Regulator's Dialogue
Recent Developments in Supervision of Anti-Money Laundering and Counter-Financing of Terrorism

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AML and Financial Crime Risk Division
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HONG KONG MONETARY AUTHORITY
香港金融管理局

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Agenda

- Using Hong Kong's ML/TF risk assessment in the risk-based approach

- Strengthening information & intelligence sharing

- Effectiveness in manging sanctions risks

- Harnessing the potential of technology in AML/CFT work

- The FATF Mutual Evaluation of Hong Kong – implications for the banking sector

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Risk Assessment Report

- Covers 12 sectors including financial sub-sectors and non-financial sectors

- Published in April 2018 (https://www.fstb.gov.hk/fsb/aml/en/doc/hk-risk-assessment-report_e.pdf)

- Examines the ML/TF threats and vulnerabilities facing various sectors and Hong Kong as a whole

HONG KONG
MONEY LAUNDERING AND TERRORIST FINANCING RISK ASSESSMENT REPORT

April 2018

Hong Kong's AML/CFT Policy

The Government is committed to upholding a robust AML/CFT regime that:

a) Fulfills the international AML/CFT standards;

b) Deters and detects illicit fund flows;

c) Combats ML/TF and restrains and confiscates illicit proceeds effectively;

d) Reduces ML/TF vulnerabilities in Hong Kong;

e) Adopts a risk-based approach (RBA) in applying compliance obligations to businesses and individuals;

f) Fosters strong external and international collaboration to disrupt global ML/TF threats; and

g) Promotes awareness and builds capacity of private sector stakeholders in combatting ML/TF risks.

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Enhancing the AML/CFT Regime

Five major areas of work:

a) Enhancing AML/CFT legal framework to address gaps in legislation;

b) Strengthening risk-based supervision to ensure targeted regulation of riskier areas;

c) Sustaining outreach and capacity-building to promote awareness and understanding of ML/TF risks;

d) Monitoring new and emerging risks; and

e) Strengthening law enforcement efforts and intelligence capability to tackle domestic and international ML/TF, and enhance restraint and confiscation of the proceeds of crime.

Vulnerability level, threat level and overall ML risks of financial sectors
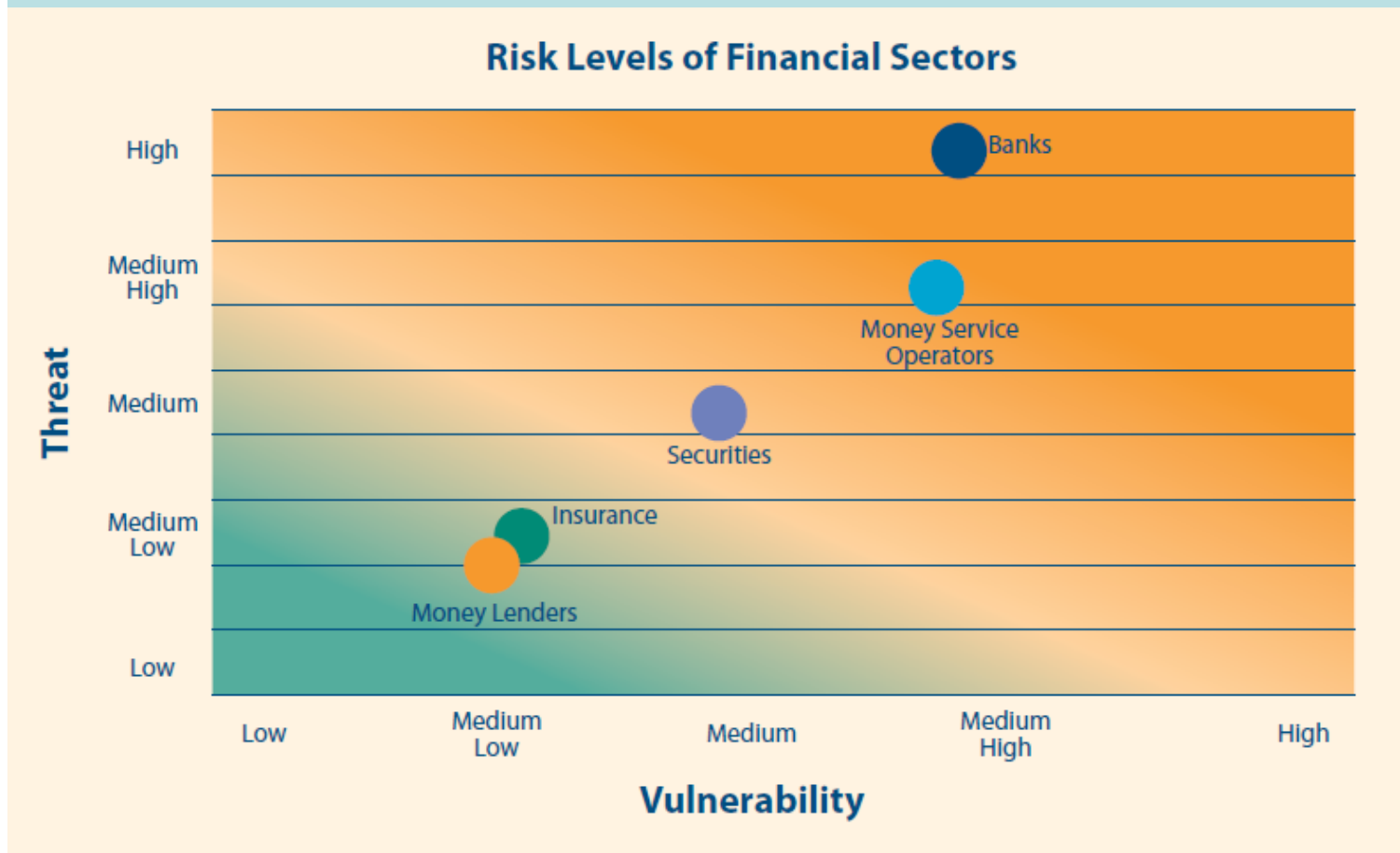
Source: Figure 5.1 of Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report

