

# Insight

Financial Services  
May 2017

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**COMPLIANCE**

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# No shortcuts

Few industries are more regulated than the financial sector. Regulations protect consumers, prevent criminal activities and diminish the motivation to take on short-term decisions. Still, authorities implement more regulations due to harmonisation of rules across the EU, new digital technologies as well as criminals on the look for loopholes to exploit.

Financial companies must pay attention to compliance as the consequences of breaking the rules are severe. We have already seen how major financial institutions have been sanctioned with billion-dollar fines – and in addition, the companies suffer a major reputation loss, negatively affecting the customers' trust and confidence. Financial services rely heavily on the trust of their customers and the markets, why a breach of confidence can be very damaging.

Consequently, there are no shortcuts. Compliance will remain top of mind on the board's agenda in the future as well. Thus, this present edition of Insight is about compliance.

We start in Finland with a debate on the implementation of EU's new Anti-money Laundering (AML) Directive. We listen to both sides of the case.

You can also read about Swedish SEB's considerations related to the new EU Payment Services Directive, PSD2, which will be effective from 2018. The regulation will break the monopoly of the financial institutions regarding bank account information and payment methods thus opening for increased competition for FinTechs among others.

While the numerous regulations challenge the incumbents, the picture is somewhat reversed for the smaller start-ups. We paid a visit to the Danish company Coinify which work with digital currencies and actually wishes for more regulation – read more on the following pages.

Enjoy reading!

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# Anti-money Laundering Directive raises controversy in Finland

The enforcement of the fourth Anti-money Laundering Directive has led to controversy as Finland has proposed a stricter treatment for non-life insurances than the EU. Companies challenge the proposal.

By Ilkka Huikko and Sanna Fäldt

In relation to the EU's fourth Anti-money Laundering Directive in 2015, the Finnish government has proposed expanding questions related to so-called politically exposed persons (PEPs) to cover not only banking and life insurance but non-life insurances as well. A PEP is someone who holds a prominent public position and therefore presents a higher risk for bribery and corruption.

The proposal will enforce stricter treatment for non-life insurances than in the rest of the EU, which has led many of the country's insurance companies to protest. They say it will bring even more pressure to an already heavily regulated industry.

"The regulation is worrisome, as there, in practice, is little or no risk of money laundering in non-life insurances for private persons. If a son of a Member of Parliament insures his car or pet, the risk levels are not higher than for any other person. Why would we want to make his life harder by prolonging the

client process?" asks General Counsel of LocalTapiola, Mika Juuso.

The Head of Security and Loss Prevention Risto Karhunen from the Federation of Finnish Financial Services (FFI) agrees. He says that non-life insurances should, under no circumstances, be included in the PEP query.

The industry – led by the FFI – has brought up their concerns with the Finnish Commerce Committee. The Committee concluded that extending PEP queries to non-life insurances sold to consumers would not help prevent money laundering.

The Committee has now given a proposition to the Administration Committee to define the regulation. It sees that, in accordance with the Directive, it is justified to include full-scale customer due diligence measures in both life and investment insurance operations. At the same time, the proposal suggests that non-life insurances would be handled through simplified customer due diligence

measures. The Administration Committee will deliver its report on the issue in the spring.

## Risk-based approach

It is remarkable that Finland, one of the least corrupt countries in the world, has taken the initiative to enforce a stricter law than the rest of Europe. The original intention behind the regulation was to prevent money laundering and terrorist financing through stronger risk-based assessment.

A Senior Officer from the Finnish Ministry of the Interior, Virpi Koivu, points out that money laundering and terrorist financing have become more professional, and terrorists use mergers, acquisitions, and ownership structures in order to hide the true beneficiaries. In addition to illegal operations and the black economy, criminals are now using legal operations to cover corruption.

"This is extremely hard to catch unless we identify the companies' ownership and decision-making structures. This is the background for setting stricter and more precise due diligence requirements for beneficial owners," she says.

## Different levels of risk

Non-life insurances were included in the anti-money laundering legislation for the first time in Finland in 1998. The existing law gives operators efficient methods for managing risks inside non-life insurance.



“The regulation is worrisome, as there, in practice, is little or no risk of money laundering in non-life insurances for private persons. “

**Mika Juuso, LocalTapiola**

Virpi Koivu explains that there are different levels of risk depending on insurance areas – also within inside non-life insurances.

