FINANSTILSYNET

MEMO

DANISH FINANCIAL
SUPERVISORY AUTHORITY

19 June 2016

J.no.

Report on the involvement of Danish banks in tax evasion revealed by the "Panama papers"

Summary

It is still too early to close the Danish FSA's inquiry into the involvement of Danish banks in the "Panama papers", partly because the documents received by the Danish FSA from the eight banks approached by the Authority, largely included information of a very general nature. Therefore, the Danish FSA has asked for supplementary material from the majority of the banks concerned. The Danish FSA's perspective on the "Panama papers" case has been to determine whether or not the banks are in compliance with money laundering regulations and the requirements concerning sound and effective risk management. With regard to the latter, focus has been on possible reputational and operational risks. The Danish FSA is currently reviewing the detailed explanations received from banks. This status report provides an outline of the inquiry, as well as a preliminary outline of the banks' role.

Background

On 3 April 2016, world media conveyed the news that 11.5 million documents had been leaked from the Panamanian law firm, Mossack Fonseca. Media press coverage indicated that the documents contained information showing that individuals and undertakings had set up funds and companies assisted by Mossack Fonseca, among other things, in order to conceal assets from local tax authorities.

According to the information in the media, a small part of the documents contained information about Danish people involved in tax evasion. Furthermore, the media coverage showed that several Danish banks had played an active role in arranging contact between bank customers and the law firm, Mossack Fonseca, which set up and managed the structures mentioned.

On the basis of the information obtained, the tax committee of the Danish Parliament (the Folketing) held a public hearing on 13 April 2016 at which three banks (Danske Bank, Nordea Bank Danmark and Jyske Bank) accounted for their possible involvement in the matter. Furthermore, a number

of tax experts and the Danish FSA explained opinions regarding this type of involvement and any intervention possibilities.

Immediately after publication of the news about the leaked documents, the Danish FSA took the following steps:

- The Danish FSA has discussed the matter with the supervisory authorities in a number of other European countries (the closest dialogue being with the Norwegian and Swedish financial supervisory authorities).
- The Danish FSA contacted the European Banking Authority (EBA) and asked for the case to be processed at a meeting with the Board of Supervisors.
- The Danish FSA has held several meetings with the Central Customs and Tax Administration (SKAT) concerning cooperation and exchange of information for use in investigations by SKAT into specific cases on tax evasion and involvement in these.
- On 13 April 2016, the Danish FSA sent a letter to eight selected banks requesting a statement on their possible involvement in the case (see below).

Subsequently, the Danish FSA has asked the majority of the selected banks for further documents, as the replies received were not specific enough.

Legal aspects

If Danish banks have been involved in tax evasion by customers, this may be contrary to the Money Laundering Act and the requirements of the Financial Business Act, which stipulates that a financial undertaking must have an effective form of corporate management. This status report does not state whether the involvement of banks is also a breach of tax legislation, as this falls outside the competence areas of the Danish FSA.

The Money Laundering Act

"Money laundering" as defined by the Money Laundering Act means that a natural or legal person unlawfully accepts or acquires or obtains for others a share of economic proceeds obtained through an offence punishable by law. Similarly, "money laundering" is also considered as subsequently contributing to securing the economic proceeds from an offence punishable by law by unlawfully hiding, storing, transporting etc. such proceeds. The definition also covers attempted money laundering.

Punishable violations are covered by the Criminal Code and specific legislation. The most important element in this context is that the economic proceeds are identifiable. It follows from the Money Laundering Act that banks must meet a number of obligations aimed at ensuring that measures to prevent and guard against money laundering are effective. In brief, the obliga-

tions entail drawing up adequate internal regulations on customer identification, the obligation of attentiveness, the investigation obligation and the notification obligation. Together, these ensure that banks have the required knowledge about their customers to be able to react if these customers intend to make transactions involving money laundering or attempted money laundering.

Transactions undertaken throughout the course of a customer relationship must be consistent with the bank's knowledge about their customer's business and risk profile, including, where necessary, the source of funds. Thus, banks are obligated to monitor continuously the circumstances of the individual customer to gain this insight.

