Ensuring Effective AML/CFT Controls

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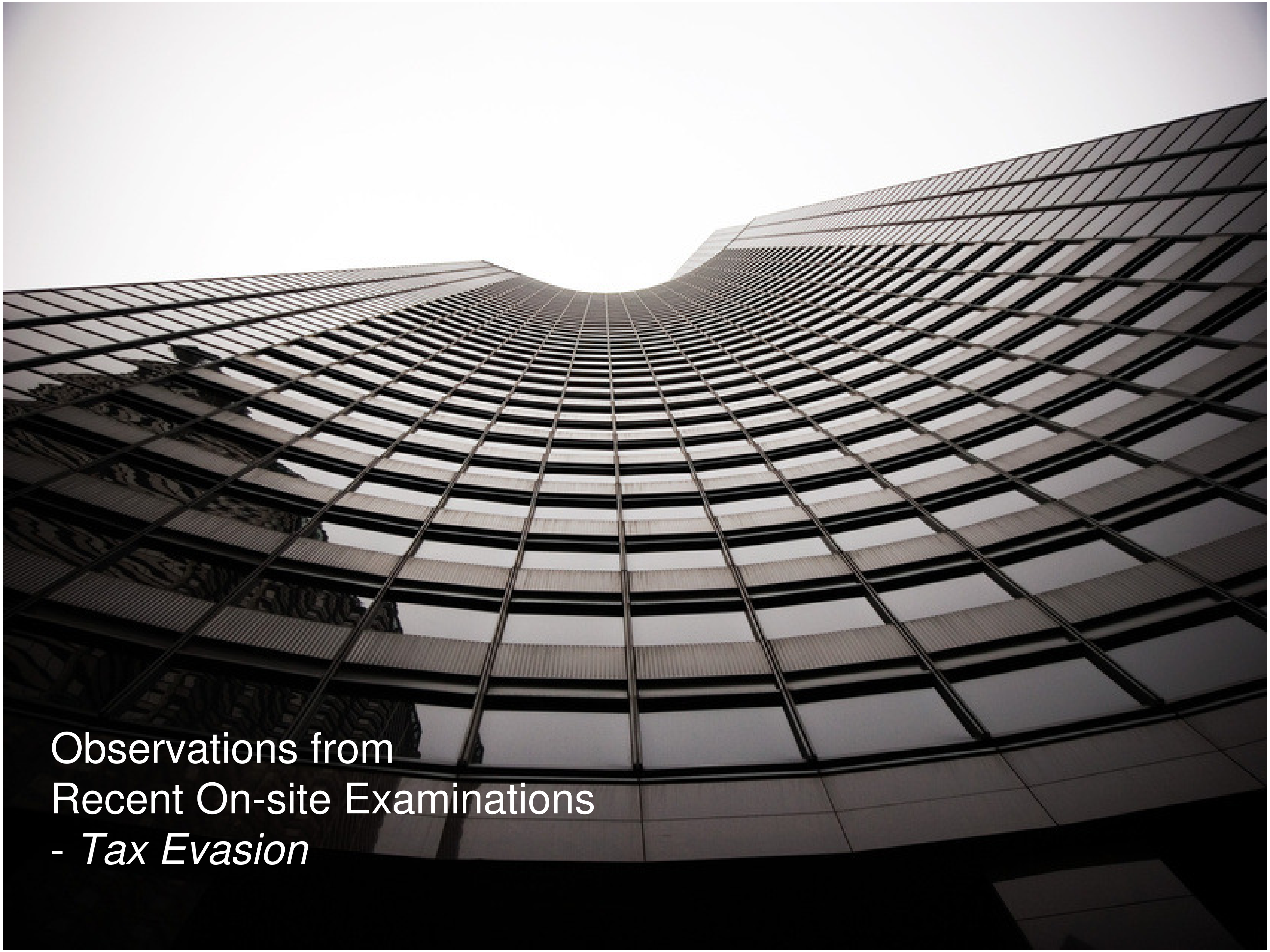
Framing the discussion

- Focus
  - AML systems and controls
- Nexus
  - Hong Kong legislation
- Understanding
  - funds become proceeds upon the “act” of evasion
  - commonalities shared with some other types of money laundering, and the vehicles used
    - non-transparent, complex legal entities, structuring etc.