“The bill, as well as the law in force, includes the option for the companies to identify low-risk areas based on their own risk assessment. They can then choose to apply simplified customer due diligence measures,” she says.

According to the Ministry of the Interior, the regulation would leave room for interpretation and best practices for insurance companies.

“The bill gives insurance companies the possibility to align operations as they see fit according to their own risk assessments. They could – for example – come to the conclusion that the management will give a one-time collective consent for certain low-risk insurance products,” Virpi Koivu says.

**Great initiative, but...**

“Especially as the fight against terrorism tightens, the FFI is pleased that they have been able to turn the industries’ worries into action in regards to non-life insurance policies”, says Head of Security and Loss Prevention at FFI, Risto Karhunen.

“All in all, strengthening and stepping up money laundering prevention is a truly important goal for the whole financial industry. We believe that leaving the low-risk non-life insurances out of the stricter PEP process would help insurance companies allocate their resources to where it really counts: the high-risk products.”

**Mika Juuso**

*General Counsel, LocalTapiola*

LocalTapiola Group is a mutual group of companies owned by its customers. It serves private customers, farmers, entrepreneurs, corporate customers, and organisations. LocalTapiola’s products and services cover non-life and life insurance as well as investment and saving services.

**Risto Karhunen**

*Head of Security and Loss Prevention, Federation of Finnish Financial Services*

The Federation of Finnish Financial Services represents banks, insurers, finance houses, securities dealers, fund management companies, and financial employers. It builds an operating environment where members can increase Finnish well-being through their business.

**Virpi Koivu**

*Senior Officer, The Finnish Ministry of the Interior*

The Ministry of the Interior is responsible for internal security and migration. The Ministry’s vision is: Finland will be the safest country in Europe - a country built on equal treatment and equal opportunity.

# FinTech company asks for regulation of digital currencies

While increased regulation makes large and well-established financial institutions frown, it may rubber-stamp small FinTechs, reports Danish Coinify.

By Johan Toft Sørensen and Jens Refsgaard Iversen



Transferring cryptocurrencies via blockchain technology may transform both the global and the local financial sectors, since financial transactions can be performed without the help of a third party, avoiding the regulatory challenges that banks experience. But companies working with digital currencies find the lack of regulation challenging for business operations. That's true, at least, if you ask Peter Nordgaard, CFO of Coinify.

"We work with some of the largest firms in the world and have world-famous investors, so I would like a badge determining once and for all that we are a decent company. So, usually I say that I wish for a regulation for my birthday," states the CFO.

As one of the leading businesses in Europe offering payment solutions for all sorts of digital currencies, the Danish FinTech conducts financial transactions worth millions of Danish kroner around the world daily. However, not being a financial institution in legal terms, Coinify is not subject to the same legal requirements as banks. The Danish Financial Supervisory Authority simply does not classify Coinify as a financial institution, and Bitcoin is not considered a currency.

The implementation of more substantial regulation does not, however, imply that

Coinify will change their behaviour. Although there are no specific legal requirements for a business like Coinify, they work systematically to maintain a high level of ethics and to avoid any connections with customers whose businesses may produce negative headlines. Otherwise, they would not be able to attract any of the investors they already have, says Peter Nordgaard:

"We are a company with huge ambitions. Consequently, we are very careful about compliance. We do not trade with pirates."

#### **Blockchain offers new opportunities**

Actually, digital currencies and the underlying technology may cause one of the banking sector's biggest challenges in the compliance area, anti-money laundering

#### **Facts**

**Coinify** supplies two services. One is to help tradesmen, such as hungry.dk, receive digital currencies for their services. The other is to exchange traditional currencies for digital currencies on behalf of private individuals and companies. Coinify's primary investors are SEB and SEED Capital, among others.

**Blockchain** is the technology behind bitcoin and a series of other cryptocurrencies, but it can also, in principle, be used to deposit and administer all sorts of assets. In short, a blockchain is a network of computers in which everybody controls everybody through common and public financial records. This means that there is not one central supervisory body approving all transfers. Blockchain has been called both the biggest innovation since the internet and a real tech revolution that will change the world.

**Blockchain.info** is the name of the world's most popular digital wallet. Blockchain has more than 12 million wallets, and all payments made via this wallet are transferred by Coinify.

