

Consolidated Supervision and Anti-Money Laundering Compliance: The Crossroads of Effective Banking Supervision

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Introduction

Increasingly, financial institutions are parts of wider groups. Banks are often affiliated with other kinds of financial businesses – insurance companies, securities firms, financial leasing companies and so forth – under the same corporate umbrella. In some cases, financial and non-financial businesses are combined into a “mixed-activity” group or conglomerate. Financial supervisors have recognized the necessity and benefits of “consolidated supervision” of such groups. In essence, consolidated supervision entails evaluation and analysis of the risks in any corporate group that contains a bank. In the broadest terms, supervision is “consolidated” when the banking supervisory body has the necessary legal tools to assess these risks, and to take action necessary to mitigate those risks that may prove harmful to a bank.

Traditionally, consolidated supervision has focused on “mainstream” items such as capital adequacy of the group, exposures of the group to third parties, and intra-group transactions that could pose problems for the bank or banks in the group. In recent years, however, financial sector regulators have come to realize that effective anti-money laundering and counter-financing of terrorism (AML/CFT) regimes must focus on group where an entity that is subject to AML/CFT requirements is part of a group. This is especially true in the case of financial groups, which will almost always have a number of such entities. This is simply an extension of the fact that banking supervision and AML compliance are complementary items: the better the quality of a country’s financial supervision, the less likely it is to have money laundering or terrorist financing problems.

This article will provide a brief look at the connection between traditional group supervision and AML/CFT compliance, and will offer some suggestions for financial regulators¹ and boards of directors and management of regulated entities. This article focuses on groups that contain banks. However, the same principles can apply to any financial conglomerate or any other group that contains a regulated financial entity that is subject to prudential supervision, such as insurance companies or investment firms.

1. In some jurisdictions, other bodies, such as a financial intelligence unit (FIU), may have primary responsibility for AML/CFT compliance. In such cases, the banking supervisor should closely coordinate and cooperate with the FIU to achieve the goals discussed here.

Overview of Consolidated Supervision

Because of the dangers that group membership can pose to a bank, financial sector regulatory authorities must be aware of the structure of, and risks inherent in, any group of companies that includes a bank. Specifically, the regulator needs to be aware of the ownership structure, actual control, corporate governance standards, internal controls and risk management systems that the group uses to carry out its activities. The regulator also needs to review and assess the group's controls on intra-group transactions and have continuing knowledge of aggregated large risk exposures within the group. The regulator further needs to assess the adequacy of capital on a consolidated basis to prevent a single financial entity within the group from showing an adequate capital position through the use of accounting "gimmicks."

In order to accomplish these tasks, the regulator must have two critical legal authorities:

- (1) the authority to obtain reliable information about all of the entities in the group; and
- (2) the authority to take effective corrective actions, or cause other financial sector supervisors to do so, when activities or conditions of these affiliated persons may be detrimental to the financial stability of the bank(s) within the group.

It is important to note that consolidated supervision goes beyond accounting consolidation. A common misperception is that consolidated supervision and consolidated accounting are the same thing. They are not. The purpose of consolidated accounting is to present a full, fair and accurate picture of the financial situation of a group of companies. While this is one part of consolidated supervision, it is only one part. Consolidated supervision, a broader concept, focuses on group-wide risk management and the ability of the financial supervisor to require the group – typically through the ultimate parent holding company – to manage and control its risks.

Risks to Banks in Groups

All banks are subject to financial risks, which emanate from activities that they directly undertake. Traditional banking risks include credit risk, liquidity risk, interest rate risk, and foreign exchange risk. But special risks, which are not as easily measured, also become applicable if the bank is part of a "group" of companies. Some of these risks have direct applicability in the anti-money laundering context. Specific risks that apply in the group setting include the following:²

2. See, e.g., Ronald MacDonald, *Consolidated Supervision of Banks*, (1998) 5 Bank of England Handbooks in Central Banking No. 15.

