

Revised supplement to the guideline on prevention of money laundering

by the Banking Policy Department

In June 2004, the HKMA issued a revised version of the Supplement to the Guideline on Prevention of Money Laundering, together with a set of Interpretative Notes, which provide practical guidance on implementing the requirements of the Supplement. In developing these two documents, the objective was to ensure there were adequate safeguards against money laundering and terrorist financing in the banking sector, while having regard to practicalities and the need to be business-friendly. This article provides background information relating to the development of these two documents, highlights the key changes made to the 2003 preliminary version of the Supplement and briefly describes the supervisory approach to be adopted in future.

Background

Following the issuance of the Basel Committee paper on "Customer Due Diligence for Banks" in October 2001 and the FATF initiative to revise its Forty Recommendations, the HKMA began a project in 2002 to develop a supplementary guideline to update its anti-money laundering regime. After industry consultation, a preliminary version of the Supplement to the Guideline on Prevention of Money Laundering was issued in March 2003.

In order to develop further detailed guidance on the practical implementation aspects of some of the requirements set out in the Supplement, an industry forum, chaired by the HKMA and consisting of representatives from the two industry associations, was established in May 2003. The forum's aims were to consider the practical implications of these requirements, develop detailed interpretative guidance as appropriate, and identify areas for further development or refinement, taking into account the revised FATF Forty Recommendations, which were finalised in June 2003. Three sub-groups covering public education, correspondent banking and private banking were also formed to look into those specialised areas.

In June 2004, the HKMA released the revised Supplement and the accompanying Interpretative Notes after further consultations with the industry. These two documents can be viewed or downloaded from the HKMA's website (<http://www.hkma.gov.hk>) under the icon "Guidelines and Circulars".

Revision of the Supplement

The key addition made to the 2003 preliminary version of the Supplement is a set of Interpretative Notes providing practical guidance for implementation of the high level requirements set out in the revised Supplement. Other changes can be broadly categorised into six areas:

Introducing guiding principles

The HKMA considered it desirable to set out some guiding principles in the revised Supplement and the Interpretative Notes as they may not be able to cover every situation encountered by authorized institutions (AIs). These general principles include:

- Risk-based approach: AIs should adopt an enhanced Customer Due Diligence process for higher risk customers, while they may apply a

simplified one for lower risk customers. In general, they may apply a simplified CDD process in respect of a customer, or a particular type of customer, where there is no suspicion of money laundering and the risk of money laundering is assessed to be low or there is adequate public disclosure in relation to the customers.

- **Reasonableness test:** AIs should be able to justify that they have taken reasonable steps to satisfy themselves as to the true identity of their customers, including beneficial owners. These measures should be objectively reasonable in the eyes of a third party. Among other things, this would require AIs to document their assessments.
- **Consolidated approach:** The general principle is that a common set of CDD standards should be applied on a consolidated basis throughout a banking group. Simplified CDD procedures may, however, be used by a group company in respect of a particular type of customer where the area of business in question is considered to be low risk. Where group standards cannot be applied for good reason, e.g. due to legal or regulatory reasons, deviations should be documented and risk mitigating measures applied.
- **Common sense approach:** AIs should adopt a common sense approach to customers who come from non-cooperative countries and territories or other jurisdictions that do not meet FATF standards or who are unable to provide proof of address.

Defining general terms

To facilitate AIs' understanding of the requirements of the revised Supplement, some general terms, such as "customer", "direct customer", "beneficial owner", "residential address" and "permanent address", are defined in the Interpretative Notes.

Extending the use of the simplified CDD process

Within the ambit of the revised FATF Forty Recommendations, the revised Supplement extends the use of the simplified CDD process to state-owned enterprises and subsidiaries of companies which are listed on a recognised stock exchange. Further, the CDD process in respect of domestic retail customers is also simplified to the extent that the elements of identity that AIs need to verify include only: (a) the name, (b) the number of the Hong Kong Identity Card, (c) date of birth and (d) residential address. In other words, most average customers will not be subject to an onerous CDD process.

Addressing the practicality issues

In order to address industry comments regarding practical difficulties in implementing some of the requirements, detailed guidance is provided in the Interpretative Notes, including details of specific areas where it is permissible for AIs to deviate from the general standards. These include, on the basis of the risk analysis, the application of a practical approach to:

- customers whose due diligence process is not yet completed;
- customers who use an offshore investment vehicle as the contractual party to establish a private banking relationship with AIs;
- corporate customers incorporated in a country where company searches are not available;
- corporate customers having a substantial number of authorised signatories;
- customers introduced by intermediaries that are not regulated; and
- trust customers managed by a trust company that is a subsidiary or affiliate of an AI.

Aligning supervisory requirements with international standards

As the revised FATF Forty Recommendations were only finalised in June 2003, some of the requirements set out in the preliminary Supplement have been refined to bring them into line with the latest international standards. Examples of these changes include:

- approval from senior management before establishing a new correspondent relationship;
- the scope of “correspondent banking” is extended to cover a relationship established for securities transactions; and
- Als may choose not to immediately obtain copies of customer identity documentation from intermediaries as long as they have taken adequate steps to satisfy themselves that the intermediaries will provide the copies upon request without delay.

Setting out the CDD process for private banking customers

In collaboration with the Private Banking sub-group, an Annex outlining the detailed CDD process for private banking customers is provided in the Interpretative Notes. This Annex sets out all the major CDD steps Als should take before establishing a private banking relationship with customers. Areas covered in the Annex include: Customer Profile, Group Know-Your-Customer Policy, Client Acceptance, Dedicated Relationship Management, and Monitoring.

Supervisory approach

The HKMA expects Als to review and revise, as appropriate, their policies and procedures on the prevention of money laundering to comply with the requirements stipulated in the revised Supplement as

soon as possible, and not later than 31 December 2004. Failure to adhere to such requirements is a serious matter and may result in supervisory action being taken.

In helping to promote public awareness of the importance of combating money laundering and terrorist financing, the HKMA and the two industry associations jointly issued in March 2004 an information leaflet “Fighting Crime and Terrorism: How You Can Help”. The leaflet explains why Als may require their customers to provide identification documents and how this can help prevent money laundering and terrorist financing. It can be viewed or downloaded from the HKMA’s website (<http://www.hkma.gov.hk>) under the icon “Consumer Information”.

The HKMA is preparing a structured self-assessment framework to facilitate Als’ regular assessment of the extent of their compliance with the relevant supervisory requirements. This will also help the HKMA identify risk indicators and develop supervisory guidance in the longer term. Als will receive the self-assessment framework in due course.

It should also be noted that the revised FATF Forty Recommendations suggest that the basic obligations relating to CDD, record keeping, and reporting of suspicious transactions should be put into law. In Hong Kong, although the obligation to report suspicious transactions is already law, the legislative process to put the other two obligations into law will take some time. Nevertheless, these two obligations are set out in the HKMA guidelines as supervisory requirements. Als should ensure compliance with these requirements. Failure to do so may expose Als and individuals not only to possible supervisory action, but to possible criminal prosecution when the new legislation comes into effect. Als are, therefore, expected to devote adequate resources to implementing the requirements set out in these supervisory guidelines.