**Digitale valutaer**, or cryptocurrencies, can soon gain more traction. In any case, Lars Rohde, Governor of the Danish central bank, has previously stated that a Danish e-kroner built on blockchain may become reality. Moreover, Cecilia Skingsley, Deputy Governor of the Swedish central bank, has told the Financial Times that Sweden is also seriously considering introducing a digital currency.

**Peter Nordgaard** has been the CFO of Coinify since 2016. Earlier, he was a part of the management of Berlingske Media, where he was CFO. Moreover, Peter Nordgaard has been a member of the boards of Bladkompagniet and JobZonen, as well as Berlingske Pensionskasse.



> (AML) and Know Your Customer (KYC), to become completely redundant, at least as they are performed today, says Peter Nordgaard. All digital currencies have an audit trail, meaning that one can always see which other transactions the currency has been a part of. This element makes it possible to trace the money instead of the person.

"With AML and KYC, we investigate who the person in question is, which gives us a situation where quite ordinary people need to show their passport [and] medical insurance card or other ID to have a deposit of 25,000 Danish kroner in their account," says Peter Nordgaard. He continues:

"It is more interesting to know when the money is actually being spent on something illegal. We will never be able to trace the money you have in your wallet and what it was spent on previously. If, for instance, you buy illegal tobacco at Christiania using digital currencies, it will show in the audit trail. And if, at some point, you wish to buy an apartment using the digital money, we will say that it is not allowed due to our compliance [requirements]," says the CFO:

"If you want to commit a crime, do not use digital currencies. I would strongly suggest you use cash."

#### Focus on Brussels

Coinify currently has representatives in the EU to give the legislative parties the best picture of the needs of the market and FinTechs. According to Peter Nordgaard, the co-operation is very productive.

"It is understood that the regulation needs to be relevant. In my opinion, however, many of the views of the legislative organs are also relevant. With our experience,

we can make it easier for the legislative authorities to make relevant regulations that support growth at the same time."

According to Peter Nordgaard, EU politicians are planning to introduce new regulations that will affect businesses like Coinify. Legislation will, among other things, create restrictions on transactions

of a certain size, whether they are digital or not. This is a first step with which Coinify is satisfied.

"Not being subject to regulation, we have nowhere to report detection of fraud – we will have that with the new regulation that is on its way," he concludes.

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## Fast payments increase the focus on compliance

"Why is it exactly that transferring 100 Danish kroner from one person to the other should be such a huge problem? If I need to send 100 Danish kroner to a person in Thailand by traditional channels, I first have to wait several days before the transaction goes through. Secondly, part of the 100 Danish kroner will be eaten up by administration. If both parties have a blockchain wallet, you can have the amount in less than one minute, and it will be practically free of charge. But slow-running payments have worked as a compliance tool because you had the chance to cancel. So, on the one hand, we require payments that are fast, easy, and secure. On the other hand, it will increase the need for compliance."

- Peter Nordgaard, Coinify

## The EU: Virtual currencies should not be anonymous

The EU will not let the market for digital currencies remain as liberal as it is today, reports the media coindesk.com.

In March, several members of Parliament submitted a bill including, among other things, a suggestion that "virtual currencies should not be anonymous." They suggest that the EU should be better empowered to collect data on the users of digital currencies.

The collection implies, among other things, setting up databases where the so-called wallet addresses – the electronic addresses where codes for the users' digital currencies are placed – are coupled with the specific users.

If Parliament passes the bill, it will be possible to share financial intelligence at a national level, as well.



# Financial Markets Regulatory Outlook 2017

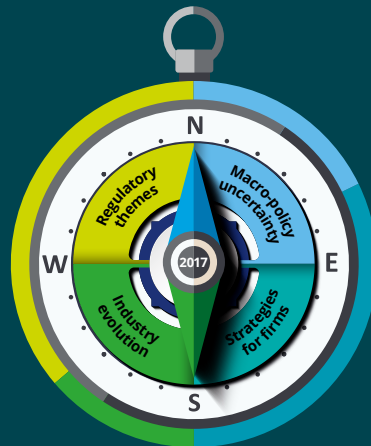
## Navigating the year ahead

2017 is bringing significant challenges to financial services firms across Europe in the form of heightened macro-policy uncertainty, the implementation of a demanding and still evolving regulatory agenda and other market developments putting pressure on the industry.