- ◆ **Contagion** – the risk that financial difficulties in an affiliated company of a bank might “infect” the bank itself. Normally this arises when the bank’s depositors assume that financial problems of the affiliated company could mean that the financial stability of the bank is also in jeopardy. This perception can precipitate substantial rapid withdrawals of deposits, resulting in a liquidity deficiency, and, if the problem escalates, a major “run” on deposits, which can even spread to other banks.

In the AML/CFT context, if one member of a group is perceived by members of the public as facilitating criminal activity, it could negatively impact the reputation of other members of the group, which in turn can cause those other members to lose business.

- ◆ **Group Transparency** – the possibility that a group’s controlling persons may deliberately choose a complex structure in order to obscure the group’s true ownership, control, or operations, and thereby avoid effective supervision of the bank. Financial groups frequently have very complex structures, which can make the implementation of group-wide policies difficult. Lines of accountability within the group must be clearly communicated and thoroughly understood by all personnel within the group who are responsible for legal and regulatory compliance. Supervisors need to thoroughly understand the group structure, the group-wide internal controls and how the group manages its risks. If this is not done, financial fraud and criminal activity, including money laundering and terrorist financing, are high possibilities.
- ◆ **Quality of Management** – the risk that management or controlling persons of a non-bank parent company might establish policies for the group that are detrimental to the banks in the group. This can come about because the parent company might have business objectives other than prudent management of the bank, or lack a good understanding of the banking business and its regulatory requirements. In these circumstances, group/parent management might override or direct bank decisions, so that bank management loses some autonomy, or cannot exercise effective control over the bank’s lending or investment decisions. In the worst-case scenario, the managers or controllers of the group might see the bank as a “piggy-bank” – a cheap funding source for the other group members, with insufficient regard for the safe operation of the bank. As with the previous point, in this scenario insider abuse and bank failure are high possibilities. For this reason, bank supervisors need to be able to vet the “fitness and propriety” of controlling persons, senior management officials and members of the board of directors of any company that can control or significantly influence a bank.

In the AML/CFT context, if the parent company's management fails to understand AML/CFT compliance issues and its board does not adopt effective group-wide policies, the AML compliance of the subsidiary institutions can be compromised. Bank supervisors need to be confident that the controlling persons and managers of ultimate parent companies clearly understand these issues, and that the bank's AML/CFT risk assessment takes this into consideration.

- ◆ **Group Exposures to Third Parties** – the possibility that individual lending limits could be circumvented through the use of bank subsidiaries. Unless these subsidiaries are included in the parent bank's large exposure calculations, regulatory limitations on large exposures are easy to evade. This is also a concern in the wider group (e.g., a bank holding company and its nonbank subsidiaries) though it is usually not practical to apply the same kinds of "bank" lending limitations to such wider groups, especially if they contain a mix of financial and non-financial entities. However, such groups should be expected to develop effective policies and procedures to monitor and control exposures by group members to the same counterparty, or group of related counterparties.

Banks engage in many different forms of lending: real estate, trade finance, cash-secured loans, consumer, commercial, and agricultural lending, and credit card programs. Lending activities can include multiple parties in addition to the actual borrower, such as guarantors or signatories.

The involvement of multiple parties may increase the risk of money laundering or terrorist financing when the source and use of the funds are not transparent. This lack of transparency can create opportunities in any of the three stages of money laundering or terrorist financing schemes (placement, layering, and integration). Examples of such schemes could include the following:

- To secure a loan, an individual may purchase a certificate of deposit with illicit funds.
- Loans made for an ambiguous or illegitimate purpose.
- Loans are made for the benefit of, or paid for, a third party.
- The bank or the customer attempts to sever or obscure the paper trail between the borrower and the illicit funds.
- Loans are extended to persons located outside the bank's home country, particularly to those in higher-risk jurisdictions and geographic locations, or may involve collateral property located in such jurisdictions.

