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Translation from original text in Danish. In case of discrepancies, the Danish version prevails.

Report on the Danish FSA's supervision of Danske Bank as regards the Estonia case

Executive summary

In Danske Bank's Estonian branch, there have been significant violations of the European and Estonian money laundering rules. In December 2018, ten former employees in the branch were arrested in Estonia. By all accounts, for a number of years employees in the Estonian branch actively carried out and covered up the violations both to the bank's senior management in Copenhagen and to the Estonian Financial Supervisory Authority (EFSA).

A major reason that the violations were not identified by the bank in a timely manner was the inadequate overall control environment in Danske Bank in the head office in Copenhagen. Thus, in the period 2007-2015, the bank has made a number of wrong decisions or failed to make necessary decisions, which did not prevent money laundering of a potentially very large amount through the bank's Estonian branch. The bank opted not to integrate IT-systems in the branch with those of the rest of the group, which impeded the effective monitoring of the business in Estonia. This decision was not compensated for through stronger risk management. The control system did not adequately and timely detect signs of violations of the law.

In the course of 2015 and until January 2016, Danske Bank closed the International Banking department in the Estonian branch, which was the department where the violations of the money laundering regulations primarily took place. The closing down occurred following orders issued by the EFSA in 2015 after the EFSA's two money laundering inspections in 2014. However, in that connection the bank failed to examine transactions and customer relationships back in time to determine whether there had been previous transactions that were suspicious, and which should thus be reported to the Estonian FIU¹. The bank did not decide to carry out such an examination until the autumn of 2017.

¹ Financial Intelligence Unit – similar to the Money Laundering Secretariat at the Public Prosecutor for Serious Economic and International Crime (SØIK) in Denmark. A FIU is the authority which receives reports of suspicious transactions and reviews these, i.a. to forward them to the police and other authorities for further investigation and prosecution.

The division of responsibilities between the Danish FSA and EFSA

The division of responsibilities between the Danish FSA and the EFSA with regard to Danske Bank's branch in Estonia follows from the EU legislation. As the host country supervisor, the EFSA is responsible for the AML supervision of the Estonian branch. This follows from the AML directives, and this division of responsibilities was also followed in practice. Thus, the EFSA conducted four AML inspections in the branch in 2007-2014, analysed the branch's customer mix, in a number of cases requested information from the branch about customers that might be suspicious, had the dialogue with the bank regarding the branch's money laundering risks and issued orders to the bank regarding the handling of the branch's money laundering risks. Suspicious transactions and activities must be reported to the Estonian FIU. The Estonian FIU has continuously received a large number of reports of suspicious transactions from the branch, and the FIU has continuously requested information from the branch on a large number of customers that might be suspicious.

The EFSA had the power to stop the violations when the EFSA became aware of them during the inspections in 2014. The EFSA was not dependent on possible actions from the home country supervisor (the Danish FSA). When the extent of the problems became clear to the EFSA, the EFSA put pressure on Danske Bank, which contributed to the bank closing the International Banking department in 2015.

As responsible for the supervision of the Danske Bank Group, the Danish FSA's task in relation to the money laundering supervision of the Estonian branch was to ensure the integration of the work carried out by the EFSA into the overall supervision of Danske Bank. The Danish FSA answered all inquiries from the EFSA, and in one case from the Russian central bank, regarding money laundering risks in the Estonian branch.

In 2007, the Russian central bank warned the Danish FSA about money laundering risks related to a number of Russian clients in Danske Bank's newly acquired Estonian subsidiary. On the basis of this inquiry, the Danish FSA asked Danske Bank for a report and discussed the matter with Danske Bank's head of the Legal department (who was also the person responsible for AML) and the bank's Chief Audit Executive. The feedback received from both was that there were no problems in relation to money laundering risks in the Estonian subsidiary. The Danish FSA informed the EFSA of this and in that context also took into consideration that the EFSA was aware of the area, as that year the EFSA had completed an AML inspection of the Estonian subsidiary. Here, the EFSA found deficiencies in relation to the subsidiary's management of money laundering risks and on that basis issued an order for the subsidiary on further measures to investigate new non-Baltic customers (non-resident customers) and to strengthen internal procedures to prevent money laundering. However, neither Danske Bank nor the EFSA identified problems on a scale anywhere near what was later identified.

In 2009, the EFSA conducted a follow-up AML inspection in the branch (the now former subsidiary). In that connection, the EFSA found that the branch had appropriately followed up on the order from 2007.

In 2012, the EFSA contacted the Danish FSA regarding the Estonian branch, as the EFSA had become concerned about the number of non-resident customers in the branch. On that background, the Danish FSA made contact with Danske Bank and asked the bank to address the EFSA's concerns. The head of the Legal department and the head of Compliance and AML replied that they were very aware of the risks associated with the branch's non-resident customers, and that processes in the branch took particular account of these risks. They also stated that the group's internal audit had assessed the processes related to AML in the branch in the autumn of 2011 and found them satisfactory.