Relevance for AIs (2)

Key results for the banking sector

Main threats

- Fraud, tax evasion, corruption, sanctions evasion
- Threats arise from domestic and, to a greater extent, external activities
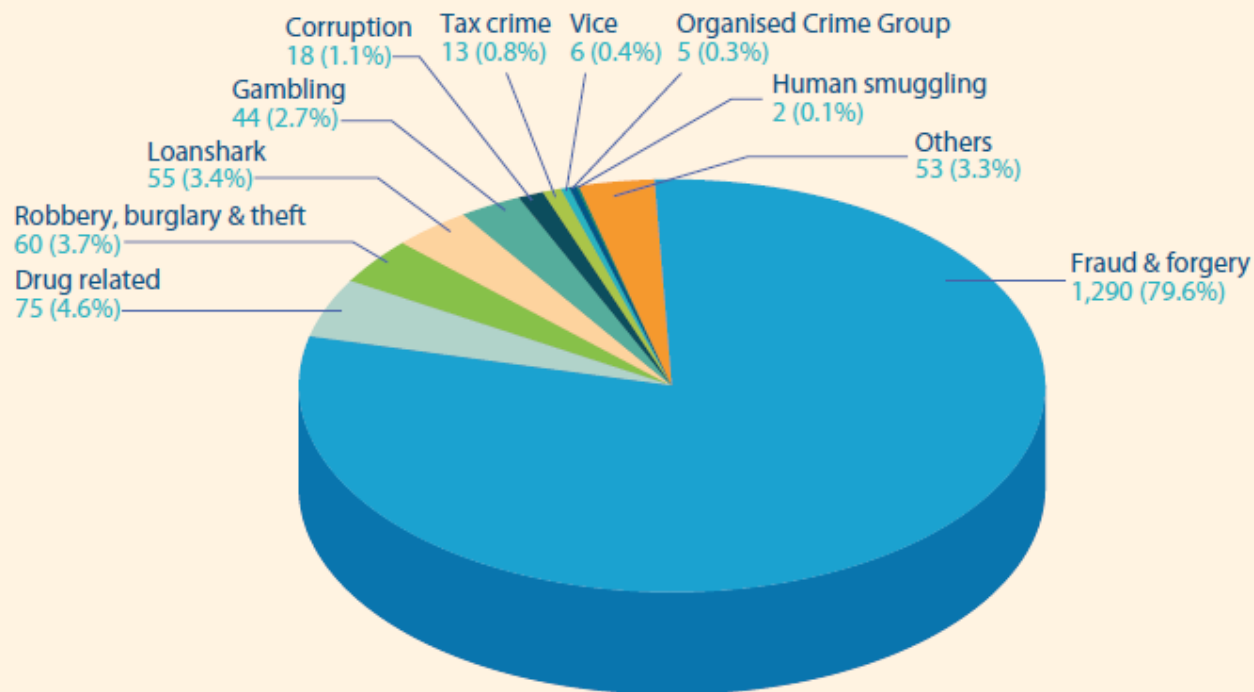
Vulnerabilities

