DeNederlandscheBank
EUROSYSTEEM

Two issues to take on together

European Banking Summit 'Building A Positive Future For Europe'
Brussels, 2 October 2019

At the end of the first day of the European Banking Federation's Banking Summit in Brussels, Frank Elderson gave a keynote speech. In his speech, Mr. Elderson highlighted two important topics that must be at the top of the agendas for the financial sector in the period ahead: combatting money laundering and greening the financial system. For both topics the financial community, and society at large, need to intervene collectively.

We are all here today, bankers, policymakers, supervisors and politicians alike, because we all share a common responsibility. It's up to all of us to look to the future. To anticipate what this future may bring. And to make sure we prepare for it.

I am sure the grandeur of your surroundings has not escaped your attention. Our venue today, the magnificent Steigenberger Wiltcher's Hotel, was built over a century ago, in 1913. It was constructed in the late Art Nouveau style, as a Grand Hotel, and named after its founder, the Anglo-Belgian Sydney-Charles Wiltcher. Looking around you, you may be forgiven for thinking nothing here has ever changed. For over a hundred years. But no.

This hotel became the Wiltcher's & Carlton Hôtel, following a collaboration with the world-famous Carlton. Then in 1935, this building was converted into the offices of a Belgian pharmaceutical company. In 1993 it was renovated, and reverted to a hotel. After that it was bought by the German Steigenberger group. The hotel we are in now opened in 2015 after a two and a half year refurbishment. It is a building that has stood the test of time. And it is as impressive and as relevant today, as it was when it was built over a century ago. It was built to endure. And - with the necessary renovation - it will still be relevant in 50, 100, 200 years' time.

But can we say the same about our financial system? Will our financial system still be relevant, not only in 10, but in 50, 100, 200 years' time?

We need a financial system that is resilient to shocks. We need a financial system that is receptive to new ideas and new ways. We need a financial system built on solid foundations. We also need to renovate our financial system. And this can only happen if we act on the risks and challenges we face, now and in the near future.

A little more than a decade after the financial crisis, we have made great strides in building a better capitalized and more resilient financial sector. The regulation of the financial sector is better and stronger. The capital framework has been revised with a new Basel Accord. Within Europe, the Banking Union has been created. And the Financial Stability Forum has been transformed into the Financial Stability Board, with a stronger mandate and enhanced capacity to monitor and promote global financial stability.

But our work is of course never finished. If we look to the future, if only by analysing recent headlines, there are two important topics that must be at the top of our agendas for the period ahead: combatting money laundering and greening the financial system. Recent years have seen a disheartening increase in media stories about money laundering. We clearly aren't doing enough to address this problem. The same holds true for the transition to a sustainable future. It is our collective responsibility to reduce the billions of euros in illicit financial flows to millions. And we need to turn the money needed for the transition to a sustainable financial system from the current billions to trillions.

In the following I will speak about both: the need to step up the efficacy of our fight against money laundering and the need to step up our efforts to establish a truly sustainable financial system. Although both are of great importance, due to time constraints, I will dedicate most of the remainder of the speech to the former and only speak briefly about the latter. In other words, I will speak mainly about black money and only briefly about green money. On other occasions, I might turn this around. But I can only ask for your attention for so long.

AML and CFT

Let me start with an example. It is 2010. Mexico caps the deposits of U.S. dollars into their banks, in an effort to prevent drug cartels laundering profits. Some account holders in the Mexican city of Mexicali, some of whom may be connected with these cartels, are hit hard by this measure. They need a new place to store their money. They find it just over the border. Armored cars loaded with cash come and go at a local branch of a well-known Dutch bank in the Californian city of Calexico.

Huge amounts of cash – sometimes over a million dollars carried in a simple backpack – are deposited and immediately transferred back to Mexico. The numbers at the local branch in Calexico keep on growing even faster, as many other banks around that time close down branches along the Southwest border to minimize their exposure. Based on numerous alerts, generated by the bank's automated monitoring system, compliance officers start inquiries. But they are largely ignored by their managers.

Daily quotas for clearing alerts are imposed that prevent any meaningful investigation of flagged transfers.

Two years later, at the end of 2012, the bank hired a consultancy to clarify how this could have happened. They find numerous deficiencies within the anti-money laundering program, including unqualified staff and failures to manage high-risk customers. When investigated by US officials, the consultancy's findings are withheld by the executive managers.

The story ends with the bank having to pay a settlement of $368 million to the U.S. Justice Department. The sum matches the amount of suspicious funds estimated to have flowed through the lender's branches near Mexico from 2009 to 2012.

