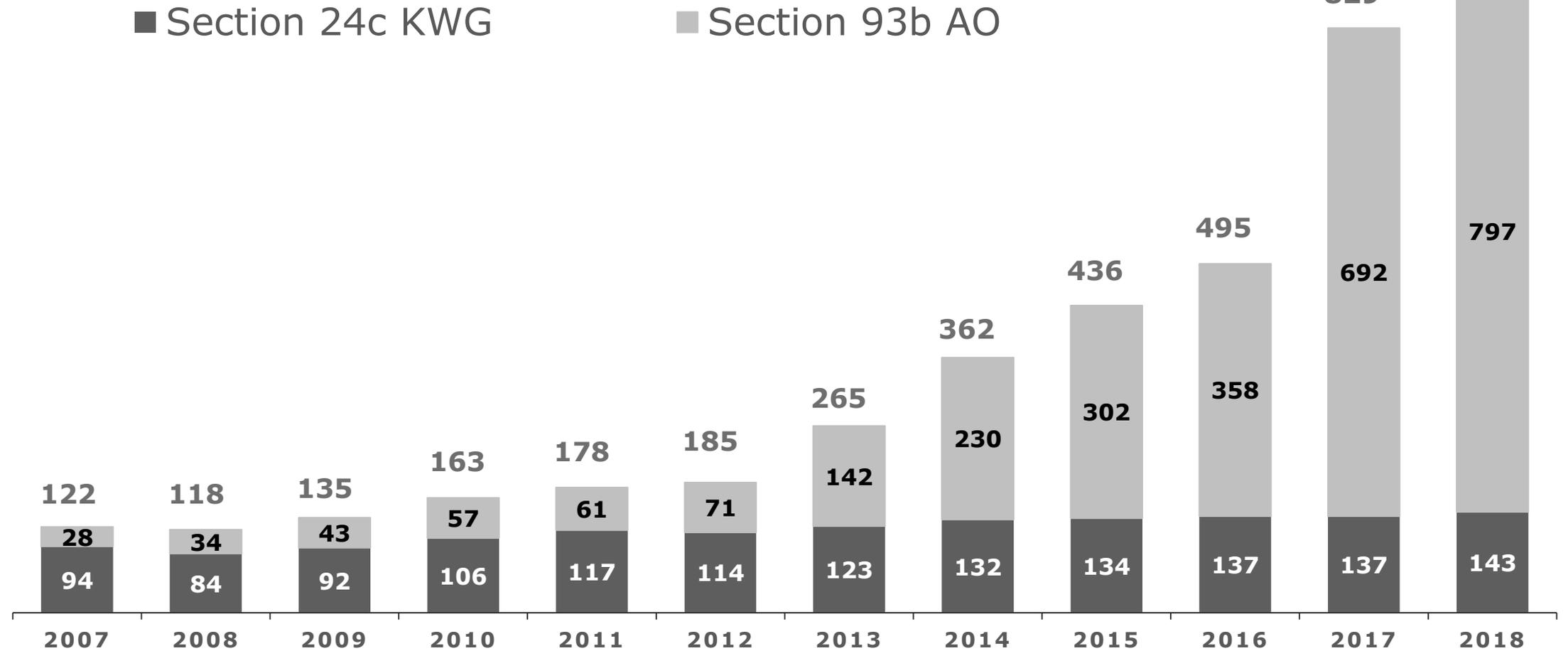
Source: FIU Annual Reports, Federal Statistical Office, Administration of Justice - Criminal Prosecution

Some more Statistics



- The **total number of SARs** filed to authorities in the EU on an annual basis **has grown** from 590 762 in 2009, to 960 463 in 2014, or by **61,5%**.
Europol, From Suspicion to Action - Converting financial intelligence into greater operational impact, 2017, p. 9
- During the same period, only **1,1 %** of criminally obtained assets were confiscated.
Ibid, p. 30
- Just over **10% of the SARs** are estimated as **useful to EU law enforcement** and are further investigated after collection, a figure that is unchanged since 2006.
Ibid, p. 5

Automated Account Data Retrieval System Germany: Numbers of Retrievals (in thousands)



Feedback

„The bigger the bank, the more SARs and the more scrap“
Senior Public Prosecutor, Der Spiegel, 28 August 2021

Actual prosecution and punishment of money laundering offenders - who by definition must number in the hundreds of thousands - takes place only on a relatively small scale (...). The concept has proven ineffective (...). The proceedings often concern so-called "financial agents", i.e. petty criminals far below the relevant structures. The number of convictions is low, and the number of profits skimmed off is even lower. A reduction in so-called organised crime has of course not occurred. The relation of the total costs of the concept to the consequences is catastrophic. By rational standards, the concept must therefore be considered a failure (...).