One of the main dangers of weak AML/CFT controls is the possibility of credit losses through exposures to fictitious companies. Criminals often create shell companies through which to obtain financing to facilitate the laundering of their illegally-obtained proceeds with no intention of repaying the loans, leaving the lending bank with a portfolio of uncollectible credits. The negative effects of this activity can multiply if banks and their subsidiaries extend loans to the same fictitious company or group of related fictitious companies.

Concentration risk is the potential for loss resulting from too much credit exposure to one client or group of connected clients. Lack of knowledge about a particular customer, or who is behind the customer, or that customer's relationship to other customers, can increase the risk to a lending institution. This is especially true where many borrowers are connected through informal relationships but share a common source of income or assets for repayment. Credit losses can also result from unenforceable contracts or contracts made with fictitious persons, both of which are high possibilities when dealing with persons involved in money laundering, terrorist financing or proliferation financing.

Because of these risks in the lending area, banks need to have policies, procedures, and processes to monitor, identify, and report unusual and suspicious activities, both within the bank itself and in its subsidiaries that conduct lending activities. There need to be procedures in place to identify borrowers that are connected through "control" relationships – regardless of the amount of formal ownership between the companies – or through a "common enterprise" so that the source of repayment is the same for a number of nominally unconnected borrowers.

- ◆ **Access to information** – the possibility that related non-bank companies of a bank may be unwilling or unable to supply information to the bank for onward transmission to the supervisor. Virtually all bank supervisory authorities have the legal power to obtain prudential information, such as financial data, transactional information, and governance policies and procedures about institutions that they directly regulate. Often this power extends to subsidiaries of the regulated institution. What is not always so common is the ability to obtain similar information from other members of the group, such as parent and sister companies, other controlling persons of the bank and entities controlled by them. In some cases, bank supervisors are limited to obtaining information from regulated banks themselves, and sometimes from their subsidiaries, but do not have similar authority relative to the broader group. This can be a particular problem in the case of foreign parents or subsidiaries, since legal powers to obtain information may have no validity in foreign jurisdictions. Without this ability, the bank supervisor cannot get a complete and accurate picture of the risks facing the group as a whole.

In the AML context, bank supervisors need to have confidence that they will be able to obtain relevant information from all members of the group, if necessary. This ability is just as important in the AML compliance area as in other areas such as intra-group transactions, large exposures and capital adequacy.

- ◆ **Moral Hazard** – the risk that related companies of a bank might take excessive risks in the belief that supervisory authorities will provide them with support to avoid a “contagion” effect on the related bank. Typically this arises in the context of lending or investment activity, but it is easy to see how it could apply in the AML/CFT context as well. If a company in a group has weak AML/CFT controls and this becomes known to the public, the contagion effect on the bank can be considerable.

The Nexus between Consolidated Supervision and the Fight Against Money Laundering

The connection between consolidated supervision and money laundering is perhaps best illustrated by the 1990s case involving Bank of Credit and Commerce International (BCCI), also known informally as the “bank of crooks and criminals international.” BCCI was a large international banking group with a parent holding company registered in Luxembourg, with numerous subsidiaries and branches in many countries all over the world. Ostensibly a financial institution, BCCI was in fact a conduit for all sorts of criminal activity. The “bank” assisted corrupt dictators in looting their countries’ treasuries, and did brisk business with terrorists, and drug traffickers. The owners and controlling persons of the bank purposely organized the group in a complex and confusing manner to avoid domestic and foreign supervision and regulation. When the bank finally collapsed in 1991, bank supervisors around the globe became determined to reconsider their focus and mission statements. Bank regulatory structures had traditionally been designed to facilitate supervision of stand-alone banks by individual regulatory bodies. The BCCI case made it painfully clear that focusing on individual banks in individual countries was no longer enough. As a result, the concepts of home-country and host-country supervisors and the concept of consolidated supervision arose. In the years following the BCCI collapse, bank regulatory authorities have increasingly entered into mutual assistance agreements and memorandums of understanding (MOUs) with their foreign counterparts, allowing for the exchange of supervisory information. The concept of consolidated supervision has become one of the most important topics in recent times, relative to the financial sector