Objectives

- Reinforce the status of tax evasion as a predicate offence under Hong Kong's AML/CFT regime
  - already caught under the ML offence (OSCO)
  - already caught under the STR reporting ordinance (OSCO)
  - risk should already be addressed in AIs AML/CFT controls under AMLO
- Raise institutional awareness
  - issue of tax evasion is on global agenda and here to stay
  - increased focus and scrutiny = aggravated risk
- Reiterate responsibility to monitor new and aggravated ML/TF risks lies with senior management
  - risk must be assessed and proportionate controls applied
  - consistent with message in high-level AML/CFT seminar in April 2013


Observations from
Recent On-site Examinations
- *Tax Evasion*

Observations - Tax Evasion

- No one-size fits all
  - HKMA does not mandate any particular measure
  - AI to determine on the basis of its business activities and risk profile
  - judgement required
- Policies and Procedures – detailed vs non-detailed
  - variations in approach
    - e.g. is voluntary disclosure addressed? Declarations?
  - customer declarations may form part of any system of controls but the <u>responsibility to conduct CDD rests with the AI</u>
  - P&P will continue to be a focus area in HKMA exams
- Consistent regional application
  - different regional standards / different risks?
- New + existing relationships
  - existing customers must be subject to any revised tax related risk assessment, but reasonable process and timeline, e.g. upon periodic review

Observations - Tax Evasion

- Does the AI have a well-developed AML/CFT risk assessment and has it identified tax evasion as a specific risk?
  - essential to applying appropriate and proportional AML/CFT controls
  - HKMA does not specify any method or format, but whatever format is used, it must be clearly understood by all parties
- How does the customer risk assessment / review process capture the risk, if at all?
  - how are customers who might pose a higher risk for tax evasion identified?
  - what measures have been considered?
    - what additional information has to be obtained or actions performed?
    - should supplement existing CDD obligations, such as proposed source of funding, the purpose and nature of the relationship (esp. where offshore)
    - what tax-specific red flags have been provided to staff?
      - how have these been developed? Has assistance from AIs tax experts been sought?

Observations - Tax Evasion

- Are escalation procedures in place for a more detailed review?
  - where customers are assessed to present a higher risk of tax evasion, then EDD measures would need to be applied [para 4.11.1 of AMLO Guideline] *to ensure the AI is able to understand / better assess the tax risk profile*
  - additional measures **<u>may</u>** include:
    - obtaining additional information on customer and the nature of relationship, to fully assess the tax-risk profile
      - e.g. asking the customer to provide verifiable information that tax affairs are in order and assets / income declared
    - obtaining senior management approval
    - conducting enhanced monitoring
    - additional controls to manage the risk while the review is being undertaken

Observations - Tax Evasion

- Has appropriate and adequate staff training been provided
  - training an important element of an effective control system
  - will need to be tailored for different staff
- Beyond training and controls senior management must ensure there must be a culture in which RMs take responsibility for making ethical decisions based on their :
  - knowledge of the client relationship
  - the ultimate (true) beneficial owners
  - the account activity
  - proactive clarification of unusual activity

Observations - Tax Evasion

- Is such an ethical culture evidenced – are internal and external STRs being made (and/or relationships being exited where there is unacceptable risk of ML/TF)?
  - consideration will need to be given to what constitutes *'reasonable grounds'* for making a STR in the context of tax evasion
    - for AI to determine, based on the guidance in Chapter 7 of AMLO Guideline
    - threshold for reporting same as other predicate offences - *business as normal*
  - clarification with the customer
    - staff should have been trained how to communicate with customers to avoid the risk of tipping off – old requirement with which AIs should be familiar
  - Para. 7.33 of AMLO Guideline applies (post reporting matters)
    - review and determine risk mitigation required – many factors will need to be taken into consideration, not least of which is the level of suspicion
    - no particular action mandated, for AI to determine
  - where an STR is made and the relationship retained
    - management will be critically involved in decision
    - rationale and grounds should be properly documented
    - EDD measures, enhanced monitoring etc. would apply

Observations - Private Banks

- ‘Complex Structure’ should be defined in P&Ps
  - essential to ensure that the AI understands the rationale for complex structures and is able to identify high-risk customers and apply EDD where appropriate
- Identification [and verification] of intermediate layers
  - AMLO Guideline requirements
    - Para. 4.9.16 & 4.9.17 clearly articulated at time of AMLO
  - verification or EDD on intermediate layers might be required in some high risk relationships
  - guidance should be codified in P&P
- Understanding changes in ownership/control of a corporate customer
  - confirming corporate still exists/registered (i.e. not wound-up, dissolved, struck-off, suspended, etc.) at time of periodic review

