Revisiting AML / CTF

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Aim for Today

Understand causes of the AML system malfunctioning

Discuss & develop concrete steps on how to improve it

Issues with AML Initiatives

- **Large** issue, as 1-2% of GDP might be illegal economic activities (Globally ≈ USD 1 trillion (of 80)). ML issue might be larger.

- Incredibly **expensive** for society

- **Cumbersome** for banks, their staff, customers, and intermediaries

- Very **ineffectual**
  - We might just find 1% of ML payments, if at all
  - Strong bias to detect the small, and unsophisticated 'criminals'

- Very **profitable** for consultants, TR(Refinitiv), etc.

- Inefficient **steady state**?

A Reminder

Sources of funds, classified as ML

1. Proceeds of (Serious) Criminal Activity

   ➢ Drugs. Human Slavery. Child Sexual Exploitation. Racketeering. Fraud. Cyber & Organised Crime

   ➢ Real impact on society, and asset prices (property & businesses)

   ➢ **Organised crime and jihadi groups** increasingly intertwined (examples from Sweden and Denmark)

2. Embezzlement of State Funds, Tax Evasion, and Serious Corruption

3. Avoidance of Currency Controls (China)

4. [Terror Finance]

The Legal & Institutional Framework
In need of restructuring

1. **FATF** (Born out of G7 in 1989): 40 rules

    Rules written by lawyers for lawyers; very difficult to operationalise

    Unclear how effective. In urgent need of a 'complement'

2. Financial Investigation Units (**FIUs**)

    Very under-resourced, as political priorities are with 'classical policing'

    High staff turnover, as Banks poach aggressively

    Staffed by police men / women, with good investigative skills

    Very short time window for investigation / decision on STRs

3. Banking **Regulators**

    Historically limited use of powers and resources (see EBA, and others)

    Branches vs Subsidiaries (remember AIG Banque – USD 180 billion bailout)

The Legal & Institutional Framework
In need of restructuring

4. **The Executive**

> Knee-jerk reactions: e.g. Prison sentences for Board Members
>
> A global problem in search of a national 'solution'. Delegate up to EU level?
>
> No holistic approach to the issue at hand

5. **FinTech**

> The 'forgotten' bad boy in the room?

On Data

The application to AML

Data Infrastructure

The Current Issues

- The data revolution has not yet arrived in the AML world

- Far too much work is done **manually**, which is expensive and cumbersome, and leads to inconsistent outcomes

- Detection algorithms focus on **within account consistency**, not across (very easy to circumvent)

- Algorithms lack an **outcome variable** (prosecution/conviction), and hence are trained to detect a small number of known cases -> key role for universities

- Substantial body of literature on SOC, but typically ethnographic, **documentary**, or biographic in nature, often picked up by the Media, and Hollywood.

- This leads to a popular conception that is based on **anecdotes** rather than empirical work (which might feed back to policy making)

Data Infrastructure

The Current Issues II

SARs / STRs

- Banks overreport, while possibly protecting their best clients
- Almost all SARs are not followed-up
- Decision time an issue
- The SARs data infrastructure is in urgent need of an overhaul - globally

KYCs central to the functioning of banks (counterparty risk)

- Understand your customer. Important for AML, but even more so for the running of the bank
- Standard Chartered – Dubai

No standardised data interchange across borders, institutions, and banks

In Summary

We fail in our objective

Our institutional structure is not delivering

Data and processes are inadequate on bank/fintech and supervisory level

What Next?

General Issue I

In need of public debate

AML will never be risk-free!

(As is any business. Lawyers vs. Economists)

We need to define - in a political process - the **accepted level of risk** society is prepared to take?

General Issue II
'The Nordics'

The Nordics have a beautiful culture of **trust** (to be protected)!

The Nordics are unprepared to deal with aspects of **globalisation**

The Nordics are very **small** – population wise

The Nordics are facing a **big threat** (jihadi)

Way Forward

**Work together,
pool resources, and data**!

*across banks

*across countries

*across institutions[1]

[1] (FIU, Supervisor, Police, Intelligence services, …)

Way Forward

Standardise, Integrate, Automate

Way Forward

Standardise, Integrate, Automate

A Digitalisation Story, which will need to start with **Processes**, not **Products**

On Institutions

Selected Reform Proposals

On Institutions

The General

We will need to rethink our decentralisation paradigm

On Institutions

Proposal I

- **Combine FIUs and supervisory bodies**, here the Danish FSA, under 'one roof'
  - The **FSA pays for all activities**, including the FIU investigators who will work alongside and in close collaboration with the FSA staff
  - The financial supervisor understands banks much better than a FIU ever can, has access to their data, should have the empirical skills, and is much better resourced than the Police Service
  - Sovereign functions still with Police/FIU, but located within the supervisor's organisation
- Centralise on EU level into a new Supra-national body (French-Dutch Proposal)