FATF Recommendations

The Financial Action Task Force, in its 2012 updates to its AML Recommendations, addresses the issue of AML/CFT controls in financial groups. FATF Recommendation No. 18 notes:

“Financial groups should be required to implement groupwide programmes against money laundering and terrorist financing, including policies and procedures for sharing information within the group for AML/CFT purposes. (FATF Recommendation No. 18)

“Financial institutions should be required to ensure that their foreign branches and majority-owned subsidiaries apply AML/CFT measures consistent with the home country requirements implementing the FATF Recommendations through the financial groups’ programmes against money laundering and terrorist financing.”

Similarly, Recommendation No. 26 provides:

“Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. Competent authorities or financial supervisors should take the necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function in, a financial institution. Countries should not approve the establishment, or continued operation, of shell banks.

“For financial institutions subject to the Core Principles,³ the regulatory and supervisory measures that apply for prudential purposes, and which are also relevant to money laundering and terrorist financing, should apply in a similar manner for AML/CFT purposes. This should include applying consolidated group supervision for AML/CFT purposes.”

The message from FATF is clear: financial supervisory authorities need to apply AML/CFT risk management principles to financial groups. The question is exactly how to go about this.

3. Core Principles, in the FATF Recommendations, refers to the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the Objectives and Principles for Securities Regulation issued by the International Organization of Securities Commissions, and the Insurance Supervisory Principles issued by the International Association of Insurance Supervisors.

Creating a Legal Framework for AML Compliance in the Group Context

The first step in creating an effective legal framework for AML compliance at the group level is to identify the “group.” For present purposes, we shall focus mainly on financial groups. FATF defines a “financial group” as:

“a group that consists of a parent company or of any other type of legal person exercising control and coordinating functions over the rest of the group for the application of group supervision under the Core Principles, together with branches and/or subsidiaries that are subject to AML/CFT policies and procedures at the group level.” [emphasis added]

What is striking about this definition is that in order to have a “financial group,” there must first be a “group.” However, FATF does not specifically define a “group.” In bank supervisory parlance, there are three basic kinds of groups:

- (1) the bank and its subsidiaries, sometimes called a simple banking group, or just a banking group.
- (2) a financial conglomerate, a group of companies that engage in a range of different financial activities that have been traditionally kept separate (typically defined as banking, securities underwriting and/or trading, and insurance);
- (3) a mixed-activity group, which contains commercial and industrial companies as well as one or more banks or financial institutions.

The precise parameters of a group can vary between jurisdictions, and between international bodies (such as the European Union). However, certain common themes can be observed. The “group” should include any legal entity that “controls” a bank; any entity that the bank “controls,” and any entity that is under common control with the bank (“sister” or “affiliated” companies).

Obviously, a critical aspect of group identification is a good “control” definition. “Control” should be clearly but broadly defined. It should contain a specific numerical threshold. 50% is common in international practice, but some countries, such as the United States, use lower thresholds, such as 25%. The definition should specifically encompass both direct and indirect ownership, in order to pick up control through a chain of ownership, such as a string of subsidiaries. It should also include a more subjective element such as “controlling influence” or “dominant influence” to pick up those situations where a person can exercise real control over the bank with little or no formal share ownership. If a 50% numerical threshold for “control” is used, a country might wish to also include other companies over which the bank or the ultimate parent company of

the group can exert considerable influence, but not actual control. For example, under many European Union directives, a “group” includes not only parent and subsidiary companies, but also companies in which the ultimate parent or any of its subsidiaries holds a “participation,” generally defined as direct or indirect ownership of at least 20%.

