EBA/Op/2020/18

4 November 2020

Opinion of the European Banking Authority on how to take into account ML/TF risks in the Supervisory Review and Evaluation Process

Introduction and legal basis

1. This opinion sets out in high level terms how the European Banking Authority (EBA) expects prudential supervisors to take into account money laundering and terrorist financing (ML/TF) risks in the Supervisory Review and Evaluation Process (SREP). ML/TF risks that are particularly relevant to prudential supervisors include the risk that an institution is misused for ML/TF purposes by members of its management body or members of its staff, or by other parties, including beneficial owners, or criminals that use weaknesses in the internal governance and controls framework such as information and communication technology (ICT) related weaknesses.

2. Involvement of an institution or its management in money laundering and terrorist financing affects the financial soundness and viability of that institution, and impacts the stability and integrity of the financial system in which the institution operates. This is why Union law requires institutions to put in place effective systems and controls to prevent their use for money laundering or terrorist financing purposes.

3. Combating ML/TF requires certain actions from both AML/CFT and prudential supervisors. This is why Union law requires prudential supervisors and authorities or bodies that supervise institutions in accordance with Directive (EU) 2015/849 and are competent for ensuring compliance with that Directive ('AML/CFT supervisors') to cooperate and exchange information to inform their respective supervisory activities.

4. Directive (EU) 2019/878[1] added a new paragraph (6) into Article 97 of Directive 2013/36/EU on the supervisory review and evaluation with an explicit requirement for prudential supervisors to immediately notify the EBA and the AML/CFT supervisor of the institution where a review,

[1] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. OJ L 150, 7.6.2019. Consolidated version: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013L0036-20180709&from=EN

in particular the evaluation of the governance arrangements, the business model, or the activities of an institution gives reasonable grounds to suspect that, in connection with that institution, money laundering or terrorist financing is being or has been committed or attempted, or there is increased risk thereof.

5. In 2018, the Council of the European Union adopted an Anti-Money Laundering Action Plan.[2] This Action Plan sets out a number of objectives, with deliverables and timelines through which the Council intended to strengthen the effectiveness of the EU's AML/CFT framework. As part of this, the Council requested that the EBA set out how prudential supervisors should factor AML/CFT-related aspects into the prudential supervisory process, including in the context of the SREP.

6. As a first step, the EBA highlighted the importance for prudential supervisors to consider concerns about ML/TF in the prudential context in its Opinion *on communications to supervised entities regarding money laundering and terrorist financing risks in prudential supervision* of 24 July 2019.[3] The EBA also published own-initiative guidelines on supervisory cooperation in the AML/CFT context[4], and facilitated the conclusion of a Multilateral Agreement between the ECB and national AML/CFT supervisors of credit and financial institutions across the EEA to facilitate information exchange in this regard.[5]

7. The EBA will include guidance on how to take into account ML/TF risks into the SREP in the EBA Guidelines on common procedures and methodologies for the SREP and supervisory stress testing (SREP Guidelines)[6] during the upcoming revision of these Guidelines aimed to be completed by end December 2021 as set out in the EBA Roadmap on Pillar 2 Deliverables.[7] In anticipation of the more detailed common guidance as part of the future revision of the SREP Guidelines, this opinion provides advice at a high level on the subject.

8. In view of Article 97 of Directive 2013/36/EU, and in line with the respective role of prudential supervisors, an integrated approach will be taken in the SREP Guidelines to embed the guidance on how to take into account ML/TF risks in the relevant related risks and areas of the existing SREP components rather than creating a separate SREP component for ML/TF risk.

[2] https://www.consilium.europa.eu/media/37283/st15164-en18.pdf

[3] Opinion of the European Banking Authority on communications to supervised entities regarding money laundering and terrorist financing risks in prudential supervision of 24 July 2019 (EBA-Op-2019-08), available at https://eba.europa.eu/sites/default/documents/files/documents/10180/2622242/a8270e12-b0c2-4194-a70f-1f1ece5c71a3/Opinion%20on%20Communication%20of%20ML%20TF%20risks%20to%20supervised%20entities.pdf

[4] https://eba.europa.eu/regulation-and-policy/anti-money-laundering-and-e-money/jc-guidelines-on-cooperation-and-information-exchange-for-aml/cft-supervision-purposes

[5] https://eba.europa.eu/esas-announce-multilateral-agreement-on-the-exchange-of-information-between-the-ecb-and-aml-cft-competent-authorities

[6] https://eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2/guidelines-for-common-procedures-and-methodologies-for-the-supervisory-review-and-evaluation-process-srep-and-supervisorystress-testing

