AML Update – Strengthening Controls

Seminars for Heads of Compliance and Money Laundering Reporting Officers

5 & 6 June 2014

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Program Outline

Implementation Issues

⬇

Observations from recent examinations

⬇

Future areas of focus

⬇

Q&A

Correspondent Banking

AMLO Guideline

Paragraph 11.1

- In the AMLO, correspondent banking is designed as the provision of banking services (such as credit, deposit, collection, clearing, payment or other similar services) by an AI (the correspondent) to another institution (the respondent) to enable the latter to provide services and products to its own customers. *Correspondent banking activity can include establishing accounts, exchanging methods of authentication of instructions, etc.*

➢ Consistency issues have arisen over 'the issue of authentication of information'

➢ Constructive industry dialogue has taken place through HKAB AML Committee

Correspondent Banking

What due diligence is required for SWIFT Relationship Management Application (RMA)?

➢ AIs may adopt the principles set out in Paper - *Wolfsberg AML Principles for Correspondent [2014]*

➢ Mere exchange of keys may <u>not</u> amount to a Correspondent Banking Relationship

➢ Where an exchange of <u>non-payment related</u> information is intended, relevant CDD *may* be unnecessary

➢ Where <u>payment related</u> information is exchanged of intended to be exchanged then AIs need to carry out CDD as required under AMLO

➢ It will be for the AI to demonstrate that a correspondent relationship does not exist and that the AI is fully compliant with AMLO

➢ The HKMA will continue to closely scrutinise due diligence and risk management practices over Correspondent Banking

Verification of the Existence and Legal Form of a Trust

Pre AMLO Requirement

- To obtain satisfactory evidence of the existence, legal form and parties
- Example:
  - obtaining a copy of the trust deed

AMLO Guideline
[*Risk based* - all examples can meet the requirement]

- To obtain appropriate evidence to verify the existence, legal form and parties to a trust
- Examples:
  - (i) sight of the instrument;
  - (ii) ref. to an appropriate register;
  - (iii) confirmation from the trustee acting in a professional capacity;
  - (iv) confirmation from a lawyer; and
  - (v) for trusts that are managed by the trust companies which are subsidiaries (or affiliate companies) of an AI, that AI may rely on a written confirmation from its trusts subsidiaries etc.

Understanding ML/TF Risk

➢ AIs must understand the nature and level of ML/TF risks
  – Assessment should include all areas, including products, services, targeted customers, entities or geographic locations
  – Detailed analysis of the data should be performed to identify and assess the risk within these categories
  – Process for periodically reviewing and updating the risk assessment must be adequate and may be assessed

➢ Objective is to demonstrate that internal controls and AML/CFT programmes been developed to adequately mitigate those ML/TF risks
  – Board should consider whether the AML/CFT programme ultimately leads to a reduction in ML/TF activity that has been identified

AMLO Guideline

2.1	AI must take all reasonable measures
2.2	Take into account risk factors
2.3	Product / Service risk
2.4	Delivery / Distribution channel risk
2.5-7	Customer risk
2.8	Country risk
3.3	An effective RBA does involve identifying and categorizing ML/TF risks at the customer level and establishing reasonable measures based on the risk identified

Regulatory Expectation

➢ Objective is to assess the AI's ML/TF risk profile and evaluate the adequacy of the its ML/TF risk assessment process

➢ HKMA will obtain and review the AI's ML/TF risk assessment as part of the examination scoping exercise:

  – Has AI included all risk areas, including any new products, services, or targeted customers, entities, and geographic locations?

  – Is the process for periodically reviewing and updating the ML/TF risk assessment adequate?

  – Is the risk assessment in written form?

  – Has the risk assessment been shared and communicated with all business lines across the bank, board of directors, management, and appropriate staff? Do those staff understand the risk assessment?

