



HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

06 Oct 2006

Prevention of Money Laundering and Terrorist Financing (Re: Approach to Formalising Use of Supervisory Measures) (Superseded by AML-1 of Supervisory Policy Manual)

Our Ref: B10/1C

6 October 2006

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Prevention of Money Laundering and Terrorist Financing Re: Approach to Formalising Use of Supervisory Measures

I am writing to set out the approach that is being adopted by the HKMA to formalise the use of supervisory measures for addressing serious money laundering or terrorist financing concerns identified in individual AIs.

Background

As you are aware, the HKMA attaches great importance to AIs' maintenance of adequate systems and internal controls for combating money laundering and terrorist financing activity, which is a major aspect covered under the minimum authorization criterion relating to systems of control (re: paragraph 10 of the Seventh Schedule to the Banking Ordinance).

Under the current supervisory approach, if an AI is found to have serious anti-money laundering and counter-terrorist financing (collectively referred to as "AML") deficiencies, whether revealed from on-site examinations conducted by the HKMA or from other sources (e.g. the AI may have been sanctioned by an overseas authority for alleged money laundering or terrorist financing activity), the HKMA will consider taking one or more supervisory measures to address the deficiencies identified. As set out in [Annex 1](#), these supervisory measures range from the use of various administrative or prudential measures to the exercise of general statutory powers available to the MA under the Banking Ordinance.

Scope and purpose

With the ever-increasing threat of money laundering and terrorist financing and the growing international emphasis on the effective enforcement of AML standards, the HKMA

considers it necessary to put in place a structured framework for ensuring the effective use of supervisory measures for AML purposes such that -

- (i) AIs are clearly informed of the possible supervisory measures that the HKMA may consider taking to address any serious management, system or control deficiencies reflected from their non-compliance with AML requirements¹. For the avoidance of doubt, these measures will not be applicable to deficiencies which are of a modest or isolated nature and are easily correctable in the normal course of business;
- (ii) there is a consistent approach for the HKMA to differentiate the AML deficiencies identified in different AIs according to their nature and level of seriousness so that appropriate supervisory measures can be promptly taken to address the deficiencies; and
- (iii) the imposition of supervisory measures, and any subsequent follow-up actions made, are adequately communicated to the AIs concerned and documented to provide assurance of the effectiveness of the measures taken.

It should be noted that the HKMA has no current plan to seek to broaden its supervisory powers for sanctioning AML non-compliance. Neither is there any immediate intention of changing the general supervisory approach being adopted by the HKMA. Having said this, consideration is being given within the Administration to putting the basic customer due diligence and recordkeeping obligations into law in the longer term, which would create criminal penalties for breaches of the requirements.

The supervisory measures mentioned in this letter are all existing measures that are similarly available to the HKMA for addressing other areas of management, system or control deficiencies identified in individual AIs. Formalising the use of such measures for AML purposes, however, will further demonstrate how the existing supervisory measures can be effectively used to promote AML compliance within the banking sector. We also see the benefit of providing more transparency to the banking sector on the HKMA's approach to using such measures.

Formalised arrangements

Categorisation of supervisory measures

To facilitate the adoption of a proportionate approach for considering the supervisory measures to be taken, the HKMA has broadly categorised available supervisory measures into three levels (i.e. Level I, II and III) to correspond with three increasing levels of seriousness of AML deficiencies revealed (i.e. deficiencies of "emerging", "significant" and "severe" concern). Unlike CAMEL ratings, this framework is not aimed at classifying or rating AIs in terms of their AML deficiencies but is aimed at providing a more structured and consistent approach in the use of supervisory measures.

The following describes how the three levels of supervisory measures are categorised:

- (i) Level I measures act as the first line of defence against an AI's AML deficiencies of "emerging" concern which, although not posing immediate risks to the AI concerned, reveal an unsatisfactory level of compliance that needs to be promptly improved in order to prevent the situation from further deterioration. For example, it could be that an AI's AML

compliance has deteriorated compared with previous reviews conducted by the HKMA and/or its AML systems and controls are only marginally effective, with notable improvements required in certain core AML control areas;

(ii) Level II measures are to tackle an AI's AML deficiencies of "significant" concern, which include major deficiencies associated with AML obligations in relation to customer due diligence and recordkeeping and a combination of other areas of non-compliance that may have an adverse impact on the financial soundness and prudential operation of the AI. For example, it could be that serious deficiencies are noted in a number of core AML control areas of an AI, casting significant doubt on the overall effectiveness of its AML compliance programme; and

(iii) Level III measures are to address large-scale and persistent AML deficiencies of "severe" concern which may have systemic implications for the safety and soundness of the banking system. For example, it could be that overall AML systems and controls of an AI are wholly deficient, the AI has been irresponsive to supervisory measures imposed for a prolonged period, and/or the AI, or any of its management and staff, is under investigation for alleged money laundering or terrorist financing activity, whether by local or overseas law enforcement authorities.

