

February 6, 2020

Ms. Carolyn Rogers
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland



Re: Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision

Dear Ms. Rogers:

The Institute of International Finance (“IIF”) is pleased to respond to the Basel Committee on Banking Supervision’s (“BCBS” or the “Committee”) consultation on the introduction of guidelines on interaction and cooperation between prudential and Anti-Money Laundering (“AML”) and Countering the Financing of Terrorism (“CFT”) supervision¹ (the “consultation” or the “draft guidance”). The IIF has long supported the goals of the international community in promoting the effective design and implementation of measures to address threats to the integrity of the financial system. The work of the Basel Committee in this area is essential to the creation of a more effective global anti-financial crime framework.

We are grateful that the Committee, by developing these guidelines, has recognized some of the difficulties and ambiguities that exist for cooperation between prudential authorities and AML/CFT supervisory authorities and the issues this could raise for effective implementation and enforcement of measures aimed at stemming illicit financial flows. We believe the broader discussion on finding workable solutions in this area encompassing the Committee, the Financial Action Task Force (“FATF”) and regional/national authorities will be an important global effort and one in which the private sector values taking a constructive role.

We are also pleased that that Committee continues to take a dynamic approach in updating its guidelines on *Sound management of risks related to money laundering and financing of terrorism*.² The societal and systemic dangers posed by criminal financiers continue to evolve and we believe the public sector response to these issues must be regularly evaluated in close cooperation and partnership with the private sector to avoid gaps in the financial crime risk management architecture which may be exploited. It is also extremely important that as new guidance or standards are developed at a global level, they are effectively and consistently implemented at the regional/national level. Otherwise, there is a real risk of missing the opportunity to bring about necessary changes and improvements to the global framework for combating financial crime.


¹ Basel Committee on Banking Supervision, Consultative Document, *Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision*, November 2019 (hereafter referenced as the “Draft Guidance”).

² Basel Committee on Banking Supervision, *Sound management of risks related to money laundering and financing of terrorism*, January 2014 (revised June 2017).

Overall, the IIF supports the approach taken by the BCBS in the consultation. A lack of integration of AML/CFT concerns in prudential supervision, and a lack of cooperation between authorities on a domestic and international level should be addressed as a matter of priority. In our comments, however, we note a number of areas where further enhancements would greatly benefit the general usefulness of the Committee's final guidance and its interrelation with FATF and/or national/regional undertakings. We also note where there is opportunity to expand the scope of the guidelines to further address issues such as cross-border information sharing and the role of cooperation with other stakeholders. Lastly, we believe that ensuring effectiveness in cooperation should also mitigate any increased complexity in the system. Where existing structures exist for operative cooperation, those should be utilized to avoid any unnecessary new requirements for both the public and private sector to implement.

We look forward to continuing our engagement with you on these important issues. Should you have questions on our letter, please do not hesitate to contact me or Matthew Ekberg at mekberg@iif.com.

Very truly yours,

A handwritten signature in cursive script, appearing to read "A. Quinn". The signature is written in black ink on a white background.

Background:

There is consensus that the current global framework for fighting financial crime is not as effective as it could be, and that more needs to be done at the international, regional and national levels to help identify and stem the flow of illicit finance – an activity which supports some of the worst problems confronting society today, including terrorism, sexual exploitation, human trafficking and modern slavery, wildlife crime and drug smuggling.

Financial crime is both a contributor to societal ill and a threat to financial stability, financial inclusion and national/international security, and its mitigation and prevention must be prioritized. While billions have been invested to tackle this type of criminality, greater emphasis needs to be placed on bolstering the efforts of law enforcement with the help of the private sector and ensuring the legal and regulatory framework and financial crime risk management toolkit are enhanced to enable stakeholders to achieve more effective outcomes.

In October 2019, the IIF published a paper jointly with Deloitte examining the global architecture for financial crime risk management.³ The paper outlined a series of recommendations where reforms of a systemic or tactical nature would enhance overarching effectiveness and would allow incremental improvement at pace, in order to continue the global dialogue on meaningful change. One of the key areas addressed in the report is the operative and coherent application of global financial crime compliance standards and the management of domestic and cross-border rules applied to AML/CFT. The inconsistent application of rules can have knock-on effects for a number of areas, including the exacerbation of issues for correspondent banking de-risking and the accessibility of cross-border financial flows to support the real economy.