➢ ML/TF risk profile will be discussed with the AI

Purpose & intended nature of the business relationship

➢ Means developing a more comprehensive picture of the customer and includes, for example, measures to establish customer's occupation and source of funds

➢ Key information for solid basis for ongoing monitoring
  – Guidance paper [December 2013] footnote 7 on Page 8
  – Legal obligation under AMLO, section 2(1)(c) of Schedule 2

➢ Meaningful steps must be taken, generic information insufficient

Source of Wealth

➢ Fundamental control in Private Banking and Wealth Management

➢ Observations:

 – Risk-based due diligence needs to be adequate, guidance to front line staff needs to be clear

 – Adequate documentation should be maintained

 – Should not accept overly simplistic explanations at face value without challenge

 – Strong oversight essential

➢ Senior management must ensure there must be a culture in which RMs take responsibility for making ethical decisions based on knowledge of the customer

Regulatory Expectation

➢ Information obtained must be meaningful
  – Risk-sensitive measures should be applied to verify information
  – Must be evidence of challenge and escalation where appropriate especially where there are elevated risks associated with the relationship

➢ Where relevant information about a higher risk customer's source of wealth was obtained, verify this and do not put reliance solely on the word of customers
  – Should <u>not</u> be routine

Internal Audit

- ➢ Effectiveness of Internal Audit Reviews
  - – IA should play a strong role and identify control failures
  - – Specialist resources may be used where appropriate
- ➢ Frequency & scope of reviews must address Bank's risks
  - – Correlation with risk assessment will be examined
- ➢ Observations of recent IA and compliance reviews on AML controls often do not drive change
  - – Quality issues or information not discussed at sufficiently senior level

Guidance Paper

3.6	AIs should take into account the size, nature and complexity of its business in an appropriate assessment, prior to the launch of the transaction monitoring system. To ensure adequate coverage of its business operations, the assessment should take into consideration the question of whether to implement, and if so the appropriate degree of, automation that is required for the transaction monitoring system. This assessment should be in writing as a record of the rationale for adopting the system, including how it meets the AI's needs and other material factors such as the appropriateness of the system vendor, the effectiveness of the interface between the new system and the AI's existing infrastructure, how updates will be undertaken and any resource implications.

Guidance Paper

3.11	AIs should ensure, through the establishment of policies and procedures, the requirement to periodically review the transaction monitoring system. This should include an assessment of the transaction characteristics it monitors, risk factors, parameters and thresholds used to ensure they remain optimal for the AI and address ML/TF risk, taking into account changes in business operations and developments in ML/TF methods.

Transaction Monitoring

- ➢ Are the AIs transaction monitoring systems adequate, given their business activities and size?
- ➢ Depending on nature and scale of the AI, automated systems may be important for effective AML controls
  - – Role of senior management emphasised in recent guidance paper
- ➢ Understanding risks – the starting point
  - – Sufficiently detailed system review is required
- ➢ Should have a clear understanding of what the system could deliver / limitations
  - – TM can only supplement, not replace human element

Ongoing Due Diligence

Section 5(1)(a) of Schedule 2 to the AMLO

➢ "A financial institution must continuously monitor its business relationship with a customer by reviewing from time to time documents, data and information relating to the customer that have been obtained by the financial institution for the purpose of complying with the requirements imposed under this Part to ensure that they are up-to-date and relevant"

Ongoing Due Diligence

"From Time to Time" / "Periodic"

➢ Paragraph 4.7.12 - FIs should take steps **from time to time** to ensure that the customer information that has been obtained for the purposes of complying with the requirements of sections 2 and 3 of Schedule 2 are up-to-date and relevant. To achieve this, an FI should undertake **periodic** reviews of existing records of customers.

Verifying Corporate Identity

Paragraph 4.9.11

| 4.9.11	The FI should verify the information in paragraph 4.9.10 from:
	for a locally incorporated company:
	(a) a search of file at the Hong Kong Company Registry and obtain a company report;
	for a company incorporated overseas:
	(b) a similar company search enquiry of the registry in the place of incorporation and obtain a company report;
	(c) a certificate of incumbency or equivalent issued by the company's registered agent in the place of incorporation; or
	(d) a similar or comparable document to a company search report or a certificate of incumbency certified by a professional third party in the relevant jurisdiction verifying that the information at paragraph 4.9.10, contained in the said document, is correct and accurate.