The name of the bank at the centre of this scandal does not matter. Because far too many European banks have been shown to have significant failures in anti-money laundering controls. Recent examples of these scandals unfortunately abound. And my fear is that they are only the tip of the iceberg. The point I want to make is that dirty money is widespread and is corrupting our financial system. Money laundering lets criminals stay out of reach of law enforcement. Not only does it allow criminals to live in the lap of luxury. It also means they can plough those funds back into other illicit activities. Or maybe even to finance terrorism. I chose the Mexican example because it highlights two aspects we face in tackling this challenge.

Firstly, there is the international dimension. Criminals don't operate in a single jurisdiction. They target countries and jurisdictions where the risk of getting caught is lowest. So if we tackle these illegal activities in one jurisdiction, the criminals will switch to somewhere else. This is the waterbed effect: push it down in one place and it pops up somewhere else. Here in Europe for example, passporting allows financial institutions to serve the entire internal market from a single Member State.

The second aspect I would like to underline is the sheer size of the numbers involved. Nobody knows the aggregate total of money laundering, but several conservative estimates suggest we are talking about at least 2% of GDP. This equates to roughly 400 billion euros in Europe. And almost 2 trillion euros worldwide. Money laundering and the underlying criminal activities therefore pose a genuine threat to the integrity of the financial system.

Given the size and the complexity of the problem, and the enormous impact it has on our societies, I am afraid there is no quick fix. If we want to succeed in tackling this problem we need to take an integral approach based on four pillars. And I want to describe each of these pillars now. Firstly, we need rigorous compliance with existing regulations. Financial institutions need to devote sufficient time, rigor and resources to comply with these regulations. More importantly, they need to promote the right culture within their organisations. Let's be reasonable: even without explicit regulation, banks understand that knowing your customers is part of their core business. It is key for adequate risk management, and for designing and maintaining a sustainable business case.

The second pillar relates to the first. There is room for financial institutions to comply with the existing regulations in smarter and more sophisticated ways. Clever algorithms and artificial intelligence can sort through the enormous amount of 'alerts', and select only the most suspicious ones for further investigation. Public-private cooperation can also bring important improvements. Combining efforts and bundling of alerts by different institutions might not only boost efficiency, but could also improve our understanding of alerts. Because one alert may give us a more complete picture of the other alert. There is no need to compete in the area of security. There is ample opportunity to cooperate and thus make the system safer. In this respect, I welcome the recent announcement of the Dutch Banking Federation that the five largest banks in the Netherlands are investigating this kind of cooperation.

The third pillar needs to address one major flaw in our current supervision: AML and CFT supervision is mainly organised at national level. International cooperation and exchange of information between supervisors is often too complex. It impedes the smooth AML and CFT supervision of cross-border institutions and activities. And yet, smooth exchange of information between supervisors is vital in identifying and addressing AML risks.

Another flaw is that there are sometimes limited resources for this supervision. And enforcement decisions may conflict with prudential and other interests.

As AML supervision is organised at national level, it fails to safeguard a level playing field. This presents the risk that precisely those members states that are most active in uncovering money laundering and terrorist financing, are also the ones suffering most from reputational damage.

Lastly, different member states implement European norms in different ways. Criminal networks target places where there is least chance of getting caught. Given their international reach, this is all too easy for them to do. A consistent and effective approach to these problems demands setting up an AML and CFT supervision mechanism at European level.

Firstly, it would enable better exchange of information between supervisors, and this would give a much-needed boost to supervision of cross-border institutions and activities. Secondly, pooling supervisory resources will generate economies of scale, including increased concentration of knowledge and expertise. It would allow resources to be deployed precisely where the risks are the most significant. Thirdly, supervisory independence will be strengthened, as supervision will be further removed from local institutions and interest groups. Lastly, European supervision will help create a level playing field, as supervisory practices will become more uniform. This will greatly increase the effectiveness of our efforts to combat money laundering and terrorist financing.

A European supervisory mechanism for anti-money laundering and combatting terrorist needs to cover the entire single market, and all financial sector operators. It also needs to be a mechanism with a European central supervisory authority, cooperating with national supervisory authorities. This is important because the existence of a central supervisory authority will help promote minimum standards of law and enforcement. It will also mean priorities can be set at European level. Both factors will be helpful in safeguarding the level playing field. With the involvement of national AML and CFT supervisors, adequate attention can be devoted to national aspects, and available expertise at national level can be effectively employed. This will also greatly facilitate the much needed information exchange between all parties involved.