However, the Danish FSA did not find the bank's explanation satisfactory and requested further information. Therefore, the head of Compliance and AML submitted a detailed description of the Estonian branch's management of money laundering risks. The Danish FSA informed the EFSA of the reply, enclosing the two letters from Danske Bank. The Danish FSA concluded that the large concentration of customers from high-risk countries could be problematic, but that the Danish FSA's preliminary conclusion, based on a review of the business procedures, was that the bank's procedures and controls were satisfactory.

In 2013, the EFSA contacted the Danish FSA again regarding money laundering risks in the Estonian branch. The inquiry was based on a warning from the Russian central bank which included a list with a number of the branch's Russian customers, which the Russian central bank considered to be suspicious, and on the EFSA's own analysis of the branch's customer mix. The Danish FSA asked Danske Bank to address EFSA's request. The bank's acting head of the Legal department replied that the Estonian branch had a special setup in the light of the elevated money laundering risk in the branch. Additionally, the acting head of the Legal department referred to the detailed description of the setup, which the bank had sent the year before. The Danish FSA informed the EFSA about this.

The EFSA subsequently informed the Danish FSA that the EFSA had requested from the branch documentation on the Russian customers in the branch mentioned in the warning from the Russian central bank, and had made an assessment of them. The EFSA had not found significant breaches of internal procedures or legal requirements and generally considered the branch's AML procedures to be in accordance with statutory requirements. The EFSA also found that while the EFSA remained concerned, there was no reason for immediate regulatory action. However, in the following months the

EFSA would decide whether to carry out an inspection in the branch and inform the Danish FSA thereof.

Regardless, the Danish FSA found that it might be relevant to conduct an AML inspection in the branch, and offered the EFSA to participate in such an inspection, should the EFSA consider it appropriate. The Danish FSA repeated the offer several times. Subsequently, the EFSA conducted two AML inspections in 2014. The Danish FSA was not asked to attend. The inspections showed significant weaknesses in the branch's AML procedures and led to orders from the EFSA and the replacement of the branch's local management. They also contributed to the bank in 2015 closing down the branch's International Banking department.

Furthermore, the Danish FSA has ensured that the supervision of money laundering risks in the Estonian branch were part of the annual risk assessments carried out in 2013-2018 in the Danske Bank supervisory college, with the participation of supervisory authorities from countries where Danske Bank operates, as well as the European Banking Authority (EBA).

When it became clear in 2017 that the extent of suspicious transactions in the Estonian branch was significantly higher than the bank had previously told the Danish FSA, the FSA launched an investigation into the bank's overall management and governance in relation to the money laundering risks in the branch. On that basis, the Danish FSA made a decision in May 2018 and issued eight orders and eight reprimands to the bank for deficiencies in the bank's overall governance in relation to the Estonian branch. The decision was made by the Danish FSA's Governing Board. In that context, the Governing Board took advantage of the option of consultation with specially summoned qualified experts, primarily in relation to the assessment of whether there were grounds for taking action under the fit & proper rules against management or key personnel in the bank at that time.

Criticism of the Danish FSA

In connection with the case, criticism has been raised against the Danish FSA, and it has been questioned whether the Danish FSA has lived up to its supervisory obligations. In this report, some of the main criticisms are addressed.

This includes the question of whether the Danish FSA should have discovered *the extent of suspicious transactions* in the Estonian branch at an earlier stage. It is evident from this report, that the Danish FSA responded to the warning which came from the Russian central bank in 2007 as well as the inquiries from the EFSA in 2012 and 2013, cf. above. The Danish FSA based its actions on the assessments from the EFSA, and the information the bank provided. Danske Bank's own investigations have subsequently revealed that by all accounts, employees in the Estonian branch actively carried out and

covered up violations to the bank's overall management in Copenhagen and to the EFSA for a number of years.

It has been argued that the Danish FSA *has been overly trusting of the information received from Danske Bank*, and that the Danish FSA should have verified the information to a higher degree.

The Danish FSA requested additional detailed documentation, depending on the quality of the information, and compared it with the information from the EFSA's AML supervision of the branch, cf. above. However, the evidence shows that the bank did not always provide the FSA with accurate information, and that in several cases this was due to the bank not being sufficiently thorough in its investigation of the facts before replying to the Danish FSA. Thus, the Danish FSA did not uncritically trust the information from the bank – neither information on AML in the branch in Estonia or on the Danish activities.

It is clear, however, that the efforts in making further inquiries, involving the information from the EFSA's AML supervision of the Estonian branch and going into more detail to get accurate information did not yield the desired result, as in the end the information was still not correct in all cases. For this reason and others, the Danish FSA has ordered the bank to ensure that the Danish FSA receives adequate information, and that the Board of Directors and the management are sufficiently involved herein.