STRs made to JFIU in the past 10 years

Chart: STRs made to JFIU, 2004–2013

Year	STRs (bar)	STRs made by Banks (line)
2004	14,029	13,570
2005	13,505	12,449
2006	14,557	13,041
2007	15,457	12,789
2008	14,838	12,388
2009	16,062	12,602
2010	19,690	16,551
2011	20,287	17,194
2012	23,282	19,202
2013	32,907	27,328
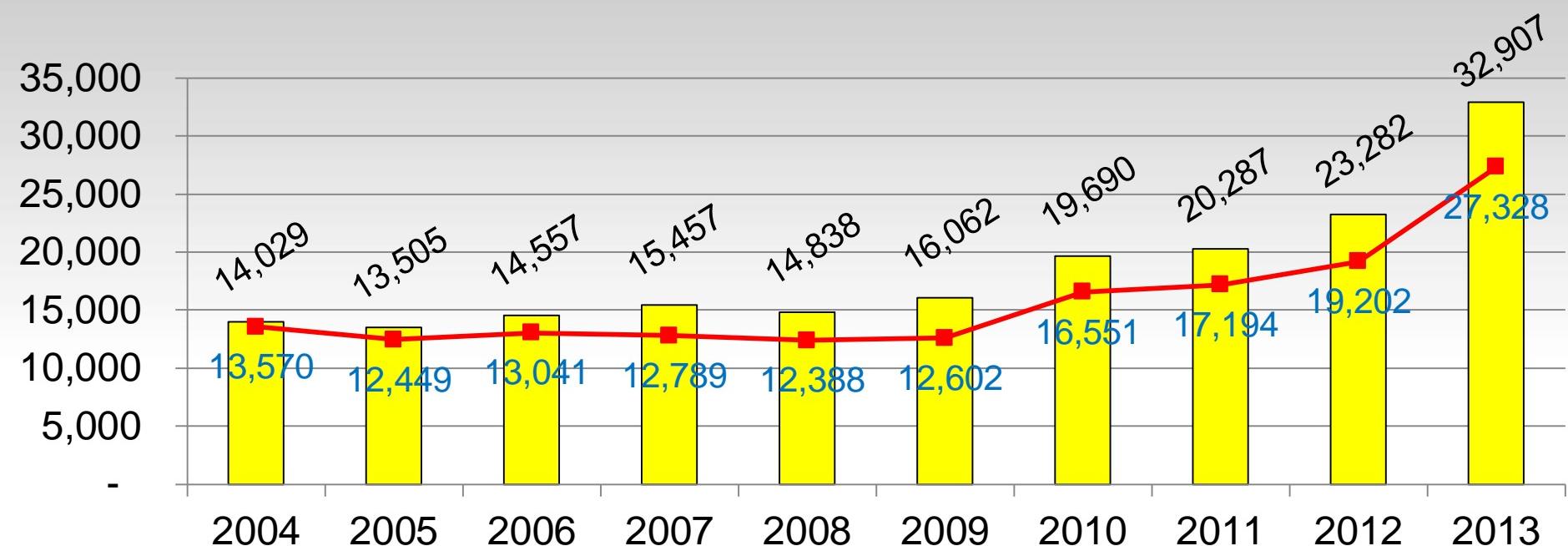
- *Represents number of STR made by Banks*
  *(As of 31 May 2014, **12,931** STRs had been filed by banks)*

Wire Transfers

S12(3), 12(4) and 12(5) of Schedule 2 to the AMLO

➢ Before carrying out a wire transfer, a financial institution that is an ordering institution must record (i) the **originator's name**; (ii) the **originator's account number** and (iii) the **originator's address**.

➢ Ordering Institution must include the verified originator's information in the wire transfer message.

Wire Transfers

➢ Observations during examinations:

– Automatic extraction process needs oversight

➢ Adequate IA or Compliance review is important

– Sampling important

➢ Straight forward AMLO provision

Governance

➢ Ownership by all stakeholders, including commitment of the Board and senior management of Banks, to strong AML culture and controls

– Training may have to be very specific at board level, tailored for executive management

➢ Can the board and senior management see what the real risks are?

– Is there audit evidence of how senior management make decisions on ML/TF risks?

– Are they the correct decisions?