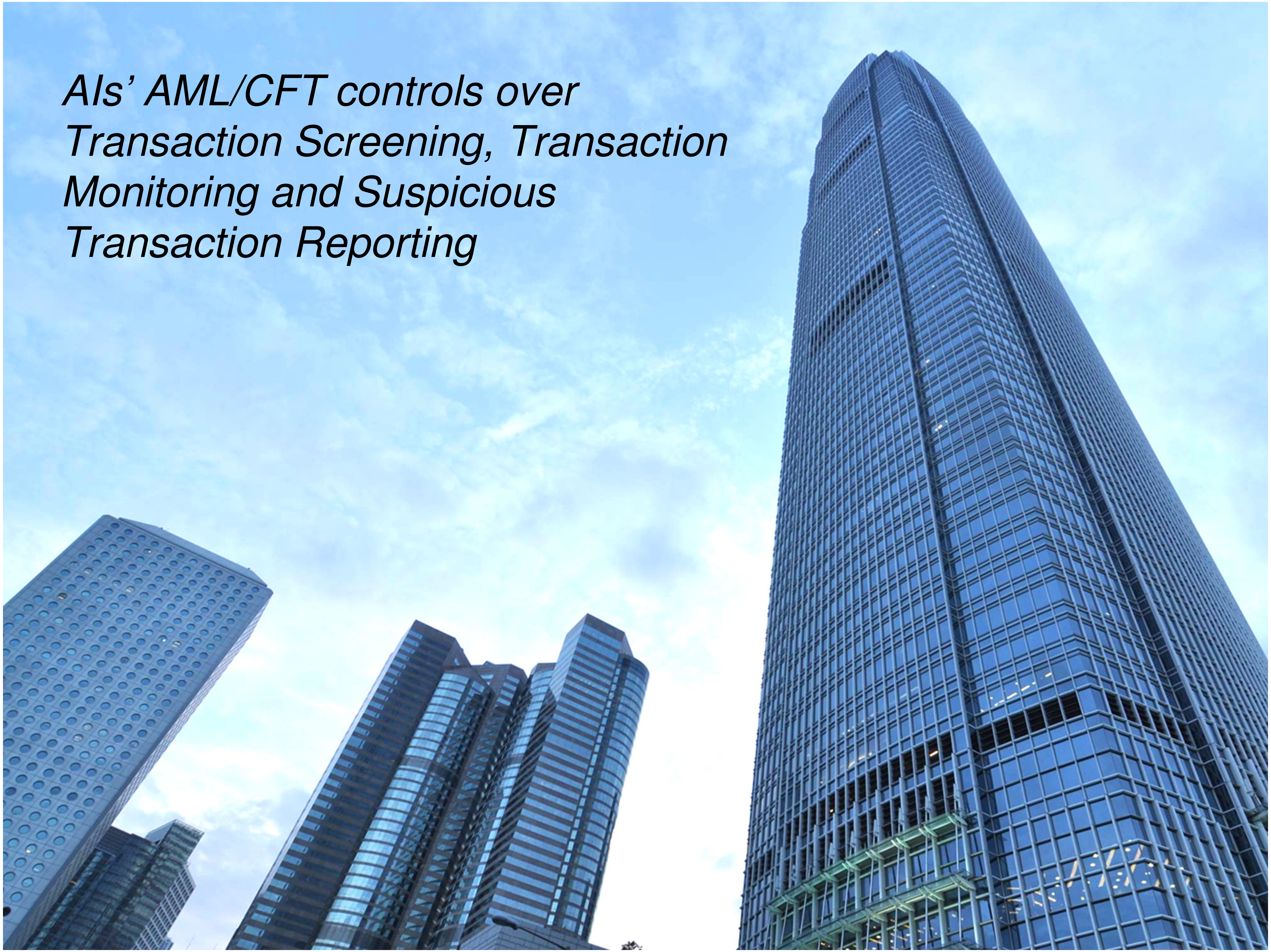
Observations - Private Banks

- Source of wealth, source of funds and background of customer
  - requirements at Para. 12.5 of AMLO Guideline apply
- Records of meetings with clients
  - AIs must be able to substantiate what steps have been taken
  - important control to identify potential tax evasion red flags
- Annual / Regular review
  - where delayed reasonable explanation should be recorded
  - where delays are resource driven, record of internal discussion or escalation should be kept
- Trigger events
  - HKMA requirement clarified in AMLO exercise
  - must be defined, to ensure review of customer profile is conducted upon trigger events

Observations - Private Banks

- Trusts - where reliance is made on a declaration from a trust company which is a subsidiary or affiliate, declarations should still contain sufficient information (e.g. details of the legal form and parties to it)
  - (settlor, beneficiaries, protector, date of establishment of trust, jurisdiction under whose laws the trust is created etc.)
- Role of Internal Audit
  - some IA playing a strong role, identifying control failures
  - IA should be able to identify significant shortcomings, where they arise

AIs' AML/CFT controls over Transaction Screening, Transaction Monitoring and Suspicious Transaction Reporting



Guidance Paper

- Consulting with HKAB on a draft for a new Guidance Paper
- Guidance paper provides best practices in
  - transaction monitoring systems
  - STR related controls
    - decision making process
    - clearance of alerts
    - completion of STRs – articulation of the analysis undertaken and suspicion
  - implementation of Para 7.33 of the AMLO Guideline – *post reporting risk mitigation*
    - application of principles contained in Para. 7.33 of AMLO Guideline, risk review etc.

Guidance Paper

- Timing of the paper
- What actions are expected of AIs
- How will the HKMA use the guidance paper

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