Law360, London (June 4, 2019, 8:53 PM BST) -- The European Banking Authority's decision to drop its probe into the Danske Bank money laundering scandal marked an inauspicious start to its life as the region's top anti-money laundering supervisor, giving new impetus to efforts to ramp up European Union-level enforcement of dirty money rules.

The EBA had been set to flex its new powers when it examined whether possible supervisory failures by Danish and Estonian regulators that allowed Danske Bank to process some €200 billion ($252.3 billion) in suspicious transactions over nearly a decade without facing scrutiny broke EU law.

But it closed the investigation in April after its board of supervisors concluded the failings did not amount to a breach of EU rules — even as the bank has continued to struggle to clean up its operations and its image.

The decision upset the European Commission, which accused the EBA of undermining its own credibility just months after being handed new powers to become the bloc's top anti-money laundering enforcer. It has also led to calls for the EU to overhaul its money laundering safeguards.

"The true test will be one of time once the new regulations have had a chance to embed. It is about what the scene looks like in two, three of four years' time rather than today. Much of the alleged misconduct we are seeing now is historical," said Steve Smith, a partner at Eversheds Sutherland. "We know the regulatory system then was not up to scratch — the real test will be to see if the changes really make a difference."

Europe's largest ever money laundering scandal has been rippling through the region's banks, engulfing lenders in Denmark, Estonia, Latvia, the Netherlands and Germany over allegations they failed to stop tainted Russian money from flowing through their branches. But even though money laundering tends to be a cross-border crime, the EU has not historically tackled it comprehensively.

"A lot of the issues that have arisen are around transactions that engage multiple member states. The challenge is that although there is some harmonization on anti-money laundering standards, supervision is almost exclusively a matter for national regulators," said Suzanne Rab, a barrister at Serle Court Chambers in London. "There can be inconsistent application and enforcement in different member states."

National authorities that can lack the capabilities or desire to counter money laundering are exploited as weak links, allowing, for instance, money from Russia or ex-Soviet states to flow into the Baltics before circulating around the bloc's wider financial system. Weak AML supervision in any one EU member state can make that country attractive to money launderers who can use it for access to the entire single market, Smith said.

"It's very clear that different countries have different challenges and different economies to regulate with different systems and markets meaning that it is difficult to adopt a one-size-fits-all approach," he said. "Events to date suggest that it is typically the smaller countries with less robust regulatory regimes that have generally been targeted by organized crime."

The EBA, as one of the pan-European financial supervisory bodies, will get more power to fight money laundering in Europe under legislative proposals announced at the end of

2018. Lawmakers also plan to give the authority the power to collect information from national regulators.

Reforms outlined by the European Commission would give the EBA reinforced powers including the ability to ask money laundering supervisors to investigate material breaches and to consider targeted action. As a last resort, the EBA would be able to address decisions directly to financial institutions, Rab explained.

The amended regulation will also develop common standards for preventing money laundering, but there are concerns these measures still won't be enough to address the problem comprehensively.

“These amendments should bring about improvements to the supervisory framework, but we also need to examine the whole system,” Rab said. “Banks, financial supervisors and law enforcement agencies all have a role to play in combating money laundering threats on a pan-European and global level."

And the EBA's decision to close the Danske Bank investigation without adopting any findings has raised questions about its governance and the way decisions are taken along with concerns it is unable to take a tough line against its own members.

Valdis Dombrovskis, the EU's financial regulation chief, has said that to be effective, the EBA requires a transformation of the watchdog's decision-making structures. One problem is that its board of supervisors is made up of senior officials from the EU's central banks and banking watchdogs who may be reluctant to judge each other.

The commission has begun taking action against Denmark and Estonia for failing to implement EU anti-money laundering regulation, and the Danske case has cast doubt over the EBA's ability to fulfil its mandate to check that national authorities enforce EU rules and carry out investigations.

Nicolas Véron, a French economist at think tank Bruegel and the Peterson Institute in Washington, D.C., called the outcome "entirely predictable." Although Véron said he supported overhauling the watchdog's governance, he said it would be easier to create a new pan-EU anti-money laundering regulator instead of beefing up the powers of existing agencies.

"It is doubtful whether the EBA can assert its governance beyond banking," Véron said. "It is not outlandish to imagine a dedicated regulator for this."

In a paper published last year, Véron and co-author Joshua Kirschenbaum said a dedicated new agency is required to close loopholes and opportunities for abusing the system. For instance, countries like Luxembourg and Germany use loopholes in EU rules that allow them not to disclose sanctions imposed on banks for money laundering violations in breach of EU law.

The authors of the Bruegel paper recommended creating a new European anti-money laundering authority that would work to build relationships with national authorities such as financial intelligence units and law enforcement agencies. Such an agency would need to be independent, publish its decisions and be able to fine companies enough money to dissuade them from breaking the rules, Véron said.

But the commission has so far resisted calls to create a new body. Instead, European lawmakers agreed in April to overhaul the powers held by three of the bloc’s top regulators, including the EBA, in a bid to revamp their decision-making structures and strengthen Europe’s fight against money laundering.

The rules, which were approved by the European Parliament, will beef up the supervisory powers held by the EBA, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority.

ESMA will receive direct oversight power over financial instruments and benchmarks. The markets regulator will also ensure that national watchdogs are supervising financial technology, promoting sustainable finance and conducting stress tests consistently across Europe. EIOPA will also be able to set up panels to examine breaches of EU law and cases that involve cross-border disputes.

But it is an imperfect solution, Véron said.

"ESMA has the same governance problem as the EBA," he said. "By elimination, you get to the option of having a new agency. The first issue to address is not in rules, it is in the way they are enforced."

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