The crux of the Committee's consultation addresses one of the key issues which creates uncertainty and can contribute to less effective outcomes for risk management on the part of both the public and private sectors. Ensuring the rationality of cooperation between AML/CFT and prudential supervisory authorities will help assist in overcoming obstacles to implementation of globally set standards and guidelines and create greater confidence for all stakeholders in managing risk.

We believe, however, that the final guidance from the Committee would benefit from further review in five key areas: 1. The interaction, cooperation and information sharing between prudential and AML/CFT supervisory authorities, financial intelligence units, law enforcement and regulated entities; 2. The cooperation between data privacy authorities, AML/CFT supervisory authorities and prudential authorities; 3. The use of coordination mechanisms and supervisory colleges; 4. Consistency in national/regional implementation of the final guidelines; and 5. Considerations for the promotion of the adoption of new technology and supervisory cooperation.

Ultimately, enhanced cooperation between authorities should aim at striking a balance between effective risk mitigation and achieving better outcomes. The dialogue should lead to either the adoption of common standards, or to shared understanding of adequate risk mitigation measures. Supervision is subject to a risk-based approach as well. The IIF would caution supervisors from combining diverging standards into a comprehensive list designed to cover any and all requirements and expectations. The authorities taking part in those efforts should show the flexibility to assess changing a practice for a solution promising

³ IIF/Deloitte, *The Global Framework for Fighting Financial Crime: Enhancing Effectiveness & Improving Outcomes*, October 2019: <https://www.iif.com/Portals/0/Files/content/Regulatory/Financial%20Crime%20Report.pdf>

better results. Areas such as the structure of risk assessments, which risk factors to consider or what due diligence measures are justified often leave the specifics to the discretion of supervisors and regulators. Authorities should put that discretion to use and formulate common expectations that strike the aforementioned balance.

Key Issues:

1. *Interaction, cooperation and information sharing between prudential and AML/CFT supervisory authorities, financial intelligence units, law enforcement and regulated entities:*

It has been well documented that lack of integration of AML/CFT concerns in prudential supervision and a lack of coordination between prudential and AML/CFT authorities – especially in cross-border situations – has led to gaps in the oversight and enforcement regime.⁴ The draft guidance is helpful in clarifying that supervisors should ensure efficient and effective cooperation between the prudential supervisory function and the AML/CFT supervisory function, regardless of the jurisdictional institutional arrangement for the respective roles.

As noted in the draft guidance, there are expectations through the FATF Recommendations⁵ regarding the roles and responsibilities of supervisors to enforce AML/CFT requirements. These include a range of effective, proportionate and dissuasive sanctions, and the principles of information exchange and international cooperation among different public authorities, including prudential supervisors. It is critical these points are interpreted clearly and consistently across jurisdictions.

As such, the draft guidance supports the principles outlined in the FATF Recommendations and sets a reasoned approach to enhancing clarity on what should be shared from the AML/CFT supervisory perspective to the prudential regulator and vice versa. It would, however, be helpful to have the final guidelines consider greater consistency in hierarchical powers for oversight/enforcement between different types of regulatory and supervisory authorities to remove any ambiguities which may exist.

Further consideration should also be given to the sharing of a financial institution's ("FI") risk assessment ("RA") as envisioned in the draft guidance, specifically in light of the following statement in the consultation: *"Deficiencies in banks' AML/CTF systems could have prudential consequences. For example, AML/CTF deficiencies could result in significant regulatory actions or criminal penalties that may lead to reputational damage affecting the banks' operations."*⁶

We recommend that in the case of supervisory authorities sharing a FI's RA with other regulators, the FI should be informed of who the RA is being shared with, the purpose for sharing and how it will be utilized. A contact from the FI where questions could be directed should also be provided. This will help mitigate the risk of the FI's RA being provided to regulators who are unfamiliar with the FI, where the content of

⁴ For example, the European Commission recognized issues in the European Union AML/CFT regime as they relate to coordination and cooperation of oversight powers in their report: European Commission, *Communication: Towards a better implementation of the EU's anti-money laundering and countering the financing of terrorism framework*, July 2019.

⁵ FATF, *the FATF Recommendations*, 2012

⁶ Draft Guidance, Annex 5, A, Para 6.

the RA may be taken out of context or where the regulator may not be familiar with the technical regulatory requirements of the legal entities covered by the FI's RA. The confidentiality that can be afforded by the receiving regulator to the FI's RA should also be at least equal to the confidentiality and protection from disclosure to third parties afforded by the supervisory regulators that typically received the RA. This is important so as to not chill the candor of the FI in assessing its risks.

