

PREVENTION OF MONEY LAUNDERING THROUGH THE BANKING SYSTEM

Banks are in the main firing line so far as money laundering is concerned. As banking supervisor, the Hong Kong Monetary Authority (HKMA) is concerned that the banking system should not be used for money laundering. It issued a revised Guideline on Prevention of Money Laundering under section 7(3) of the Banking Ordinance on 17 October 1997. This revised Guideline sets out in detail the standards and procedures expected of authorised institutions in their customer identification, record keeping and reporting procedures to combat money laundering. This article highlights the new requirements under the new Guideline and discusses what the banking sector can and should do to prevent the use of the banking system for the purpose of money laundering.

Money Laundering through the Banking System

According to the Financial Action Task Force (FATF)*, the amount of drug trafficking money is estimated to be around US\$500 billion each year. The first problem faced by the money launderers is how to convert this huge amount of money into some other form of assets so that it can be more easily handled and utilised and the true origin of the funds disguised. This is the so-called "placement" stage of the money laundering process. While a variety of assets may be used, an obvious home for large amounts of cash is the banking system. Authorised institutions therefore stand in the forefront to detect any suspicious transactions which may be related to money laundering.

The vulnerability of the banking system to attacks by money launderers is a matter of extreme concern not only to the law enforcement authorities but also to banking supervisors. If banks are seen to be involved, even inadvertently, with drug traffickers and other criminals, the resultant bad publicity may damage confidence in the banks concerned and the banking system as a whole. Apart from this, banks may expose themselves to direct risk of loss from fraud through association with criminals.

As a banking supervisor, the Hong Kong Monetary Authority (HKMA) therefore has a clear responsibility to participate in the fight against money laundering. However, the banking supervisor is not a policeman. The principal role is not to

detect and investigate crime. The supervisor's task is rather to ensure that banks have introduced appropriate and adequate measures to prevent themselves from being used by money launderers.

The Supervisory Approach towards Money Laundering in Hong Kong

The HKMA's supervisory approach towards money laundering in Hong Kong can be summarised as follows:

- compliance with international supervisory standards;
- issuance of guidelines on internal controls against money laundering;
- monitoring of authorised institutions' compliance with those guidelines; and
- co-operation with other interested parties in Hong Kong, such as the Joint Financial Intelligence Unit (JFIU) (which is made up of the Police and the Customs and Excise department) and the industry Associations in the fight against money laundering.

Compliance with International Supervisory Standards

In December 1988, the Basle Committee issued a Statement of Principles on the prevention of criminal use of the banking system for the purpose of money laundering. This seeks to deny use of the banking system to those involved in

* FATF is an international body which aims at fostering international co-operational efforts against money laundering. It comprises 28 members including Hong Kong, China.

money laundering by application of the following four cardinal principles:

- *know your customer*: banks should make reasonable efforts to determine the customer's true identity, and have effective procedures for verifying the bona fides of new customers;
- *compliance with laws*: bank management should ensure that business is conducted in conformity with high ethical standards, that laws and regulations are adhered to and that a service is not provided where there is good reason to suppose that transactions are associated with laundering activities;
- *co-operation with law enforcement agencies*: within any constraints imposed by rules relating to customer confidentiality, banks should co-operate fully with national law enforcement agencies including where there are reasonable grounds for suspecting money laundering, taking appropriate measures which are consistent with the law; and
- *policies, procedures and training*: all banks should formally adopt policies consistent with the principles set out in the Statement, and should ensure that all members of their staff concerned, wherever located, are informed of the bank's policy. Attention should be given to staff training in matters covered by the Statement. To promote adherence to these principles, banks should implement specific procedures for customer identification and for retaining internal records of transactions. Arrangements for internal audit may need to be extended in order to establish an effective means for general compliance with the Statement.

The principles laid down by the Basle Committee have subsequently been developed by the FATF. In February 1990, FATF put forward forty recommendations aimed at improving national legal systems, enhancing the role of financial systems, and strengthening international co-operation against money laundering. A stock-taking review of the forty recommendations was carried out in 1996. As a result of this review, the FATF has adopted a set of revised recommendations to improve the customer identification requirements e.g. in respect

of shell corporations, and new technology developments.