- ML/TF vulnerabilities exist in various segments and banking products / services
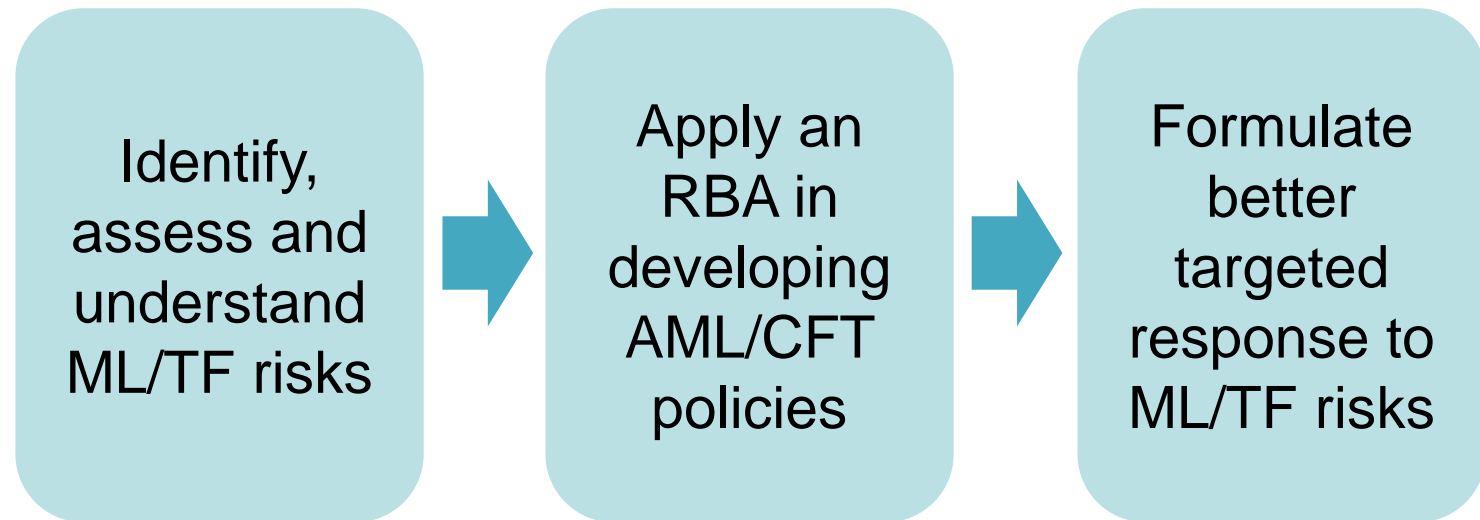- Private banking, trade finance, international funds transfer and retail and corporate banking

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Major Predicate Offences

Breakdown of 1,621 identified predicate offences associated with 1,908 ML cases in 2011 - 2015

Corruption 18 (1.1%)
Tax crime 13 (0.8%)
Vice 6 (0.4%)
Organised Crime Group 5 (0.3%)
Human smuggling 2 (0.1%)
Gambling 44 (2.7%)
Others 53 (3.3%)
Loanshark 55 (3.4%)
Robbery, burglary & theft 60 (3.7%)
Drug related 75 (4.6%)
Fraud & forgery 1,290 (79.6%)

Source: Figure 4.1 of Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report

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Identify, assess and understand ML/TF risks

→

Apply an RBA in developing AML/CFT policies

→

Formulate better targeted response to ML/TF risks

Expectations

Institutional Risk Assessment (IRA)

- No assumption of "replicating the Risk Assessment results" in conducting AIs' own IRA:
  - a "high" ML risk level for the banking sector does <u>not</u> mean each AI's IRA result must also be "high"
- AIs should take into account the main threats and vulnerable areas of business identified in the Risk Assessment
- AIs should study the Risk Assessment Report carefully, consider relevant insights and implications, review and update IRA according to your business model