– Responsibility AIs to decide

FATF

INTERNATIONAL STANDARDS
ON COMBATING MONEY LAUNDERING
AND THE FINANCING OF
TERRORISM & PROLIFERATION

The FATF Recommendations

February 2012

FATF

Methodology

FOR ASSESSING COMPLIANCE WITH THE
FATF RECOMMENDATIONS AND THE
EFFECTIVENESS OF AML/CFT SYSTEMS

February 2013
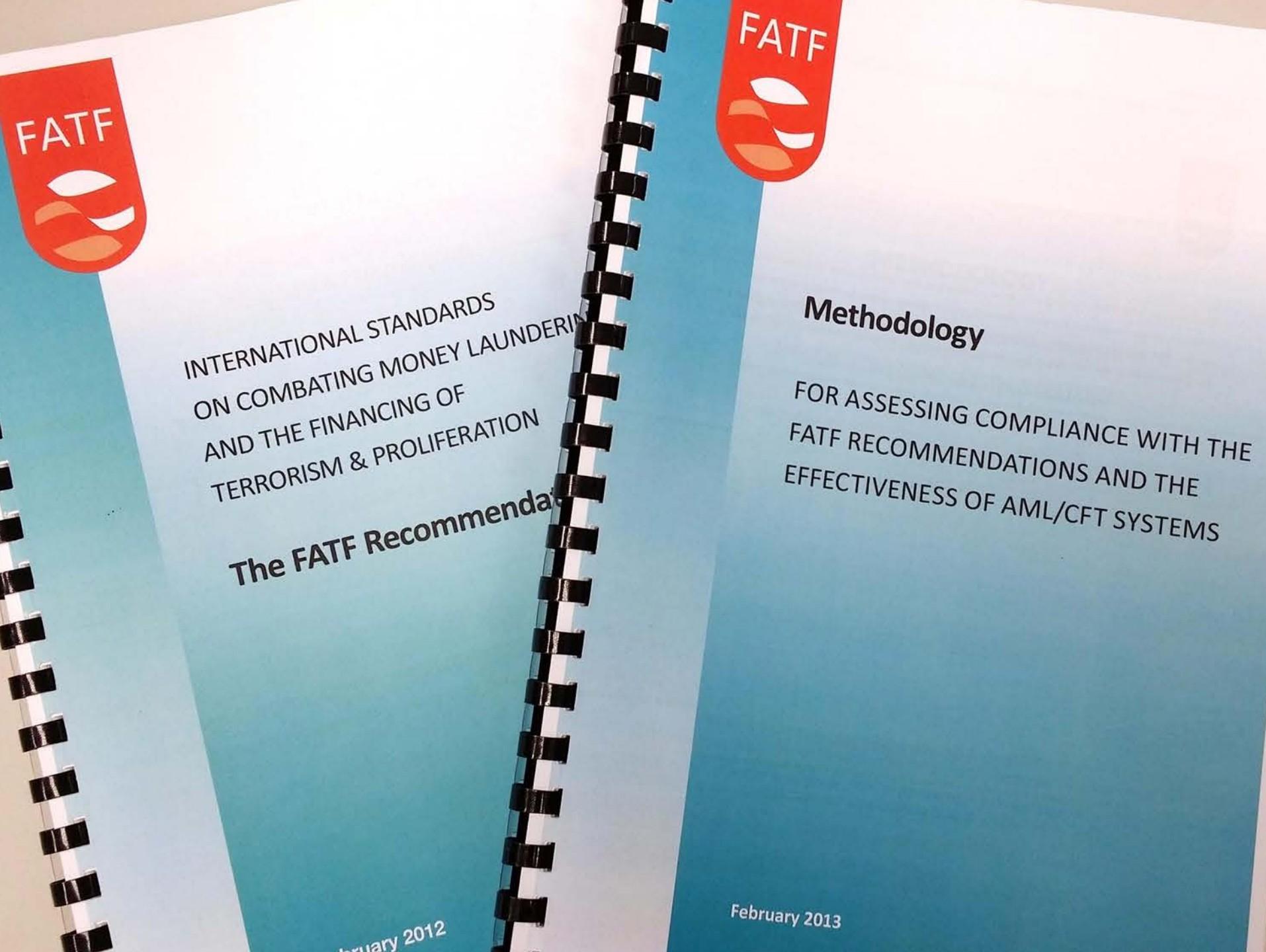
Key Points

- ➢ Risk Assessments
  - – National Risk Assessment ['NRA'] will commence soon
  - – Understanding ML/TF risks central to strong AML/CFT systems for AIs
- ➢ Understand purpose and intended nature of relationship
  - – Retail – will help to reduce exposure to criminal activity
  - – PBs – source of wealth and funds remains a core CDD component
- ➢ Perform Gap Analysis on Guidance paper on Transaction Monitoring
  - – Review system requirements and level of automation that may be required, now and in the future
- ➢ Periodic reviews are important to ensure CDD is up to date and relevant
- ➢ Quality of STR reporting
  - – Self assess - be proactive and have a plan to improve quality
- ➢ Understand and mitigate ML/TF risks in Trade Finance
  - – Future supervisory focus

Questions