This brings me to the fourth and last pillar. When we again consider the enormous amounts involved in money laundering – 2 trillion euros worldwide, and probably more – we can only conclude that it is not enough to look at the banks and other financial institutions. They are the gatekeepers, and as such, they must do all they can to be effective gatekeepers. But in the end, let's not forget it is the criminals who try to circumvent the gatekeepers. We should not confuse the gatekeepers with those they are trying to keep out of the financial system. The fourth pillar is about society having to become more effective in pursuing the real criminals. For this we need to take a much broader view, we need to invest in law enforcement, we need to look at our tax laws, we need to become more effective in combatting crime.

So to summarize these four pillars I would say we need rigorous compliance with existing regulation. Secondly we need smarter and more sophisticated ways of cooperation between financial institutions and between them and public authorities in the field of CDD and transaction monitoring. We need a European supervisory mechanism to guarantee an effective and consistent regulatory framework. And finally we need more comprehensive public sector action, including devoting sufficient resources to prosecution, to ensure there is less dirty money sloshing through the system to start with.

Climate related risks

Let us now turn to our next challenge. I don't need to tell you how our climate is changing. You can now see the impact of higher temperatures and severe weather events everywhere you look in the world. I could spend the rest of the day reciting extremely chilling examples of our ever hotter world. I will skip that. You know these examples by now.

But what I would like to talk about today is how the changing climate presents substantial financial risks to the financial sector. We can divide these risks into two main channels: physical risks and transition risks. The increasing severity and frequency of climate change-related events such as flooding, droughts and storms, present physical risks that have a direct impact on the financial sector when they materialize. And then there are the transition risks. These stem from new laws and policies, technological advances or changes in public sentiment that come with the transition to a lower-carbon economy. These factors can leave carbon intensive assets vulnerable to value reassessments by financial markets. This can happen very abruptly, or could even render these assets 'stranded'. Financial institutions with balance sheet exposures to the fossil fuel and utility sectors could particularly be affected.

That climate-related risks translate into financial risks via the physical and transition channels (and thus fall squarely within the existing mandates of central banks and supervisors) is now widely understood and accepted by an ever growing number of central banks and supervisors around the world.

As Chairman of the NGFS, the central banks and supervisors network for Greening the Financial System, I'd like to tell you about our work. In just under two years the NGFS has grown significantly. From the original 8 founding members, today, the NGFS brings together 46 central banks and supervisors and 9 observers, representing five continents, representing half of global greenhouse gas emissions, responsible for supervising three quarters of the global systemically important banks and two thirds of systematically important insurers. And only last Month, during climate week, New York's Department of Financial Services became the first U.S state banking regulator to join the Network. So we have a collective leverage that is incredibly powerful. Also the IMF joined as an observer. The World Bank, the BIS, the Basle Committee, the OECD and others had already joined before. This year, the NGFS reached another milestone: a report with six recommendations to inspire central banks and supervisors to take the necessary measures to foster a greener financial system.

As said, climate-related risks translate into financial risks via the physical and the transition channels. This is not only true for climate-related risks. It also holds for broader environmental and social challenges. Water scarcity is a source of financial risk. Diminishing biodiversity is a source of financial risk. Human rights controversies are a source of financial risk. We need to think 'beyond climate'. Financial institutions need to think 'beyond climate'. We as a world, we as central banks and supervisors, but also financial institutions, cannot afford the luxury of worrying about climate related risks this decade, and postpone worrying about and mitigating biodiversity-related risks the decade thereafter. And the same holds true for water scarcity. Resource scarcity. Human rights. We need to look at these world-wide problems, and the financial risks they cause, in a holistic manner.

Closing remarks

Ladies and gentlemen, I've already kept you long enough. Drinks and dinner are waiting. You should start enjoying the wonderful offerings of this age-old hotel beyond just sitting here and listening to me orating about black and green money.

I have addressed two topics in my speech: anti-money laundering and sustainability. These two topics share a clear international dimension. Fighting money laundering and the financing of terrorism, and enhancing sustainability, can only be properly achieved if we work closely together internationally, and at all levels. But in my opinion there is an even more striking similarity between the two topics. They are both instrumental in abiding by the key theme of this conference, that is: Building a positive future.

In the case of sustainability, I would go one step further. It may be the only future we have. And certainly the only future for our children. If we want to continue our high standard-of-living, we genuinely need to integrate sustainability into all aspects of our life. This also holds true for the financial sector. All finance shall become sustainable, or there shall be no finance.

And fighting illicit financial flows is also one of the main building blocks for a positive future. We need to contain the size of the black economy. This is drastically needed, to defend the rule of law and democracy on which our societies are based.

To put it plainly, we need to pump the dirty money out and pump the green money in!

Thank you.

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