In addition, certain areas of the envisioned cooperation and exchange of information regarding enforcement actions should be reassessed.⁷ Specifically, we believe the final guidance should stress that the sharing of pending enforcement actions should rest between supervisors themselves rather than placing the onus on the financial institution involved. Otherwise, questions may arise as to the conflict with private sector prohibitions on sharing confidential supervisory information.

The draft guidance could also be improved by providing a greater focus on financial intelligence unit ("FIU"), law enforcement *and* private sector cooperation with AML/CFT supervisory authorities and prudential authorities, in both directions.⁸ The broader issue in creating a more effective financial crime risk management structure – both from a public and private sector perspective – is ensuring the totality of the right information is available to better target and mitigate risk in the system. There is a link here to the advancements in the development of country national risk assessments, a longstanding FATF requirement.

As such, it is vital to ensure the exchange of information across borders between entities of the same group (intra-financial institution information exchange), between entities of different groups (FI-to-FI information sharing) and through financial intelligence sharing partnerships between governments and the private sector is not impeded. This includes confirming that secrecy and privacy laws⁹, and tipping-off or similar provisions, do not inhibit the exchange of relevant information, including Suspicious Activity Reports ("SAR") and associated underlying information, for the purposes of managing financial crime risk. The Committee should examine how the draft guidance could support the goals for broader information sharing and, specifically, how it can be used to support current public/private partnerships underway.¹⁰

Cross-border cooperation between prudential and supervisory authorities on AML/CFT matters is crucial for financial institutions active in more than one jurisdiction. Divergences in interpretation of global standards are onerous for any institution trying to aim for a consistent risk mitigation standard across its operation. Supervisors and prudential authorities should be aware that a common understanding of the broad principles is a welcome first step, but it needs to be followed by close alignment on the implementation details and consistency in enforcement.

⁷ Draft Guidance, Section D.

⁸ We note that Section E2 of the draft guidance reflects on cooperation and information exchange with third parties, however this appears to be limited to FIUs and law enforcement and does not include the private sector.

⁹ Please see section of 2 of this letter for further discussion on data privacy issues.

¹⁰ Please see also: RUSI, *Expanding the Capability of Financial Information-Sharing Partnerships*, March 2019 https://www.future-fis.com/uploads/3/7/9/4/3794525/expanding_fisps_-03-2019_web.pdf

In that sense, reflecting on ways the guidance could facilitate greater feedback to the private sector on the AML/CFT information exchanged between AML/CFT authorities and prudential authorities would go a long way in developing a better AML/CFT architecture globally. We believe it is important for the public sector to develop better lines of communication with the private sector, whereby the private sector receives regular feedback on information shared via FIUs and related law enforcement, prudential and supervisory bodies, alleviating ambiguity regarding objectives and processes that will help enhance the effectiveness of outcomes for both sides.

2. *Cooperation between data privacy authorities, AML/CFT supervisory authorities and prudential authorities:*

The draft guidance reflects that information exchange should be created and maintained in order to ensure that prudential supervisors have access to timely and appropriate information gathered during the AML/CFT supervisors' activities that could be relevant to prudential supervisors in considering money laundering/financing of terrorism ("ML/FT") risks. Similarly, prudential supervisors should share with AML/CFT supervisors any information gathered during their supervisory activities that could be relevant to the supervision of AML/CFT obligations and the assessment of ML/FT risks. It correctly and appropriately caveats these statements by noting such information exchange be conducted to the extent permitted by applicable laws.

As referenced above, information sharing may be limited due to such issues as inconsistent legal frameworks for data protection, management of SAR-type information, privacy, and bank secrecy across different jurisdictions. It is also important to note that a lack of clarity in the interpretation of rules impacting data sharing may have the unintended consequence of limiting that exchange. This can be particularly true of rules applicable to data privacy and data protection.¹¹

Whilst the protection of customer/personal data and the right to privacy are of unquestioned importance, the upholding of such principles is not mutually exclusive with sharing information on illicit financial activity where necessary to limit its furtherance. The FATF recognized this point in February 2018, when it adopted revisions to FATF Recommendation 2 on national cooperation and coordination. The amendments expanded the Recommendation to include information sharing between competent authorities, and emphasized that cooperation should include coordination with the relevant authorities to ensure the compatibility of AML/CFT requirements with Data Protection and Privacy ("DPP") secrecy rules and other similar provisions (e.g., data security/localization).¹² The purpose of the change was to help improve the compatibility, coordination and cooperation of AML/CFT and DPP rules in order to assist in facilitating exchanges of information.¹³

¹¹ For further discussion on data privacy and information sharing issues, please see: IIF: *Financial Crime Information Sharing Report*: <https://www.iif.com/publication/regulatory-report/iif-financial-crime-information-sharing-report>.