The FATF recommendations refer to the obligations of an institution to apply AML/CFT risk management principles to its overseas branches and wholly-owned subsidiaries. However, the FATF principles also note that AML/CFT compliance needs to be enforced by financial supervisors at the “group” level, without limiting this concept to parents and wholly-owned subsidiaries. As a practical matter, legal compliance needs to be enforced relative to any company that a bank or its parent holding company can “control” (regardless of whether such control results from majority ownership, being the largest shareholder albeit less than a majority, or merely through exercise of a dominant influence through informal means). As any seasoned bank supervisor is aware, actual control is much more relevant than formal ownership. To put it another way, the obligation to apply AML/CFT prevention measures to a bank and its majority-owned subsidiaries is a necessary – but not sufficient – component of an effective AML/CFT regime.

Legal Powers of the Supervisory Authorities

Once “control” is defined and the “group” is identified, the next step is to ensure that the supervisor has adequate tools as described above – that is, the power to review and approve all controlling persons, board members and senior management officials of any parent company of the bank; the power to require all members of the group (particularly the ultimate parent company) to provide relevant information to the supervisor; and the authority to require appropriate corrective action if necessary. The supervisory authority should also have the legal power to approve the ownership structure of the group, including the major shareholders and management officials of the parent company.

All of these items have strong applicability in the context of AML/CFT compliance. Virtually all bank supervisory bodies have the authority to approve the composition of the ownership and controlling persons of banks, both at the licensing stage and whenever there is to be a change in control or significant ownership/influence over the bank. Part of the regulatory inquiry should include examination of the impact of the licensing decision or acquisition on the bank’s AML compliance function. If the bank is to be a subsidiary of another company, the inquiry should entail an analysis and evaluation of the ultimate parent’s AML/CFT policies, including how the parent monitors AML/CFT compliance by its subsidiaries (and if applicable and to the extent feasible, by other companies within its group over which it can wield a significant influence). This task is easiest if

the parent company is a regulated financial entity that is subject to AML/CFT requirements in its home country. If the decision-making supervisory authority will also be the supervisor of the parent company, it should use its supervisory powers to insist on high-quality AML/CFT procedures at the parent level, to include group-wide policies and procedures. If the parent is regulated and supervised by another financial regulatory body, the decision-maker should closely coordinate and cooperate with that body. This will normally consist of obtaining information from the other regulatory body about the quality of the parent's AML/CFT regime. If the other regulatory body is located in a foreign country, this task will be more difficult, but still should be undertaken. Countries should ensure that mechanisms exist for the exchange of information between regulatory bodies that have AML/CFT jurisdiction, so that financial regulators can confidently evaluate the AML/CFT policies of proposed foreign acquirer of control or significant influence over their domestic financial institutions.

If the proposed acquirer is not an entity that is subject to AML/CFT compliance requirements, this task is more difficult, but it is not insurmountable. This issue could arise, for example, in the case of a mixed activity group, where the ultimate parent company may be an unregulated entity (a chain of grocery stores, an industrial company, etc.) or simply a non-operating holding company that controls a wide range of financial and non-financial businesses. Because these entities may not themselves be subject to AML/CFT compliance, they may not have existing AML/CFT policies and procedures to evaluate. However, the analysis and evaluation should still take account of AML/CFT compliance issues. While it may not be feasible to require the acquiring entity to implement a full-blown AML/CFT compliance program for itself and its group, it is eminently reasonable to insist that the acquirer ensure that at least the regulated entities in the group have acceptable AML/CFT compliance programs. Banking laws often contain provisions whereby the supervisory authority can approve proposed acquisitions subject to conditions that are not expressly enumerated in the approval criteria, but that are deemed to be necessary for the protection of the bank or its depositors.

Post-acquisition Issues: Examination Authority

The Basel Committee notes that a bank's Customer Due Diligence management program, *on a group-wide basis*, should have the following essential elements:

- (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks;
- (b) a customer identification, verification and due diligence program on an ongoing basis, which encompasses verification of beneficial ownership, based reviews to ensure that records are updated and relevant;

- (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions;
- (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);
- (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and
- (f) clear rules on what records must be kept on CDD and individual transactions and their retention period, which should be at least five years.