Areas of Further Work

Sanctions compliance

Reduce compliance burden

Strengthening ML/TF risk understanding

Risk-**B**ased **A**pproach

Public – private partnership

Innovation and use of technology

Regulatory cooperation

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A major area of work to enhance Hong Kong's AML/CFT regime:

- Strengthening law enforcement efforts and intelligence capability to tackle domestic and international ML/TF, and enhance restraint and confiscation of the proceeds of crime, including through multi-agency cooperation/ partnership
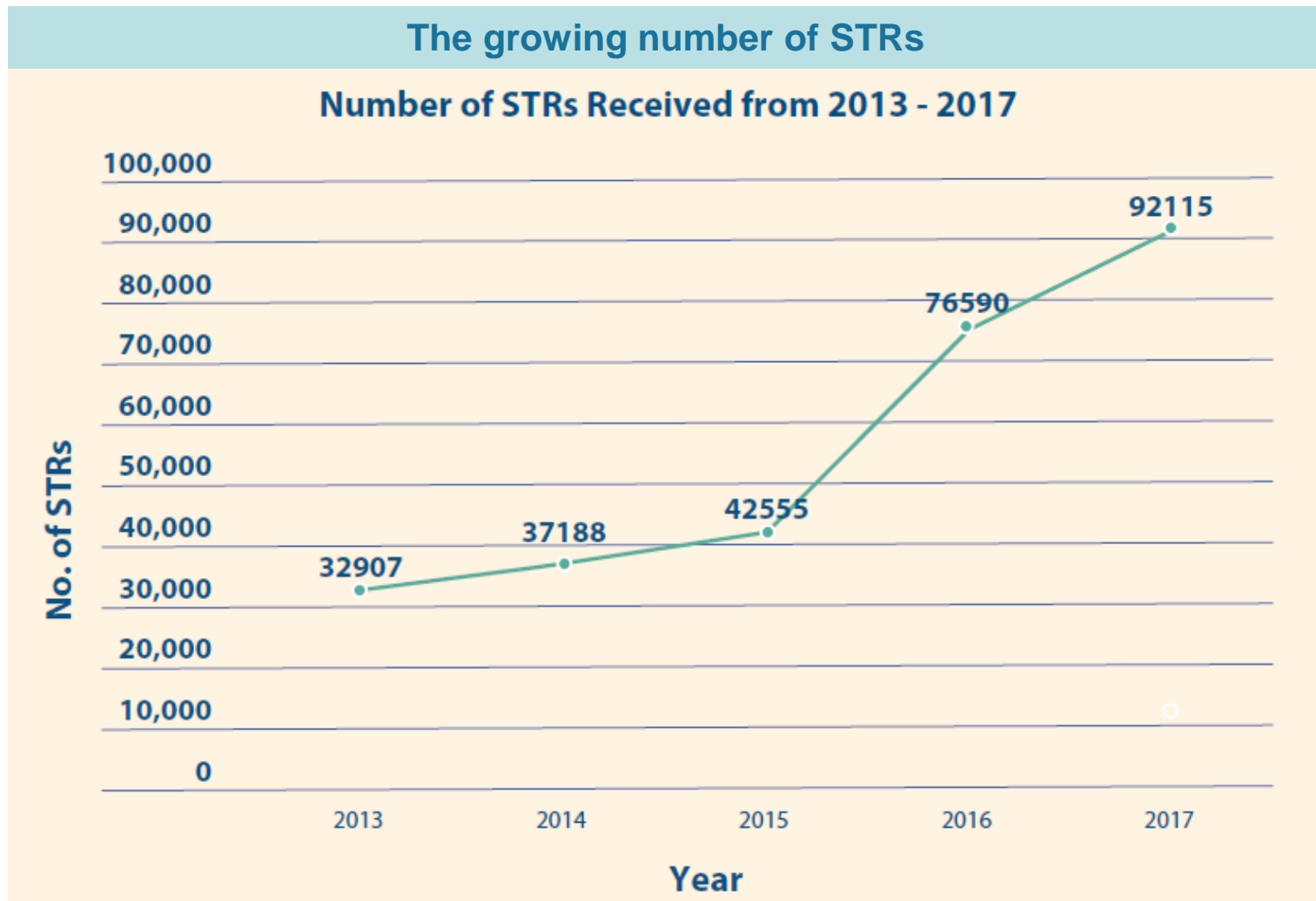
Information & Intelligence Sharing