Issues concerning the impact of data localization are also pertinent to the discussion around access to financial crime information. Please see: IIF: *Data Flows Across Borders: Overcoming Data Localization Restrictions*: https://www.iif.com/Portals/0/Files/32370132_iif_data_flows_across_borders_march2019.pdf

¹² FATF, *Outcomes FATF Plenary, 21-23 February 2018*.

¹³ We note that IIF will shortly be undertaking a review of the adoption of Recommendation 2 by national authorities and where AML/CFT and data protection authority dialogue can be improved nationally and regionally.

Though some issues concerning DPP are set out under section E.3 of the consultation¹⁴ in order to address mechanisms of cooperation, we believe that the current construct of the guidelines may still inhibit certain necessary disclosures for data privacy or data protection reasons. As such, the Committee should consider the FATF standards in this context and ensure there is a mechanism for dialogue in place between AML/CFT supervisory authorities (and where applicable, prudential authorities in the context of this consultation) and the relevant data protection and privacy authorities. This will help ensure that information pertinent to an incident of financial crime under consideration by authorities addressed in the draft guidance can be fully examined by those with a legitimate interest in the matters at hand.

3. *Coordination mechanisms and supervisory colleges:*

Formal mechanisms for cooperation and information exchange envisioned by the draft guidance are particularly important in order to address many of the information sharing issues outlined in our comments earlier in this submission. This is particularly true where the draft guidance seeks to work on issues for cooperation with third parties and when coordinating cross-border. Indeed, supervisory cooperation in the international context warrants fulsome support, as criminal financiers do not operate based solely on national boundaries.

The issues surrounding supervisory colleges outlined in the draft guidance can be useful to enhance coordination internationally in oversight of financial institutions which operate cross-border. The presence of AML/CFT supervisors on a prudential college where no AML/CFT college exists (and, vice versa in any such circumstance) can add to the cooperation benefits. In addition, putting in place formal memorandums of understanding and addressing legal barriers to international cooperation would be helpful in the context of implementation.

However, when considering the setup of *new* supervisory colleges (whether domestically or cross-border), it remains important first to maximise the use of existing structures which should be run as efficiently as possible. Setting up additional supervisory colleges has potential to add another layer of complexity for regulated firms and duplicating existing procedures should be avoided in order to ensure seamless cooperation and information exchange between competent authorities and with third parties, where applicable.

The final guidance should also take the opportunity to consider topics that should feature prominently on the first agendas of such supervisory college meetings. These could include:

- The consequences of global supervisory practices to financial institutions' correspondent banking strategy and how to mitigate the practicalities of escalating requirements;
- Setting common supervisory expectations for global financial institutions to profit from synergies created by relying on intra-group, cross-border AML/CFT activities including customer due diligence and AML/CFT monitoring;
- The development of common supervisory principles for the application of technology for AML/CFT purposes (see also section 5 of this letter);

¹⁴ Draft Guidance, Section E.3, p. 15

- A dialogue on overcoming jurisdictional differences in implementation of AML/CFT requirements; and
- A dialogue on consistent cross-border regulatory compliance expectations, driven by, and measured against, the strategic objectives of detection, prevention and disruption.

We would strongly encourage the private sector to be included in these supervisory college discussions as well, even if this occurs at a later stage. We would also encourage the BCBS to connect with the work of the FATF Supervisors' Forum – a priority under the Chinese FATF Presidency. The forum is looking in part at three areas: risk-based supervision, international cooperation between supervisors, and the use of technology.

4. *National/regional implementation of the guidelines:*

Significant ambiguities can exist in domestic and regional implementation of international anti-financial crime standards and guidance, leaving substantial room for interpretation and leading to fragmentation among jurisdictions with conflicting sets of requirements. Though national competencies must be recognized, financial institutions, regulators, supervisors and law enforcement authorities need to trust that rules as written and as enforced are congruous. This would eliminate one of the incentives criminals have to channel their operations through jurisdictions they know are less resilient than others.