Bank regulators have the ability to conduct examinations of banks. If their country has a good consolidated supervision regime, the regulatory body will also have the legal authority to conduct examinations of parent companies of banks and other members of the group (sometimes this authority is limited to banks and their subsidiaries, which is problematic). With regard to other group members that are regulated non-bank financial institutions, this function can often be coordinated with other financial sector regulators in order to avoid overlap and duplication. Particularly with regard to the ultimate parent company of a group, examination procedures should include a review and evaluation of the quality of the AML/CFT regime at the group level, to ensure that the parent is effectively overseeing AML/CFT compliance for the entire group.

Post-acquisition Issues: Enforcement Issues

An important aspect of consolidated supervision is the ability of the bank supervisor to take enforcement action, or cause other financial supervisory bodies to do so, if violations of unsafe/unsound practices are discovered during the course of the supervisory process. An effective consolidated supervision regime authorizes the bank supervisor to issue corrective orders against bank holding companies, controlling persons, and in many cases other group members, if the financial condition or activities of those other companies could adversely affect the bank or banks in the group. This process should extend to AML/CFT compliance. Weak or ineffective AML/CFT compliance programs at the group or parent level could negatively impact any bank in the group, as a result of contagion or the possible misuse of the bank by the controlling persons. In the event that deficiencies are detected at the parent level, the supervisory authority should require the parent company to improve the group AML/CFT compliance program.

A common legislative provision in banking laws is the ability to impose fines for violations. Such provisions are useful and necessary, but are not sufficient by themselves to achieve corrective action. The *Basel Core Principles* contains the following advice in its “Essential Criteria” for compliance with Principle 11 (Corrective and sanctioning powers of supervisors):

The supervisor raises supervisory concerns with the bank’s management or, where appropriate, the bank’s Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank’s Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.

A good analogy is the “Prompt Corrective Action” regime in the United States, which is used in cases of capital-deficient banks. If a bank’s capital falls below a certain prescribed threshold, the bank is required to develop and implement a capital restoration plan satisfactory to the bank supervisor, with specific targets and methods of how they will be achieved. The bank is required to submit periodic progress reports to the bank supervisor, and if the goals of the plan are not achieved or if the bank’s capital declines further, additional provisions may be added to the plan.

The same logic should apply to correction of deficient AML/CFT policies and procedures. This should apply at both the individual bank level and at the level of the group, through action directed at the ultimate parent company, if applicable.

Governance Aspects of Group-wide AML/CFT Compliance

While bank supervisors or AML compliance authorities can do a great deal to foster AML/CFT compliance in their countries, the ultimate responsibility for safe and sound operation of a bank – including AML/CFT matters – rests with the bank’s board of directors.

Specifically, in the AML/CFT context, the board is responsible for approving the bank’s AML/CFT program, overseeing the implementation of that program by the bank’s AML/CFT compliance function and senior management, receiving reports from management and the bank’s internal audit function, and reviewing the program periodically and ensuring that it is updated as necessary, and ensuring that any deficiencies are addressed in a satisfactory manner.

When a bank is a subsidiary of another company, however, the parent company’s board is responsible for the entire group. The parent company should have policies in place to prevent practices that could jeopardize the subsidiary banks or the consolidated organization. A fundamental principle of the bank holding

company/bank subsidiary relationship is that the holding company should serve as a source of financial and managerial strength to its subsidiary bank(s). In the AML/CFT context, the key word is “managerial.” The holding company board must ensure that its subsidiary institutions that are subject to AML/CFT requirements are developing and implementing effective AML/CFT programs.