If a bank suspects that the relevant customer's transaction or request has or has been linked to money laundering, this matter must undergo further scrutiny. If the bank is unable to fully disprove the suspicion, the bank must notify the Public Prosecutor for Serious Economic and International Crime. Thus, stating that the bank's further investigation into a matter has merely weakened the suspicion will not suffice.

The requirements of the Money Laundering Act concerning notification of suspicious transactions to the Public Prosecutor for Serious Economic and International Crime do not take into account the underlying type of criminal activity.

The reporting obligation only applies, however, if the violation has a maximum penalty of one year or more. In practice, this has no great significance, as most types of criminal activity involving proceeds for money laundering have a maximum penalty of more than one year. The requirement of a year's maximum penalty will not be included in the bill for a new Money Laundering Act soon to be presented, as this is not expedient for banks and their employees to work from.

Note that this is solely compulsory notification and not a police report.

The boards of directors of banks have overall responsibility for ensuring that the individual banks comply with the money laundering regulations. The board of directors is obligated to ensure that the bank has prepared a risk management policy for money laundering. Furthermore, on the basis of a specific risk assessment for the bank, the board of directors must ensure that the bank's management has implemented sufficient measures to counter the money-laundering risks identified. Finally, on the basis of the bank's current risk for money laundering, the board of directors must assess the extent to which there is a need for periodical and ad hoc reports from the bank's management or the person responsible for the money laundering ar-

ea and continuously monitor the adequacy of management's administration of the area.

If the board of directors and the board of management fail to meet this responsibility, it may be necessary to carry out a new fit and proper assessment pursuant to the regulations laid down in the Financial Business Act. However, violations of the Money Laundering Act alone have not yet caused the Danish FSA to make such reassessments of the individual members of the management.

Examples of situations where a customer launders illegal proceeds from tax evasion include: A customer in a bank who makes a cash deposit deriving from income where tax has not been paid. After this, the customer will be able to carry out, or attempt to carry out an electronic transfer abroad, often by means of companies established in tax havens which do not have any genuine activity, or the customer could disguise funds as proceeds from legal business transactions. The customer will then have the funds retransferred to repay (fictive) loans or to pay (fictive) invoices from the foreign company which the customer controls.

Another example could be that, in connection with sale of a company, the owner of the company, intends to keep the proceeds from the sale outside the jurisdiction of the taxation authorities. In order to do this, the funds are transferred to a company and subsequently channelled back to the company owner in the same way as described above. In this case, the bank is obligated to react to a suspicion of illegal transactions, see the description above concerning the obligations of the Money Laundering Act.

Financial Business Act
Pursuant to section 71 of the Financial Business Act, a financial undertaking must have effective corporate management. This includes a requirement that banks must have effective procedures to identify, manage, monitor and report the risks the bank is or could be exposed to.

The Executive Order on Management and Control of Banks etc. contains a number of requirements for the structure and organisation of banks to ensure that overall risk management by the relevant bank is managed effectively. The reputational risk and strategic risks of banks are not independently described in the Executive Order on Management and Control of Banks etc., however, Annex 3 of the Executive Order on Management and Control of Banks etc. states that, where relevant, reputational risks and strategic risks must be treated according to the same principles as operational risks.

In recent years, reputational and strategic risks in relation to anti-money laundering have been under increasing scrutiny from authorities and media at national and international levels. Therefore there is currently a significant

trend towards banks allocating more resources to ensure compliance with the obligations laid down by the Money Laundering Act, because there can be significant image-related, and thus business-related, consequences for a bank if it becomes public knowledge that a bank is failing in this area of its business.

In short, the above means that the management of a bank must assess the risks in relation to the bank's reputation and strategy with regard to the bank's participation in special structures or customer relationships with particular customer segments which, in this case, are intended to effect tax evasion. Similarly, the management must ensure that the bank's overall business model has been assessed in relation to establishing customer relationships involving a risk that the bank contributes to, or even participates in tax evasion. A poor reputation in relation to compliance with applicable legislation may mean that the bank loses customers as they will not want to have to a bank with a stained reputation. Furthermore, failure to comply with legislation may lead to supervisory reactions from the Danish FSA that may affect share prices in the event of major and significant violations invoking public attention. Therefore there are several risks associated with tax evasion by customers which the bank must manage as part of its risk management.