[Annex 2](#) provides further details about the three levels of supervisory measures, which are shown alongside the nature and characteristics of supervisory concern corresponding to each of these levels of supervisory measures.

Application of supervisory measures

Broadly speaking, the HKMA can be expected to deal with Level I and Level II situations largely through the use of administrative or prudential measures while Level III situations will mainly be addressed through the exercise of statutory powers. Moreover, the HKMA will take into account an AI's AML deficiencies, particularly those falling within the Level II or Level III category, in its assessment of the AI's CAMEL ratings or minimum capital adequacy ratio (CAR) under the Pillar 2 framework. Whether this will lead to a downgrade of the AI's CAMEL ratings or an increase in its minimum CAR will depend on the impact of such deficiencies on the AI's risk profile and financial soundness.

While the HKMA will generally have regard to the above categorization of supervisory measures, it should be made clear that the actual supervisory measures to be taken in each particular situation are primarily governed by the facts and circumstances of that situation, and the HKMA's discretionary power will not be bound by the supervisory measures listed in [Annex 2](#), which are shown for AIs' reference and are by no means exhaustive. In other words, the HKMA may consider taking any other appropriate measures if this is warranted by the circumstances of the case.

If the HKMA intends to impose certain supervisory measures on an AI as a result of the serious AML deficiencies identified in the AI, the AI will be given a chance to make representations. In addition, the imposition of specific supervisory measures will continue to be subject to any review or appeal mechanism currently available to AIs (e.g. in respect of the increase in minimum CAR under section 101 of the Banking Ordinance).

Documentation / monitoring of supervisory measures taken

Als with serious AML deficiencies identified will be clearly informed of the HKMA's perception of the seriousness of their deficiencies (e.g. whether the deficiencies belong to a Level I, Level II or Level III category). In such cases, the HKMA will, in a letter or an examination report to the AI concerned, include details of the AML deficiencies, specific directions for remedial actions to be taken and, where appropriate, incorporate caution or warning statements highlighting possible supervisory consequences if the deficiencies are not promptly rectified.

To further enhance supervisory monitoring of Als' AML compliance, the HKMA will set up internal records analysing individual Als' level of AML compliance and documenting cases of non-compliance, the HKMA's subsequent follow-up actions (including use of supervisory measures) and Als' remedial actions for ongoing assessment and reference.

This letter should serve to reiterate the importance for Als to maintain an effective AML compliance programme and to promptly rectify any AML deficiencies identified. The HKMA will continue to collaborate with the banking industry through the recently established Industry Working Group on the prevention of money laundering and terrorist financing, with a view to further enhancing the level and quality of AML compliance within the industry.

Please feel free to get in touch with your usual contact at the HKMA if you have any questions on the contents of this letter.

Yours faithfully,

Simon Topping
Executive Director (Banking Policy)

1. Apart from the statutory obligations pursuant to the Drug Trafficking (Recovery of Proceeds) Ordinance, the Organized and Serious Crimes Ordinance and the United Nations (Anti-Terrorism Measures) Ordinance, Als are subject to the AML guidelines issued by the MA under section 7(3) of the Banking Ordinance, including -

- (i) Guideline on Prevention of Money Laundering (December 2000);
- (ii) Supplement to the Guideline on Prevention of Money Laundering (June 2004); and
- (iii) a set of interpretative notes (June 2004),

which are minimum standards that they should fully comply with.

Encl. [Annex 1](#) (MS Word file, 42KB)
 [Annex 2](#) (MS Word file, 86KB)

c.c. FSTB (Attn : Mr Clement Chan)
 HKAB (Attn: Mr Peter Wong)
 DTCA (Attn: Mr Geoffrey J Mansfield)

Last revision date : 01 August 2011