The rationale for this policy is that in acquiring a commercial bank, a parent company derives certain benefits at the corporate level that result, in part, from the ownership of an institution that holds enormous amounts of other people’s money (deposits) and has access to central bank credit. The deposit aspect is heightened if a country offers deposit insurance. The existence of these governmental “safety nets” reflects an important public policy determination regarding the critical role of depository institutions in the country’s economy as repositories of depositors’ funds, operators of the payments system, and impartial providers of credit. Said differently, in return for obtaining the advantages that stem from ownership of a commercial bank, bank holding companies have an obligation to serve as a source of strength and support to their subsidiary banks.⁴ This goes beyond providing financial support when needed, and extends to ensuring that the banks are operated safely and soundly, and do not wittingly or unwittingly become conduits for aiding criminals.

The parent company should therefore maintain AML/CFT policies for itself and its subsidiaries that provide guidance and controls in all key areas. The existence and wording of these policies, the degree to which the policies are followed by the subsidiaries, and the effectiveness of the policies in controlling risk to the entire organization are all matters of which the parent’s board needs to be keenly aware. Management and the board of the parent company should periodically interact with the board and management of each subsidiary company to discuss and review the group’s and subsidiary’s AML/CFT policies.

There is no particular best format for this purpose. Much will depend on the characteristics and specific lines of business of the members of the group, the size of the group, whether the group operates in foreign countries or purely domestically, and so forth. The important thing is that the parent company’s board is aware of the AML/CFT programs in any of the company’s subsidiaries that are subject to AML/CFT requirements; that these programs are being implemented effectively; and that the group as a whole (including any non-regulated entities that may not themselves be subject to the full panoply of AML/CFT requirements) is operated in a manner that does not leave the group vulnerable to criminal activities.

Each regulated entity in the group should of course have its own AML/CFT policies and procedures, but the ultimate parent company of the group should have responsibility for overall group compliance. This can be accomplished by having the

4. U.S. Federal Reserve Board Bank Holding Company Supervision Manual (2014).

board of directors designate an AML/CFT Compliance Officer at the parent company level, and to mandate that this person's responsibilities would be to coordinate the group's AML/CFT policies to ensure consistency. This may require a certain amount of flexibility, since the specific procedures may differ depending on the precise nature of the business. There should also be a requirement for all regulated entities of the group to provide reports to the parent's AML/CFT compliance function, including reports of suspicious transaction reports and currency transaction reports filed with the country's financial intelligence unit or equivalent body. The parent company's internal audit function should also review the effectiveness of the parent's AML/CFT compliance function, including the effectiveness of its oversight of the AML/CFT programs of the other companies in the group.

This does not mean that the bank's own board is off the hook. The primary duty of a bank's board is to ensure the bank operates in a safe and sound manner. In the case of a bank that is a subsidiary of a holding company, the bank's board must ensure that relationships between the bank and the other group members do not pose safety and soundness issues for the bank and are appropriately managed. Specifically, the bank's board should carefully review the parent company's policies that affect the bank, including AML/CFT policies, and ensure that those policies are adequate for the bank. If the bank's board is concerned that the holding company is engaging in practices that may be detrimental to the bank, or that the company's AML/CFT policies are inadequate or ineffective, the bank's board should notify the holding company's board and seek to bring about changes, if possible. If the holding company board does not address these concerns, the bank directors should dissent on the record and consider actions to protect the bank. This may entail hiring independent legal counsel, accounting experts or other consultants. The bank's board also may also wish to raise its concerns with the supervisory authority or financial intelligence unit.

Conclusion

Effective AML/CFT compliance cannot be achieved in a bank that is part of a group, unless it is implemented at the level of the group. By only focusing on the policies and procedures of the bank itself, bank supervisors or financial intelligence units may miss money laundering risks to the bank that could emanate from the bank's relationships with other members of the group. Giving high priority to AML/CFT issues as part of the supervisory mission – whether these are addressed mainly by the prudential supervisory authority itself or by the financial intelligence unit acting in cooperation with the prudential supervisor – will greatly enhance the overall quality of the supervisory function and the integrity of the financial system. To reiterate a point made earlier, the better the quality of a country's financial supervision, the less likely it is to have problems in the money laundering and terrorist financing areas.