Request from the Danish FSA for a statement

In mid-April 2016, the Danish FSA sent a request for a statement to eight selected banks. The banks concerned had been selected on the basis of an overall assessment of their business model. The statement was to include the following:

1. Information about how the bank and its subsidiary companies have ensured that they do not participate in, or assist their customers in making transactions in order to evade taxes. This could, among other things, be a possible breach of the money laundering regulations.
2. The extent to which the bank and its subsidiary companies are familiar with their customers' foreign company structures set up with the primary purpose of tax evasion. This could be, but is not limited to, information about setting up foreign trusts the paid-up capital of which can continue to be part of the assets of the promoter. Furthermore, this could be information received in connection with services rendered in relation to foreign companies or accounts owned by customers.

3. Whether or not the establishment, or simply the continued use of such company structures took place at the request of the bank or its subsidiary companies.
4. How reputational and operational risks have been assessed by the bank's management in relation to participation by the bank or its subsidiary companies in the above structures and customer relationships.
5. Whether or not the bank's overall business model has been assessed in relation to establishment of customer relationships where the above risk of assisting in tax evasion could occur.
6. Significant changes made by the bank or its subsidiary companies since 1 January 2006 in the matters described in points 1 to 5 above.

As stated above, the Danish FSA's request had a broader aim than merely information which solely concerns customer relationships established in Panama or other specific geographical areas or which involved specific advisors. This was intended to ensure that banks described their overall possible involvement in tax evasion cases.

If a bank is part of an international group, the financial supervisory authority in the country where the parent undertaking is located has the primary responsibility for overall supervision of the banking group. For such group structures, the Authority supervises domestic activity in each of the countries where the bank is present, whereas the overall view of the group falls under the jurisdiction of the supervisory authority of the parent bank. The supervisory authorities concerned participate in "colleges" where topics of relevance for all parties are reviewed.

Banks were given a 14-day deadline to submit their statement.

All eight banks submitted a statement within the deadline. However, for many of the banks, the statement was incomplete in that the banks failed to provide information about how and to which extent the banks had been involved in such cases. Against this background, the Danish FSA has decided to ask a number of supplementary questions to most of the banks and the Danish FSA has not yet finished this review. However, on the basis of the replies received it is possible to describe the current general status of the banks' involvement.

Current status

Since the beginning of the process the Danish FSA's discussions with the supervisory authorities in other European countries have entailed close cooperation including mutual exchange of information of relevance to the other supervisory authorities. This close cooperation will continue for as long as

new information arises about the involvement of various banks in tax evasion.

The EBA's Board of Supervisors met in April 2016 to discuss the Panama papers.

The Danish FSA will continue its cooperation with the Central Customs and Tax Administration (SKAT) and is discussing developments in the matter, as well as how the two authorities can together contribute to clarifying the matter.

The replies received from the banks concerned indicate that the primary reason the Danish FSA has not received the information requested within the initial deadline is that the banks themselves have not had the required insight into their obligations to take action in the event that they become aware of possible tax evasion by customers. Thus, in the assessment of the Danish FSA, several of the banks only started investigating after the Danish FSA's inquiry, whether their customers could be of the type whose foreign company structures invoke special attention in relation to the risk of money laundering. The basis for this assessment is that several of the initial replies are very brief and without documentation attached. Furthermore with regard to the first part of the ten-year period covered by the request, it appears that the banks had customers who did not pay statutory taxes. The basis for this assumption is that some of the banks, in their replies, state that during the ten-year period, they have tightened their procedures to avoid getting involved in tax evasion.

However, based on the preliminary information received by the Danish FSA, only a few Danish banks have had customers who have not paid taxes due. These are primarily private banking customers. Furthermore, there is much to indicate that the majority of the customer relationships concerned pertain to customers who are not liable to pay tax in Denmark and where the customer relationship is solely anchored in the bank's international subsidiary company/branch. At this time, it is not possible to comment on whether the contact with the international entity took place at the request of the customer or through consultancy from a Danish employee in the relevant bank. However, on the basis of the information available, there only seems to be limited involvement by Danish banks in the Panama papers or other similar structures relating to tax evasion.