This report also addresses whether the Danish FSA has sufficiently involved knowledge from the *internal whistleblower* in Danske Bank. The FSA's considerations regarding this subject were, on the one hand, whether information from the whistleblower could provide better insight into the case, and on the other hand, the fact that the Danish FSA's investigation of Danske Bank was confidential information that would be unjustifiably disclosed if the Danish FSA approached the whistleblower. Furthermore, the case was sufficiently clarified to allow the Danish FSA to make its decision in May 2018, even without further information from the whistleblower, as the Danish FSA had received the information from the whistleblower from Danske Bank in 2017 and 2018, and largely took it into account in the decision.

In the media, the whistleblower was quoted as saying that there were deficiencies in the presentation of facts in the Danish FSA's decision, without specifying which deficiencies. Therefore, the Danish FSA contacted him repeatedly. This has not led to the whistleblower wanting to speak to the Danish FSA.

There has been criticism of the Danish FSA for not reporting Danske Bank to the police in connection with the decision in May 2018. According to general principles of Danish administrative law, the Danish FSA may only report a firm or a person to the police when, on the basis of its knowledge and professional

assessment of the case in conjunction with court practice, the Danish FSA considers it likely that the report might lead to conviction. In a number of cases with Danish banks in the period following the 2008 financial crisis, it has proved to be very difficult to bring cases of mismanagement to conviction according to the management rules in the Financial Business Act. Despite the bank's managerial failures and the seriousness of the matter, it was not likely that a police report for violation of the management rules in the Financial Business Act would lead to a conviction.

The Danish FSA has also been criticised for not demanding members of Danske Bank's management removed to be from their positions. In connection with the Danish FSA's investigation of Danske Bank's management and governance in the spring of 2018, the Danish FSA assessed whether, as a result of their handling of the Estonia case, the involved management members continued to live up to the fit and proper requirement. However, there was no basis for initiating fit and proper proceedings.

In the media, it has been criticised that the decision from May 2018 does not mention *a meeting at Danske Bank in October 2013*, where it was discussed whether the bank should scale down the International Banking department of the Estonian branch as a result of money laundering risks. In the meeting, the CEO requested that a middle ground was found and that the topic should be debated in another forum. The Danish FSA was aware of the statement, and it was thus also part of the basis for the decision. However, the Danish FSA considered it more appropriate to include a similar quote from the Board of Director's strategy seminar in June 2014, where the strategy in the Baltic countries was discussed. At this time, the CEO had much more extensive knowledge than in October 2013 regarding the shortcomings of AML in the Estonian branch. Therefore, it was considerably more significant that the CEO warned against a quick phase-out of Baltic activities in June 2014, than it was when he did it in October 2013.

There has been criticism that, as a former executive in Danske Bank, the *Danish FSA's chairman at the time* in the period 2016-2018 may have affected the Danish FSA's conclusions in regard to the processing of the decision regarding Danske Bank from May 2018. Throughout the period when the Danish FSA's Governing Board processed the case against Danske Bank, the Danish FSA's chairman at the time declared himself to be disqualified, and thus did not participate in the meetings at this point. Thus, there has been no risk that the Danish FSA's decision would be influenced by the chairman at the time's personal interests in the case. This is underlined by the fact that the Danish FSA's decision contains significant criticism of the FSA's chairman at the time for his work in the role as the bank's CFO and executive responsible for compliance and AML.

Possible initiatives

The Danish FSA has developed a catalogue containing a number of proposals concerning tightening of legislation, strengthening of AML supervision and the allocation of extra resources to the Danish FSA. Some of the proposals concern supervisory activities where the Governing Board lays out the priorities for the Danish FSA. It will require a political decision to allocate additional resources to the Danish FSA, if these proposals are to be implemented. If resources are allocated, the proposals could be initiated relatively quickly. Other proposals will require legislative changes.

The proposals aim to address issues exposed by the case, but there are also proposals which can contribute to ensuring that Denmark has a regulation and a supervision in the area which are in the European elite. The proposals are grouped into four main areas and elaborated in Chapter 5:

A: Better and more effective lines of defence in banks

B: Duty to disclose and criminal liability, as well as improved protection of whistleblowers

C: Tougher consequences when bank management fails to live up to its responsibility

D: A money laundering supervision in the European elite

Danske Bank is continuing its work to uncover the activities in the Estonian branch. The Danish FSA has also reopened its investigation into the bank and is investigating if the bank's own investigations supervised and directed by a law firm provides new information compared with the information which was the basis for the Danish FSA's decision in May 2018. In addition, the case is being investigated by the State Prosecutor for Serious Economic and International Crime (SØIK) and by both the Estonian as US authorities. Issues that can be uncovered in these processes are not included in the report.

A number of other official investigations of the specific case, as well as the Danish FSA's AML supervision in general, will be or have been launched. The European Banking Authority (EBA) is thus in the process of investigating i.a. the Danish FSA's actions in relation to the specific case. The Public Accounts Committee has also asked the National Audit Office (Rigsrevisionen) to examine the Danish AML supervision at the more general level. Finally, the Danish FSA has agreed with the IMF that later this year, the IMF will benchmark both regulation and supervision in the AML area against other, relevant countries. These investigations may lead to further proposals to strengthen the money laundering supervision and the money laundering regulation in Denmark.