

# Regulatory Update on AML/CFT

## *Putting 'Risk-Based' in AML: The Road Ahead*

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- Current AML/CFT Supervisory Focus
- Changes on AML/CFT Horizon
- ML/TF Risk Assessment
- ML/TF Risk Governance



# ML/TF threats remain on the radar

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## Colombian drug cartels used Hong Kong banks to launder more than US\$5bn

US court documents reveal at least US\$5bn in illicit proceeds 'cleaned' in HK and the mainland

Niall Fraser and Mimi Lau

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(Source: SCMP)



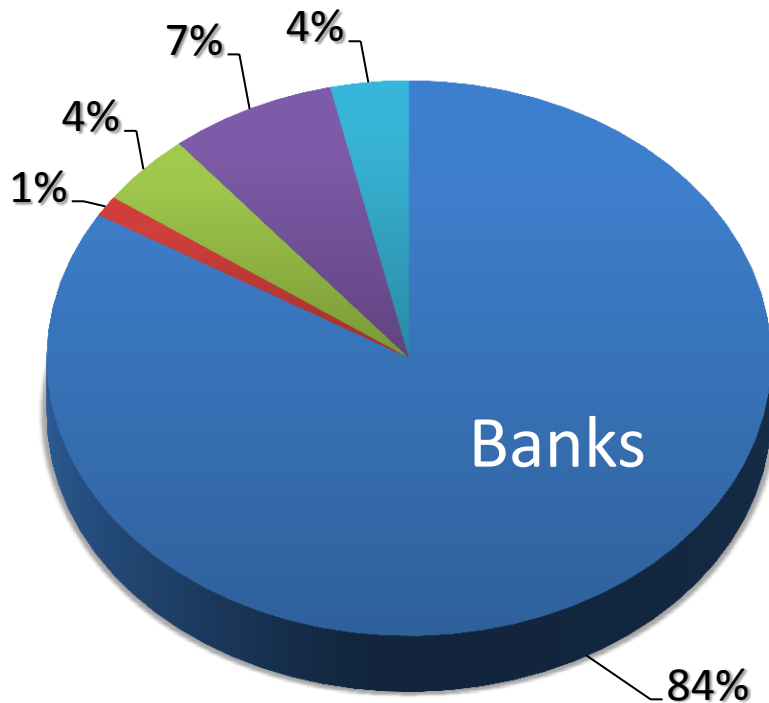
According to US prosecutors, billions in drug proceeds went via Hong Kong bank accounts to casinos, Chinese currency exchange houses, export companies and factories. Photo: Bloomberg

## Ongoing Supervisory Focus

- Importance of effective screening and transaction monitoring systems stressed in all AML/CFT supervision
  - Hong Kong is a global payments hub
  - must be able to identify and report suspicious activities and transactions
  - sanctions also a key risk
  - important role for banking sector
- Recent guidance on transaction monitoring
  - stressed system development, testing and validation

# STR Statistics

**No. of STR received in 2014 = 37,188**  
*(compared to 2013, ↑ by 13%)*



	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
■ Banks	(31,095)	(27,328)	(19,202)	(17,194)
■ Insurance	(446)			
■ Securities	(1,574)			
■ Money Service Operator	(2,772)			
■ Others	(1,301)			

*(Source: JFIU's website)*

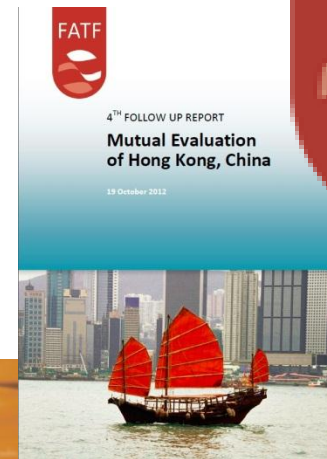


## Key Points

- Screening and transaction monitoring will continue to be a focus
- Ability to identify higher risk customers and report suspicious transactions: important requirements
- Transaction monitoring
  - based on sound CDD/KYC with recognition that risk is dynamic
  - expectations: risk-based but higher for complex institutions
  - TM systems to be based on sound modelling, tested and validated as fit for purpose
- HKMA will use every available part of our toolkit – including our powers to sanction and reprimand

# What will drive changes to AML/CFT regime?

- FATF Standards
- Mutual Evaluation
- National Risk Assessment
- Terrorist Financing





## How are banks preparing for change (1)

- Banks increasingly understand the benefit of good AML/CFT compliance
  - essential for growth [not prevent]
  - essential to operate in high risk sectors or locations
  - essential to allow innovation
- AML/CFT controls should
  - be both effective and sustainable
  - be proportionate to identified risks

## How are banks preparing for change (2)

- AML/CFT system optimization is important
- More people and more systems may not necessarily enhance controls
  - no panacea in AML space
- Answer lies with system optimization, which is dependent on
  - effective ML/TF risk assessment
  - strong / enhanced ML/TF risk governance

*“Sound risk management requires the identification and analysis of ML/TF risks within the bank and the design and effective implementation of policies and procedures that are commensurate with the identified risks. In conducting a comprehensive risk assessment to evaluate ML/TF risks, a bank should consider all the relevant inherent and residual risk factors at the country, sectoral, bank and business relationship level, among others, in order to determine its risk profile and the appropriate level of mitigation to be applied”*

**Sound Management of Risks Relating to Money Laundering and Financing of Terrorism  
Basel Committee on Banking Supervision, January 2014**

## ML/TF Risk Assessment [1]

- Identify and remediate gaps in AML/CFT system
- Informed board level decisions
  - ensure effective implementation of control efforts
  - develop risk appetite
  - ensure resources aligned with risks
- Assist in strategic decisions
- Ensure regulators are aware of key risks

## ML/TF Risk Assessment [2]

- Process important
  - lack of sensitivity or granularity to specific risks can dilute effectiveness
- Can produce tension between truth and cost
  - may be cost implications for a poorly delivered assessment
- Consistency
- Dynamic process

## ML/TF Risk Assessment [3]

- Requirement is not to simply produce an assessment
- Requirement is to demonstrate ownership of the risk over the longer term
- External support may be required – cost of getting it wrong may be substantial
- No expectation for small institutions to have complex assessments
  - reasonable risk assessment tailored to the institution



## ML/TF Risk Governance Questions [1]

- How do you identify ML/TF risks inherent within your bank?
  - concept of risk appetite should be embedded
- Who is responsible for managing ML/TF risks?
  - how do you encourage responsibility at all levels
  - front-line own and know the risks
  - objective is effective sustainable business practices
- How proactive is ownership of the AML/CFT agenda
  - not simply compliance orientated
  - clear and transparent ML/TF risk accountability

## ML/TF Risk Governance Questions [2]

- Is your ML/TF risk management forward looking?
  - not solely focused on fighting fires
  - must contain strategic aspect looking at future challenges
  - flexible, adapt easily to change
- How do you test controls effectiveness
  - front-to-back, across three lines of defence
  - Do IA and Compliance functions both play the proactive role expected
  - Do they regularly find gaps, standardisation issues

## Reference

- BCBS paper – Sound Management of ML/TF Risks (Jan 2014)  
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- FATF paper – Risk-Based Approach for the Banking Sector (Oct 2014)  
(<http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf>)
- Wolfsberg paper – FAQs on Risk Assessment for ML, Sanctions and Bribery & Corruption (Sep 2015)  
(<http://www.wolfsberg-principles.com/pdf/home/Wolfsberg-Risk-Assessment-FAQs-2015.pdf>)
- HKMA circular – ML/TF Risk Assessment (19 Dec 2014)  
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