Firms need to refresh their strategies for how they respond to regulations and do business in a regulatory, economic and political environment that could be fundamentally more constraining.

Those that will succeed will capitalize on their inherent resilience, agility and efficiency, to navigate an ever-changing regulatory landscape. They will take the opportunity of the challenges ahead to not only make it work for them, but also transform and improve.

For an overview of the regulatory key-drivers affecting the financial services sector, read our "Financial Regulatory Outlook 2017".





### Resolvability

Europe test-drives bank resolvability

In 2017, resolvability will become the driving force behind structural reform in the EU. The SRB will push Eurozone banks to demonstrate their practical preparedness for resolution as EU and international regulators step up their work on CCP resolution. Resolution regimes for insurers, however, will be less of a priority.



### Conduct and culture

Firms have yet to put misconduct truly behind

The work of the FSB and IOSCO will introduce measures to tackle poor culture, lack of accountability and misaligned incentive policies. A key theme in 2017, however, will be on market participants creating industry standards that go beyond the regulatory minimum and encourage tangible behavioural and cultural change. In addition, conduct risk will increasingly be monitored by prudential regulators as part of ICAAP assessments and stress tests.



### Financial resilience

Significant implementation challenges ahead

Following the BCBS's conclusion of most of its work on the risk framework early in 2017, the EU will deliberate how to adopt the new capital standards, while protecting the region's economic priorities. Banks will have to deal with uncertainty over the final shape of the rules as well as enhance balance sheet management capabilities for TLAC, MREL and IFRS 9 implementation.



### Regulation of new technologies

The tricky business of keeping up with the times

FinTech will continue to change the industry, along with Artificial Intelligence and data analytics. Innovative entrants will find more support from European and national regulators, who will also be vigilant about the risks they pose. While PSD2 presents many business opportunities, both FinTech firms and retail banks will find its implementation challenging, in part because of the lack of specificity in some of its provisions.



### Cyber and IT resilience

More specific and more demanding

Spurred by a number of high-profile attacks on firms, supervisors will increase their focus on cyber resilience. Supervisory expectations will include more detailed planning for responses to scenarios such as cyber breaches and technological failures. Firms will increasingly use testing, war-gaming and red-team exercises to demonstrate the robustness of their resilience plans.



### Opening up markets

Vulnerable incumbents

Increased competition and the higher degree of transparency and disclosure on products and pricing under MiFID II and PRIIPs will shift the ground for all firms providing investment products. In the UK, the introduction of pension freedoms will intensify competition between life insurers and investment managers in the retirement market. Banks will need to determine their strategic positioning following strengthened competition in the payments market.



### Evolution of the trading landscape

Decision time for trading strategies

The introduction of new trading venues and the entry into force of the clearing and margining requirements will reshape how firms develop and execute their trading strategies. The authorisations and registrations for trading venues in preparation for the implementation of MiFID II will further play a crucial role. Firms will also choose to clear an increasing volume of OTC derivatives centrally.





### Brexit

Prolonged uncertainty is here to stay

The picture for EU market access remains unclear for firms assessing the impact of Brexit on their business model and strategy. This is also the case for EU firms' access to the UK market. While supervisors in the UK and EU will be watching firms' preparations and actions closely, we do not expect regulatory changes while the UK remains a member of the EU. In the light of continuing uncertainty, firms may decide to start implementing their contingency plans during 2017.

### Other drivers of macro-policy uncertainty

- Low growth and subdued interest rates
- Political risk and policy volatility in developed markets
- Rising challenges to the free movement of capital and services across borders



### Controls efficiency

The rise of RegTech

RegTech promises to enable firms to push down costs, rein in compliance risk and improve controls. However, the effective implementation of RegTech solutions will require up-front investment that may be hard to justify in the difficult commercial conditions that will prevail in 2017. For this reason we expect the adoption of RegTech to be gradual as firms seek to demonstrate how such investment will add value to the business.



### Governance strategy

Too big to manage?

Boards and senior management teams will come under increasing pressure to show supervisors that they can effectively manage groups comprising a multitude of legal entities and activities spanning numerous countries. Questions related to organisational complexity will be raised, whether on the functioning of intra-group relationships or the ability of subsidiaries to operate independently of their parent company if the need arises. This, however, will be an opportunity for firms to reduce their complexity and, in so doing, become more manageable organisations.