On Institutions

Proposal II: Standardise, Integrate, Automate across Nordics

- Standardise
  - STR/SARs data collection across Nordics / Europe

- Integrate
  - SARs data across Nordics / Europe (as part of the normal police information exchange)
  - Organised Crime Group data across Nordics (if not yet done), and integrate with FIU system/data
  - Current integration level of Intelligence data?
  - Share (SARs) data for research purposes
  - Sanctions list

- Automate
  - Better algorithms, in part by:
    - Counterparty check with OCGM (ideally offer as an API service to Banks [+/-]).
    - Plausibility check via OpenCorporates / Experian / …
    - Pattern detection across countries, banks, etc.
    - Empirical knowledge is in universities

On Institutions

Reorganised FSAs along clear lines of responsibilities, and without conflict of interest

- *Regulatory, Policy, and Algorithms* (pre-legislative work)

- *Inspection* (inspections into bank's compliance with regulation)

- *Investigations* (investigations under strengthened legal guarantees and legal controls, handed over from the Inspections Unit)

- *Enforcement*

On Data

The application to AML

On Data
The General

Society will win the AML race on its ability to:

- **collate**, and **analyse** data very **fast and cheap**
- **execute** resulting actions **fast and cheap**

(but here we will need a human at the end of process)

=> Standardise, Integrate, Automate

On Banks

Proposal II: Standardise, Integrate, Automate across Nordics

- Standardise
  - KYC data requirements (ideally just do it once)
  - Transaction data (Value in that data, but London data pool not successful)
  - Geographic information on the same level as open data (very promising!)

- Integrate
  - KYC initiative for Nordics (currently only for commercial clients)
  - Transaction data pool, and networks (there is value in it, if done well)
  - Counter party information (with common rule book across Nordics)
    - Organised Crime Group data across Nordics (if not yet done), and integrate with FIU system/data
    - Pooling of SARs, and Geographic SARs information
    - Counterparty check with OCGM (ideally offer as an API service to Banks [1/0]).
    - Plausibility check via OpenCorporates / Experian / …
    - Sanctions list

- Automate
  - Better algorithms, in part by tailoring algorithms to use cases (1-4)
  - Allowing universities to contribute, and give access to outcome variables
  - See above counter-party info requirements

On Detection

An Example

We devised a new, devilishly simple, and effective way of detecting 'problematic' accounts.

https://point.exposed

PoINT.

Search... | Search

Point.Exposed is a new and innovative open source platform that allows compliance officers and other interested parties to reliably check counter parties. It introduces many new tools that should dramatically improve the detection of problematic payment counterparties, and so make the process more reliable and complete. The system can be accessed via an intuitive web search interface, and soon via an API that will then allow organisations to systematically check against all transactions. In this system we add many new functions that are currently not available on the market in this form.

1. Sanction List – complete and updated weekly
2. Sanction Maps – a new way of depicting the sanctions list
3. Politically Exposed Persons (PEPs)
4. Panama Papers - both individuals and companies
5. Counterparty verification – pioneering process that lets you check whether a company is operating, and transactions are in line with its balance sheet
6. A number of new cutting-edge algorithms that help detect suspicious counterparties

In short, Point.Exposed is trying to make the entire compliance verification process better, faster, and cheaper