[7] The Pillar 2 Roadmap forms part of the set of roadmaps published in November 2019 for the delivery of the EBA mandates stemming from the revised Capital Requirements Directive (CRD V) and the Capital Requirements Regulation (CRR II): https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package

9. As it is the case with the SREP Guidelines, this opinion is addressed to prudential supervisors. In line with the division of responsibilities between prudential supervisors and AML/CFT supervisors as set out in Union law and international banking supervision standards, including the BCBS guidance on supervisory cooperation,[8] the EBA expects prudential supervisors to develop sufficient understanding of ML/TF risks that enables them to identify in the context of their work ML/TF risks and prudential concerns that are directly relevant to their own work. The EBA expects prudential supervisors to cooperate in a timely manner with AML/CFT supervisors to alert them to ML/TF risks and draw on their expertise as necessary and appropriate. Nothing in this opinion should be understood as an expectation for the prudential supervisors to duplicate the expertise and tasks of AML/CFT supervisors. The EBA stresses the importance of timely information exchanges between prudential and AML/CFT supervisors to support effective and sufficiently robust supervisory outcomes.

10. The competence of the EBA to deliver an opinion is based on Article 29(1)(a) of Regulation (EU) No 1093/2010[9], as part of the EBA's objective to play 'an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union'.

11. In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors[10], the Board of Supervisors has adopted this opinion which is addressed to 'prudential supervisors' that are competent authorities referred to in point (2)(i) of Article 4 of Regulation (EU) No 1093/2010.

12. The steps supervisors should take to factor ML/TF risks into the SREP will be addressed at a later stage, in significantly more detail, in the upcoming revision of the SREP Guidelines. Given the more precise nature of the changes that will be made to the SREP Guidelines, the EBA has decided not to publicly consult on this opinion, nor to carry out a cost-benefit analysis, and to take these steps instead when the SREP Guidelines will be revised. For the same reason no advice from the Banking Stakeholder Group (BSG) was requested.

How to take into account ML/TF risks in SREP

13. With this opinion, the EBA calls on prudential supervisors to take into account ML/TF risks in the SREP.

14. When performing the SREP, prudential supervisors are advised to be mindful of the fact that ML/TF risks are not necessarily linked to an institution's size or financial soundness and that small institutions can nevertheless present significant ML/TF risks.

[8] Guidelines on interaction and cooperation between prudential and AML/CFT supervisors as included in the BCBS' Guidelines on Sound management of risks related to money laundering and financing of terrorism: https://www.bis.org/bcbs/publ/d505.pdf

[9] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

[10] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

15. The EBA expects prudential supervisors to consider ML/TF risks in the SREP in particular in the following components of the SREP, each of which is explained in detail below:

    a. The monitoring of key indicators;

    b. Business model analysis;

    c. Assessment of internal governance and institution-wide controls;

    d. Assessment of risks to capital; and

    e. Assessment of risks to liquidity and funding.

Monitoring of key indicators

16. Some prudential supervisors have developed a set of indicators based on quantitative or qualitative information from prudential reporting that may point to ML/TF risk. The EBA invites prudential supervisors to share the outcome of the monitoring of these indicators with AML/CFT supervisors if deemed relevant as it may inform their ML/TF risk assessment of the institution. An example could be if the amount of non-EEA non-resident deposits compared to total deposits cannot readily be explained by the institution's business model. The EBA considers this a good practice and encourages prudential supervisors to use such indicators where feasible in the prudential supervisory context.

Business model analysis

17. If in the context of the business model analysis, prudential supervisors identify indications that the business model or changes to the business model could give rise to increased ML/TF risk, the EBA expects prudential supervisors to alert AML/CFT supervisors as necessary. Taking into account ML/TF risks in this way is particularly relevant for the business model analysis since a financially successful business model could at the same time give rise to ML/TF risks and concerns. If this is the case, these concerns could impair the viability and sustainability of the business model.

18. Examples of indications that could point to increased ML/TF risk include the type of services offered (in particular where these are associated with higher ML/TF risk, such as private banking) and the regional scope of business activities. Also, prudential supervisors could identify that certain entities have levels of profitability that are significantly higher than its peers' and that cannot be explained by the business model (e.g. RoA, RoE or operating margin). There could be merit in paying particular attention to certain sources of profit that may be a result of banking activities that are misused by criminals for ML/TF activities or the investment of funds that might result from such activities. This could comprise, for example, activities in high risk jurisdictions or where the institution regularly makes use of Special Purpose Vehicles (SPVs), conduits or entities managed on behalf of customers as trustee. In respect of these

activities, prudential supervisors should liaise with relevant AML/CFT supervisors and exchange information where relevant and necessary.