This is particularly important when discussing the purpose of the consultation and the ultimate goals of the final guidance. The inconsistent application and coordination of oversight powers by regional and national financial crime supervisory bodies and prudential authorities can lead to conflict between the interpretation of the rules themselves, and a breakdown in cooperation, contributing to inefficiency and negative outcomes.

Guidance by its very nature can only go so far in providing the regulatory clarity needed by both financial institutions and national authorities. Still, it must be applied in good faith across jurisdictions in order for it to be fully useful. As such it will be incumbent on national authorities to clarify regulatory expectations as to their ultimate effects. The final guidance considered by this consultation should thus be followed up by statements at the national level by regulators to clarify expectations domestically so that they are appropriately reflected in supervisory practices and risk management platforms.¹⁵

As the draft guidance is finalized, it is vital therefore to have a review mechanism in place to evaluate its national or regional adoption in a manner as consistent as possible with its focus and intent. For example, the FATF previously undertook a survey of its member states and the private sector on the adoption of the FATF Guidance on Correspondent Banking.¹⁶ Such an exercise can be extremely helpful in understanding how guidance is applied, how it has helped achieve AML/CFT objectives and what

¹⁵ We note this point was emphasized by the Financial Stability Board action plan to assess and address the decline in correspondent banking: Progress report to G20 Summit of July 2017, P. 2.

¹⁶ FATF Guidance, *Correspondent Banking Services*, October 2016

strategies are employed in implementing guidance across jurisdictions.¹⁷ However, it must be followed up as part of ongoing review and dialogue with states that may be lagging behind in adoption.

Though we understand this may not be common practice in the context of the *Sound management of risks related to money laundering and financing of terrorism*¹⁸ and its annexes, review processes for other BCBS measures (and in particular, the Regulatory Consistency Assessment Program for Basel III) do exist and similar schemes fashioned in a manner appropriate to the issue at hand should be considered in the context the Committee's work on AML/CFT policy.

5. *Adoption of technology and supervisory cooperation:*

As outlined in previous IIF papers on the subject, the financial crime risk management space is one that can benefit from advancements in financial technology solutions. From machine learning¹⁹ and data analytics, to digital identity²⁰ and distributed ledger technology, it is clear that the potential to change the day-to-day approach to these matters is significant.²¹

In the same way as money laundering and financial crime are global, so are the methods to combat the illicit use of the financial system. Using technology as a tool to enhance one's safeguards can only work if it is deployed consistently across an organization, including across borders. As standards for the application of technology are either being developed or redesigned from the ground up, the IIF would urge the BCBS to take a leadership role (in close cooperation with other organizations like the FATF and the Financial Stability Board) in promoting cooperation and coordination between supervisors in order to prevent fragmentation and promote efficiency and innovation in the fight against illicit finance. Officials should enable and support domestic and international dialogues on the topic, be open to new concepts and techniques, support technological solutions to scale and avoid any approach that is too prescriptive.

Crucially, neither individual nor common standards or principles should lead to unrealistic expectations of the capabilities of new technologies. Expectations should be developed in cooperation with representatives of the financial industry (ideally with institutions of various sizes and with different business models) to gain more clarity on how new systems work, what safeguards can be implemented and where those might have some limitations. The results should be a measured approach that allows for a continuous evolution of capabilities in parallel with supervisory expectations, instead of setting a bar that cannot be cleared.

¹⁷ A country to country comparison can also be carried out, comparing countries with high adoption rates compared with countries having difficulty in implementing the Guidance. The strategies adopted by these countries can be shared with other countries.

¹⁸ Basel Committee on Banking Supervision, *Sound management of risks related to money laundering and financing of terrorism*, January 2014 (revised June 2017).

¹⁹ IIF, *Machine Learning Paper on Explainability in Predictive Modeling*, November 2018: <https://www.iif.com/Publications/ID/1423/Machine-Learning-Paper-on-Explainability-in-Predictive-Modeling>

²⁰ IIF, *Digital IDs in Financial Services Part 1: Embedding in AML Frameworks*, August 2019: https://www.iif.com/Portals/0/Files/content/Innovation/08272019_iif_digital_id_part_1.pdf

²¹ Please also see: Refinitiv, *Innovation and the Fight Against Financial Crime*: <https://www.refinitiv.com/en/resources/special-report/innovation-and-the-fight-against-financial-crime>