### Business model sustainability

Accelerating strategic change

In re-shaping their business models, firms hold the key to managing costs and restoring returns. As firms respond to the need to address new regulations and tackle increased macro-policy uncertainty, they will need to re-shape their financial resources to allow for strategic flexibility and efficiency. Supervisory and resolution authority discussions will add further pressure to integrate regulatory compliance, stress testing and resolution planning more comprehensively into business strategy and strategic planning.



# SEB takes on PSD2 with customer-first approach

“It is our job as a bank to take these ten or so regulations and create the best customer journey based on the limitations that are set,” says Head of Personal Banking at SEB.

By Daniel Blommé, Albin Lingman and Albin Hasselgren

The PSD2 will come into effect in January 2018, and many well-established financial services providers are feeling a healthy sense of worry but also seeing opportunities. At SEB, Lars Millberg, Head of Digital Banking, and Per Långsved, Head of Personal Banking, are determined to embrace PSD2 and manage the regulations with a “customer-first” strategy.

“The customer will not care which supplier is the one being most compliant with a regulation. They will choose the supplier that gives them the best customer experience and solves their pain points,” says Lars Millberg.

But – as they both point out – it can be challenging to go “customer-first” when new regulations are not always created with existing regulations in mind.

“Whether it’s MIFID or GDPR, many regulations are – just like with PSD2 – created with the customer’s rights in focus, but, putting it together, it might not have the intended effect,” says Per Långsved, and he adds that, for that reason, a bank cannot approach and manage regulatory changes as mere compliance projects.



“It is our job as a bank to take these ten or so regulations and create the best customer journey based on the limitations that are set,” he says.

### Work across value chain

And SEB is in a good position to do so. They both refer to the fact that the bank is now organised around the customer instead of products and channels.

“Regulations like this do not limit themselves to impact a single channel or a product. Our ambition is to not treat these compliance projects separately. The customer will be the common denominator,” he says.

With this approach, the bank is also determined to work agile across the whole value chain with the customer journey at the centre. And, following the customer-centric approach, transparency, openness, and daring to challenge the bank’s existing business are key in order to succeed with PSD2 projects.

### Threats from competitors

At the same time, they both acknowledge the threats of fast-paced competitors as well as the PSD2 rules that allow third-party providers (“TPPs”) access to the banks’ payments infrastructure and data. As an example, Per Långsved notes the

private finance app Tink, in which SEB, in May, made an investment. Only two months after starting, more than 20,000 Swedes had given Tink access to their bank accounts.

Tink is one of those TPPs with which SEB needs to compete or partner, and they chose to go for a “co-opetition approach,” which means that SEB wishes to both compete and cooperate with FinTechs going forward.

SEB’s customer-first approach also means that they are careful to ensure that they conduct business on their own terms instead of trying to follow the path of the FinTechs.

“A ‘full-suite’ bank with 160 years of history and customers across all ‘types’ cannot simply focus on a niche product or market, as it would betray many of its customers it has built long-term relationships with,” says Per Långsved.

### Some uncertainties

It is well-known that there currently remains some uncertainties in how one, in practice, must manage the PSD2, as all the details on the regulation are not yet clear. As the implementation of PSD2 draws closer, SEB is focusing on what they know, which is that digitalization of the industry will continue at a high speed and with that comes new fast-paced and agile market entrants. For this, SEB needs to be prepared.

Moving forward, both Lars Millberg and Per Långsved agree that remaining uncertainties on details of PSD2 should neither control nor paralyse an organisation in its effort to become customer-centric.

“Because even if something would be out of scope for PSD2 – will that mean that we do not go ahead with it? If it will improve the customer experience – why shouldn’t we do it for the sake of our customers?,” Lars Millberg concludes.



# Financial Crime Risk Management in the Nordic Region: A Clean Start

Nations and their businesses have yet to achieve full compliance with international financial crime risk management standards. Why is that? What lessons could be learnt from others?

By James Graham Dillon, Partner, Deloitte UK and Emma Hardaker, Director, Deloitte UK

The magnitude of fines for financial crime control-related failings is the stuff of global headlines. Some of the world's largest banks have been subject to multi-million, if not multi-billion, dollar penalties for circumventing sanctions, poorly controlling money laundering, and failing to prevent bribery in their organisations.