For more information, please get in touch info@point.exposed

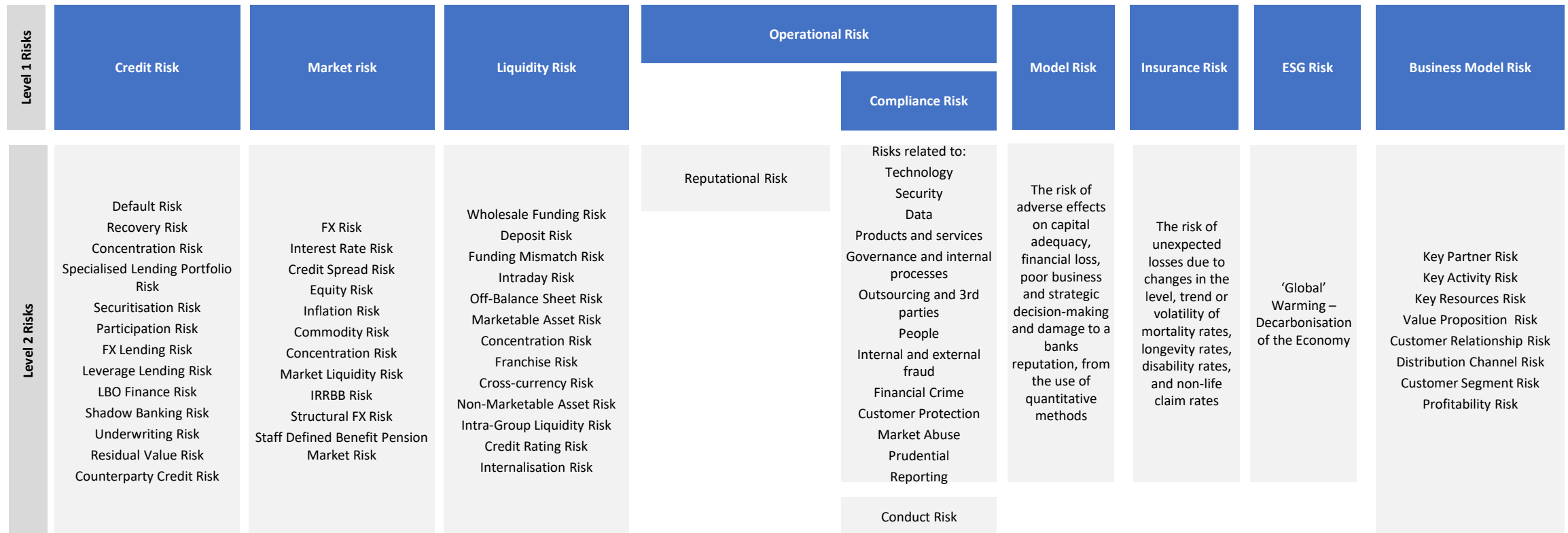**Persons of Interest & Designated Nationals Tracker**

On Risk and Compliance

AML is just one piece of the puzzle

Compliance is a Function of Risk
(and risk is multi-dimensional)

Dimensions of Risk

By Britta Hjorth-Larsen, Nordea – as part of the *CBS Risk Management and Compliance* Minor

Level 1 Risks	Credit Risk	Market risk	Liquidity Risk	Operational Risk		Model Risk	Insurance Risk	ESG Risk	Business Model Risk
				Reputational Risk	Compliance Risk				
Level 2 Risks	Default Risk Recovery Risk Concentration Risk Specialised Lending Portfolio Risk Securitisation Risk Participation Risk FX Lending Risk Leverage Lending Risk LBO Finance Risk Shadow Banking Risk Underwriting Risk Residual Value Risk Counterparty Credit Risk	FX Risk Interest Rate Risk Credit Spread Risk Equity Risk Inflation Risk Commodity Risk Concentration Risk Market Liquidity Risk IRRBB Risk Structural FX Risk Staff Defined Benefit Pension Market Risk	Wholesale Funding Risk Deposit Risk Funding Mismatch Risk Intraday Risk Off-Balance Sheet Risk Marketable Asset Risk Concentration Risk Franchise Risk Cross-currency Risk Non-Marketable Asset Risk Intra-Group Liquidity Risk Credit Rating Risk Internalisation Risk		Risks related to: Technology Security Data Products and services Governance and internal processes Outsourcing and 3rd parties People Internal and external fraud Financial Crime Customer Protection Market Abuse Prudential Reporting Conduct Risk	The risk of adverse effects on capital adequacy, financial loss, poor business and strategic decision-making and damage to a banks reputation, from the use of quantitative methods	The risk of unexpected losses due to changes in the level, trend or volatility of mortality rates, longevity rates, disability rates, and non-life claim rates	'Global' Warming – Decarbonisation of the Economy	Key Partner Risk Key Activity Risk Key Resources Risk Value Proposition Risk Customer Relationship Risk Distribution Channel Risk Customer Segment Risk Profitability Risk

Compliance efforts need to be proportional to risk

Regulator is interested in process, not 'box-ticking'

If you want to learn more about it

We are running a course on it

GRC - GOVERNANCE, RISK MANAGEMENT AND COMPLIANCE

- **Risk Management and Compliance** (May 2019)

- **Digitalization of Finance** (October 2019)

- **Governance, Sustainability and Ethics** (January/February 2020 and you can still enroll)

- The program will be repeated again in Spring 2020. You can read more about it: https://www.cbs.dk/en/research/departments-and-centres/department-of-accounting/center-corporate-governance/grc-governance-risk-management-and-compliance/education

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