Banks' exposures with customers in which the banks cannot deny their involvement in tax evasion seem to have decreased as public perceptions in general have changed with regard to whether tax evasion is acceptable behaviour. However, the choice does not seem to have been made on the basis of an assessment of possible reputational and operational risks as the

decision to have such customer types does not seem to have been taken on such an informed basis.

At present, it is clear that banks do not have a full overview of the number of customers who have used the bank to channel funds for tax evasion, and who are still bank customers.

With regard to money laundering legislation, it seems that Danish banks have not in general been aware that tax evasion is an area covered by the money laundering definition. It is still too soon to draw conclusions about this, but banks may have been reluctant to ensure that they have the required information about the origin of funds, particularly from private banking customers, and similarly, their monitoring has not been able to identity such suspicious transactions. Without this knowledge, it will be difficult for banks to set up the measures required to prevent money laundering.

The preliminary replies also leave the Danish FSA with the impression that the bank managements are not fully aware of their responsibility to ensure compliance with the money laundering legislation.

The replies received indicated that several of the banks concerned are dominated by a culture in which increased earnings have been allowed to take precedence over focus on the importance of money laundering regulations. The individual boards of management and boards of directors are responsible for ensuring a sound culture in the relevant bank, in which the bank's social responsibility to protect against abuse of the financial system for money laundering prevails. In the view of the Danish FSA, the ongoing assessments by all banks should establish whether the bank has the right competences to ensure that management meets its responsibility.

Some banks refer to the fourth Money Laundering Directive, in which tax evasion will be more clearly included as underlying criminal activity, although tax evasion is already included in the definition of money laundering, as the Act does not specify the type of criminal activity from which the proceeds derive. Some of the replies state that the banks have notified the Public Prosecutor for Serious Economic and International Crime about suspicious transactions indicating tax evasion, which means that in these cases, banks have not considered tax matters to be exempt from the scope of the Money Laundering Act.

The process moving forward

Over the summer, the Danish FSA will further assess the replies received. To that end, the Danish FSA will consider the need to launch targeted on-site inspections at banks where the Authority assesses that there may be a risk that the bank is or has been involved in tax evasion. The Danish FSA

will also intensify its existing dialogue with the Central Customs and Tax Administration (SKAT) in order to further strengthen this collaboration.

Possible new initiatives

The Danish FSA is seriously considering whether or not the entire "Panama papers" matter should give rise to changes in the regulatory foundation for financial undertakings, or whether initiatives should be taken in other ways to safeguard the state of the law in this area.

Banks play an important role in society with regard to protecting the financial system from abuse for illegal purposes such as money laundering. This is often argued to be an administratively heavy task for the banks, but, as illegal proceeds can be disguised far more effectively and can more easily be transferred across borders once they have entered the financial system, it is crucial that banks are a robust and efficient safeguard against this type of criminal activity.

Therefore, the Danish FSA suggests considering the following initiatives:

- The Danish FSA is currently prevented from sharing specific information with the Central Customs and Tax Administration (SKAT) due to the special duty of confidentiality stated in the Financial Business Act. Therefore, an amendment is proposed that would enable the Danish FSA, at its own initiative, to share such information with SKAT, if such information is to be used in a subsequent investigation by SKAT into specific tax evasion cases. A corresponding option to share information is proposed for SKAT so that SKAT can pass on information to the Danish FSA to the same extent.
- It is proposed that the Danish FSA analyses whether the current provisions on fitness and propriety in the Financial Business Act should be tightened to ensure reassessment of an individual member of the board of directors or board of management to a greater extent than at present, and if necessary, take a decision to dismiss the person concerned. This will establish a greater incentive to ensure that those responsible for the money laundering area in the banks have sufficient mandate to execute their tasks.
- It is proposed that further resources be allocated to the Danish FSA's current money laundering supervision, so that the Danish FSA, to a greater extent than at present, can carry out inspection visits, and in other ways help disseminate knowledge about the specific obligations laid down by the Money Laundering Act.

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