But national assessments indicate that financial crime risk management in many nations still does not meet the internationally agreed-upon standards for combatting the use of the financial sector for the profiteering of criminals. This may be a surprising state of affairs when one considers how long those standards have been in place, not to mention the monetary expenditures of nations seeking to adhere to them.

So – why is this? And what are the lessons that could be learnt and applied in countries that are keen to learn them?

## A step back

In 2014, Norway was formally revisited by the Financial Action Task Force (FATF) after their evaluation cycle began. Despite the

intervening period of follow-up supervision, and despite the events of the intervening years since Norway was first visited in 2005, the evaluation still found “significant weaknesses in a number of key areas.”

The terrorism-financing sanctions regime and limited publicly available information on corporate ownership were two of the weaknesses identified. At this time, it is not possible to say what the findings will be when the other Nordic countries are visited in the near future. However, it is possible to say that the countries should look to the Norwegian experience and ask themselves, “Are we ready, or do we need to do more?” The consequences of negative mutual evaluations for the globally significant companies established in the Nordic region could be significant, as financial institutions outside of the Nordic region do include the results of FATF evaluations in their assessment of their counterparts' financial crime risks.

That the local regulators are alive to this fact is undeniable. Sanctioning and fining within the region is increasing, and some companies have been caught

by surprise to find themselves under a spotlight. One thing is clear: any actual or perceived deficiencies in the region interest both the home state regulator as well as supranational actors. There is, year after year, a greater spotlight from regulators, as well as the global community, on the effectiveness of financial crime risk management frameworks.

## How do others approach this?

The examples available are not always the best ones to follow, resulting, as they have, in fines and restrictions on trading for companies. But the opportunity exists to learn from their mistakes. As a start, failing to take this seriously is a mistake that neither regulators nor companies should make. Assessment of the financial crime threats within the region aid institutions in undertaking vulnerability assessments, enabling them to modulate their business practices to better safeguard the financial system.

The other key lesson that can be learned from experiences elsewhere is that the fines may not have produced the desired results. Companies are subject to repeated

### FATF Facts

- The FATF is an inter-governmental body with its roots in the G-7 Summit held in Paris in 1989.
- In 1990, the FATF produced the first iteration of its Recommendations to provide countries with a comprehensive plan of the actions needed to combat money laundering, terrorist financing, and the proliferation of weapons of mass destruction.
- All members of the FATF are subject to evaluation against the Recommendations; these evaluations are conducted by teams from other member nations.
- In common with a number of countries, the Nordic countries were found to be deficient as against the FATF Recommendations in their mutual evaluations conducted in the first decade of this century, and were subject to a follow-up regime commonly deployed by FATF.
- Due to the progress made, all exited this follow-up regime by mid-2013.
- In 2014, the cycle began again, with Norway being the first country reviewed.

finer; that much is certain. There is limited evidence to suggest that the fining of one institution results in a reduction in other companies committing offences of a similar nature. Rather, the offences seem to be continuing whilst the fines increase.

So the message from regulators would seem to be that the "stick" is better than the "carrot." However, the headlines only tell part of the story. The companies that are encouraged, rather than coerced, into compliance are not making the headlines. The gentle but unyielding application of principles can produce long-term results where perhaps fines and other enforcement tools do not. The balance of clear rules, to be applied to govern the most serious breaches, versus the capacity

to make judgements and steer companies in the right direction, where such an approach is justified, should be considered carefully when defining regulatory frameworks. Principles-based regulation, such as what is seen in the UK, may not produce headline-grabbing results, but it can produce potentially more impactful long-term results in a reasonable economic situation.

Neither companies nor regulators should underestimate the resource augmentation required to staff a fully effective approach. For a global bank, staffing for financial crime functions can run in to the hundreds, if not the thousands of people, even where the function is purely for the second line of defence. Add in the efforts of the first

line and specialist teams therein, and that number only increases. Regulators need the capacity to supervise, to visit, to report, and to make policy – roles that do not always sit comfortably with the few individuals trying to cover them all.

### The bottom line

There is a great opportunity for the Nordic region to establish a financial crime risk management framework at regional, country, regulator, and institutional levels that reflects the needs of the region. Careful consideration of the appropriate modulation of approach, the balance of carrot and stick that will be suitable for achieving the stated aims, and the proper staffing to manage the task will all be critical factors in success.





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