Prof. Thomas Fischer, Strafgesetzbuch (Commentary Penal Code), 68 Edition 2021, Section 261 Rdnr. 4c

"This has something of class justice. We still hunt rather the egg thieves and not the big, international money launderers"

Prof. Kai Bussmann, Halle University, Der Spiegel, 28 August 2021

Many SARs do not in any case lead to many convictions for money laundering. I cannot give you any concrete figures on the reports. But there are a lot of reports and we have difficulties processing them. We are at the absolute limit with our capacities.

Public Prosecutor J. Berthold, Public Hearing of Deutscher Bundestag Finance Committee, 60th meeting of 6 November 2019 on the Draft law implementing the 5th EU AML Directive

Conclusions as to the current AML/CFT regime

- Although ML/TF is said to be „international by nature“ **problems in international judicial cooperation remain**
- As a result from the above pressure is imposed on the financial sector to **handle high risk countries with specific care**; this has started to pose **problems for international financial inclusion**
- **More international harmonisation is crucial**. Acknowledgement of financial sector standards can be helpful (e. g. Wolfsberg Group Correspondent Banking Due Diligence Questionnaire)
- On EU level: Trend to **more harmonisation** especially of CDD on EU level and establishment **of government operated registers** for (1) data on **beneficial owners**, (2) **bank account data** and (3) real **estate information positive**
- Due to **constantly tightened sanctions**, pressure on obliged entities to **file even more SARs** remains high
- **„Data-Hoover“-Approach** of some authorities **critical**: For successful AI research either too small data basis or - on the contrary - sliding into the role of a „data octopus“; AI implementation must start at obliged entities
- Information exchange on modi operandi (→ typology papers) has improved with implementation of **Public Private Partnerships** (e. g. UK: Joint Money Laundering Intelligence Taskforce, Germany: Anti Financial Crime Alliance), but important steps still need to be taken (→ next slide)
- **Evaluation of the SAR-System impossible** due to lack of data about the causality for convictions and seizures
- **Not enough systematic criminological research** as a basis for further developments of the system as a whole.

Proposals for a AML/CFT 4.0 concept

- **KYC/CDD** regime urgently needs **harmonisation, simplification and technological progress**.
- Government **registers** must become a „**golden source**“ for the respective information.
- Key factors for a **major improvement of the Monitoring and SAR-System**:
 - The **SAR reporting threshold** should be **recalibrated** to minimise defensive reporting
 - **Information exchange** among banks and with authorities
 - in the **forefield of a suspicion**
 - on **operational data**
 - to investigate **serious forms of organized crime/terrorism**
 - based on a **solid legal basis** that is in line with data protection legislation
 - Clear **legal basis for cooperation between banks** in certain areas (KYC and/or transaction monitoring utilities)
 - Exchange with supervisory authorities on **standards for the implementation of AI tools** (→ sandbox approach of regulation to implement eID eco system [section 13 AML-Act – *Geldwäschegesetz*] could perhaps serve as a role model)

EU-COM Legislative Package of 20 July 2021

Positions

To be welcomed:

- **Single-rule-book approach**: Important progress for uniform KYC rules in the internal market.
- After initial examination, standardisation of the relevant information on clients and CBs **largely practical**
- Establishment of AMLA basically positive; Frankfurt/Main location suitable

Room for improvement:

- Rules on **exchange of information among obliged entities and with authorities not sufficient**
- Role of **transparency registers** (yet) **not fully exploited**
- **Limitation of cash transactions** of €10,000 or more politically sensitive
- Approach of the **crypto assets regulation** **technologically difficult**

To be noted:

- **No double responsibilities** and **no double payment** obligations (to **AMLA** and to **BaFin**) for obliged parties.



"Combining the efficiency and accuracy of digital solutions with the knowledge and analytical skills of human experts produces more robust systems that can effectively respond to AML/CFT requirements whilst being fully auditable and accountable."

FATF, Opportunities and Challenges of new Technologies for AML/CFT, July 2021, p. 5

Thank you!