The 1997 Revised Guideline

The revised Guideline has taken into account the changes in money laundering legislation since 1993, including the passage of the Organized and Serious Crimes Ordinance (OSCO) in 1994 which extended the money laundering offence to the proceeds of serious crimes other than drug trafficking and the subsequent amendments to both OSCO and the Drug Trafficking (Recovery of Proceeds) Ordinance (DTRAP) in 1995 which imposed a clear statutory duty to report knowledge or suspicion of money laundering transactions. It should be noted that section 25(4) of OSCO provides that references to an indictable offence in the Ordinance include a reference to conduct which would constitute an indictable offence if it had occurred in Hong Kong. It means that it shall be an offence for a person to deal with the proceeds of crime or fail to make the necessary disclosure even if the principal crime is not committed in Hong Kong provided that it would constitute an indictable offence if it had occurred in Hong Kong. It is believed that the extension of the scope of money laundering offence to cover proceeds of indictable crimes is a contributing factor to increase in reporting by authorised institutions (from 549 in 1994 to 4,121 in 1996) as is the introduction of a specific duty to report suspicions.

Regarding the detailed provisions in the Guideline, the main changes are in respect of the customer identification requirements. The relevant section has been substantially revised and expanded in line with the practices in other financial centres and with the FATF requirements. This is necessary to maintain the reputation and credibility of Hong Kong as an international financial centre.

The guiding principle in these requirements should be to obtain satisfactory evidence of the identity and legal existence of persons applying to do business with an authorised institution. For the purposes of the Guideline, evidence of identity can be regarded as satisfactory if –

- (a) it is reasonably capable of establishing that the applicant for business is whom he claims to be; and

- (b) the institution which obtains the evidence is satisfied, in accordance with the procedures established by the institution, that it does establish that fact.

For individual customers, there is essentially no change to the requirement under the previous guideline - institutions should institute effective procedures to obtain customers' information such as name, address, date of birth and occupation.

For corporate customers, the customer verification requirements have been significantly strengthened with new provisions incorporated in relation to shell companies, trust and nominee accounts and other types of intermediaries, in line with the recommendations of the FATF. Under the new Guideline, institutions should obtain satisfactory evidence of the identity of beneficial owners, directors and authorised signatories of shell companies. In short, the veil of secrecy should not be allowed in respect of shell companies.

For accounts opened by intermediaries on behalf of a third party e.g. trust and nominee accounts, institutions should obtain satisfactory evidence of the identity of trustees, nominees and authorised signatories and the nature of their trustee or nominee capacity by obtaining a copy of the trust deed. Enquiries should also be made of the extent to which the intermediary is subject to official regulation e.g. by a body equivalent to the HKMA. In case where an intermediary is a regulated financial institution in Hong Kong (including its subsidiaries), or a regulated financial institution in certain other jurisdictions with equivalent money laundering legislations or a company with which the authorised institutions has an established business relationship, it shall suffice for the institution to accept a written assurance from the intermediary that evidence of the underlying principals has been obtained, recorded and retained, and that the intermediary is satisfied as to the source of funds. In other cases, the institution should obtain satisfactory evidence of the identity of the underlying

principals and the source of funds and the use of a standard format for obtaining the relevant information is recommended.

Monitoring of Compliance

Checking of controls on money laundering is a regular agenda item in the supervisory process. The HKMA takes any breach of the Guideline seriously and will monitor compliance with the Guideline during its regular on-site examinations. External auditors' reports may also be commissioned if the circumstances require.

Education and Training

Staff training and fostering of problem awareness among staff are of utmost importance to the effective tackling of money laundering problem. It is therefore both the FATF's expectation and the requirement of the Guideline that institution should provide proper anti-money laundering training to their local as well as overseas staff. We believe that the Hong Kong Association of Banks (HKAB) can also play a significant role in this respect.

In this connection, the HKMA is glad to note that HKAB has finalised a revised training package on the subject which comprises a video tape and a booklet. This training package serves as excellent training materials for front line staff of authorised institutions. We encourage all authorised institutions to acquire and make effective use of it.

In addition, a seminar was organised jointly by the HKMA and the industry Associations in November with the participation of representatives from the JFIU and the Department of Justice. The seminar will help to deepen management and compliance officers' understanding of the important role they play in promoting problem awareness among bank staff and in ensuring effective internal systems are in place against money laundering. ㊟

— Prepared by the Banking Development Division