

Money Laundering and European Banks

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Several prominent European banks — such as Danske Bank in Denmark — have been accused of having inadequate systems to detect and report suspicious activity potentially related to money laundering. According to the UN Office on Drugs and Crime, around 2% - 5% (\$800B to \$2T) of global GDP is laundered annually, though not all of it through banks. Banks and other financial institutions are under assault daily from potential money launderers. These institutions' role is not to prosecute potential money launderers, but to make it difficult for money launderers to use their facilities, and to report suspicious activity to the authorities. In Europe, anti-money laundering (AML) enforcement is a national responsibility, and the European Central Bank has limited jurisdiction. Questionable transactions involving banks currently amount to hundreds of billions of Euros.

Danske Bank experienced severe AML control and reporting problems at its branch in Estonia with non-resident customers. From 2007, when the operation was acquired from another bank, to 2016 when the customer accounts were finally closed, around €200 billion of non-resident flows went through the branch, many being suspicious. In 2014 an internal audit report noted that AML controls were inadequate. Issues came to a head in September 2017, and Danske issued a release acknowledging the AML problems at its Estonian branch. Since then, Estonian, Danish, French and US authorities have launched investigations. Danske has changed its CEO, CFO and Chief Compliance Officer, among other executives. The Danish bank has also had significant Board turnover, including a new chairman and vice-chairman. On a positive note, Danske passed the November 2018 regulatory stress tests. And last year, the bank donated 1.5B Danish kroner to an independent AML foundation, as management did *“not wish to benefit financially from suspicious transactions that took place in the non-resident portfolio of its Estonian branch in the period from 2007 to 2015.”*

It is important to differentiate among money laundering problems. Conspiring with money launderers can result in heavy sanctions and perhaps criminal penalties, whereas performing a subpar job in AML control tends to be less penalized. The fact that numerous banks in several countries are being investigated for money laundering indicates that it is a widespread issue — one which regulators have not supervised well. These factors tend to attenuate penalties. Danske has a market-leading franchise in Denmark, ample capital and sound core earnings — and is working hard to address AML control legacy issues. European authorities have not indicated that any fines assessed against Danske will be unmanageable. And it is unclear whether US authorities will fine or otherwise sanction Danske. Such fines tend to be high. **AML issues should not be a solvency concern for European banks, though we caution it is still early. Post-Crisis, European banks are more resilient as they have improved their capital and asset quality. However, we expect higher AML-related compliance spending by all European banks.**

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