Governance and internal controls

19. The EBA expects prudential supervisors to consider, as part of their assessment of the institution's internal governance framework, whether it encompasses arrangements and mechanisms put in place by the institution to comply with applicable AML/CFT requirements.[11] As part of this, the EBA expects prudential supervisors to assess, in cooperation with AML/CFT supervisors, if the institution has implemented an effective internal control framework, developed and maintained an integrated and institution-wide risk culture and that the risk management covers all the risks the institution faces, including ML/TF risks.

Risks to capital

Operational risk

20. The EBA advises prudential supervisors to pay attention to ML/TF risks that could result in reputational or operational risk (including legal and conduct risks). Under the SREP, prudential supervisors will consider this as part of the risks to capital. In turn, operational risks, arising from IT related issues or inadequate controls, can give rise to increased ML/TF risk exposures. For example structural weaknesses in the ICT environment could lead to the institution being vulnerable to be misused for ML/TF purposes as adequate controls cannot be applied.

Credit risk

21. Prudential supervisors are asked to pay attention to ML/TF risks within the context of the credit granting process of the institution. In particular, prudential supervisors are encouraged to assess that institutions have systems and controls in place to ensure funds used to repay loans are from legitimate sources.[12] Indications for increased attention could be significant loan portfolios for customers that are engaged in activities or sectors associated with higher levels of ML/TF risk, for example gambling businesses.

Risks to liquidity and funding

[11] In this respect the EBA updated the Guidelines on internal governance (EBA/GL/2017/11) issued 26 September 2017 to reflect the changes introduced following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRDV). Further to CRDV Article 91, the revised Guidelines stress that identifying, managing and mitigating ML/TF risks is part of sound internal governance arrangements and risk management framework of an credit institution. The revised Guidelines include explicitly that there should be controls and principles that target ML/TF, whether committed directly or indirectly. In addition any events in that context must be considered within the suitability assessment of members of the management body as provided for in the revised Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders.

[12] As provided for in the EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06) that are expected to be effective as from 30 June 2021. https://eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring

22. The EBA advises prudential supervisors to remain alert to indications that could signal ML/TF risks when assessing the liquidity and funding profile of an institution. Such indications could include deposit taking in high risk jurisdictions,[13] or a funding mix that cannot be explained by the business model or strategy of the institution. When an institution is or is perceived to be exposed to ML/TF, this may have regulatory consequences (investigations, remedial measures and penalties). It may also result in reputational damage, that can negatively affect the bank's operations, for instance in the form of depositor outflows, loss of counterparties, loss of market access or loss of correspondent banking relationships.

Overall SREP assessment, application of measures and supervisory cooperation, including in the cross-border context

23. The EBA expects prudential supervisors to maintain effective channels for cooperation and information exchange with AML/CFT supervisors and other relevant stakeholders. In this respect the EBA calls on prudential supervisors to liaise, where appropriate, with AML/CFT supervisors in order to obtain their input, and to share the outcomes of the prudential assessment where relevant. Where necessary, prudential supervisors are expected to take measures to address prudential shortcomings related to AML/CFT issues within their supervisory remit. The mutual exchange of supervisory assessments and information should enhance the overall supervisory view on the institutions, their viability and risks.

24. In the assessment of the prudential implications of ML/TF related risks and concerns in the SREP for a cross-border institution, the EBA advises prudential supervisors to leverage on the information obtained through bi-lateral engagements with relevant AML/CFT supervisors or through their participation in AML/CFT colleges and prudential colleges.[14]

25. Prudential supervisors are reminded that where a review, in particular the evaluation of the governance arrangements, the business model, or the activities of an institution, gives reasonable grounds to suspect that, in connection with that institution, money laundering or terrorist financing is being or has been committed or attempted, or there is increased risk thereof, the prudential supervisor is required under Article 97(6) of Directive 2013/36/EU to immediately notify the EBA and the relevant AML/CFT supervisor. In the event of potential increased risk of money laundering or terrorist financing, the prudential supervisor and the AML/CFT supervisor are required to liaise and notify their common assessment immediately to the EBA, and the prudential supervisor shall take, as appropriate, measures in accordance with Directive 2013/36/EU.

This opinion will be published on the EBA's website.

[13] For example the EC list of high-risk third countries under Article 9(2) of Directive (EU) 2015/849 (and its updates).

[14] AML/CFT colleges set up in line with the JC Guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions ("AML/CFT Colleges Guidelines").

Prudential colleges, some of which have dedicated AML/CFT substructures, set up in line with Articles 51 and 116 of Directive 2013/36/EU.

Done at Paris, DD Month YYYY

[signed]

[José Manuel Campa]

Chairperson
For the Board of Supervisors