- HKMA working together with Joint Financial Intelligence Unit (JFIU), Hong Kong Police Force (HKPF) and banking sector in two work streams

  – Strengthening public-private information and intelligence sharing on serious financial crimes and ML/TF activities

- Circular on "*Strengthening Information and Intelligence Sharing*" issued on 10 May 2018

Suspicious Transaction Reports (STRs)

The growing number of STRs

Number of STRs Received from 2013 - 2017

Year	No. of STRs
2013	32907
2014	37188
2015	42555
2016	76590
2017	92115

Source: Figure 3.3 of Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report

Suspicious Transaction Reports (STRs)

- Revised "*Guidance Paper on Transaction Screening, Transaction Monitoring and STR Reporting*" *[May 2018]*

  - Take into account recent experience and, in particular, analysis and comments from JFIU
  - AIs expected to conduct gap analysis and effect necessary process changes
  - Objective should be consistent, systematic approach
  - Proactive in enhancing STR reporting

- A public-private partnership for sharing information on cases and typologies

- Assists in the detection, prevention and disruption of crime in a more targeted way

  - Greater collective understanding of risks
  - More informed, risk-based decision making in allocating private sector AML/CFT resources

- Industry support for FMLIT essential to its success

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Overview

- **Geopolitical developments**

- **Increasing complexity of sanctions**

- **HK vulnerable to abuse as conduit for illicit funds**

UN News — Global perspective Human stories

Security Council approves toughest resolution yet against DPR Korea

Recent Initiatives

- "*Anti-Money Laundering / Counter-Terrorist Financing: United Nations Sanctions*" – Jan 2018

- "*FATF Guidance on Counter-Proliferation Financing*"; and discussion with stakeholders – March 2018

- "*Feedback from Thematic Reviews of AIs' Sanctions Screening Systems*"; providing industry guidance after thematic reviews – April 2018

Thematic Review - Background

- Review of automated sanction screening systems
  - Assistance from Regtech firm

- Conducted on selected AIs

- Assessing the **effectiveness** and **efficiency** of screening systems

Testing Process – Key Aims

Effectiveness

- Whether systems generate alerts on un-manipulated names
- Whether "fuzzy matching" rules are effective at matching manipulated names

Efficiency

- Whether false positive levels are within operable levels

Comparison with industry standards

- Whether system performance is in line with AI's expectations and how it fares compared to its peers

- Consider risk of sanctions breaches, determine appropriate level of sanctions screening to manage risk

  – Proven methodology for determining system settings and performance

  – Justifying deviations from group-wide policies

- Role of Management Information

- AIs are required to demonstrate thorough testing and tuning before system deployment and upgrades

- Documentation of testing and analysis
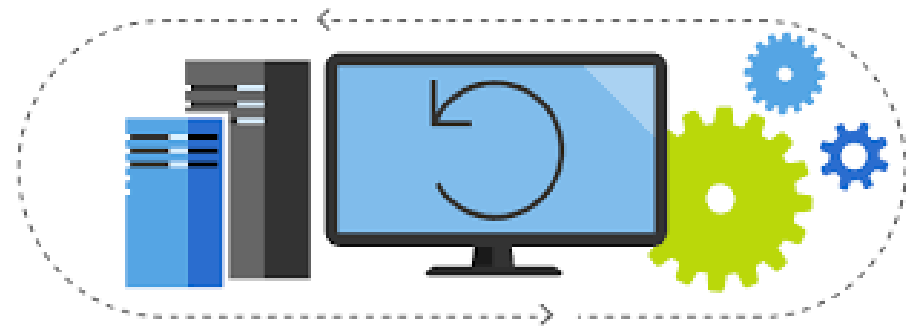
- Adequate understanding of obligations under HK and other overseas sanctions regimes (as applicable)

- Ongoing testing on system effectiveness and efficiency

Expectations: Adequate Skills & Knowledge

- Clear and demonstrable understanding of system filters employed in the institution's screening technology

- Clarity around ownership and accountability of risk

- Monitoring of suppression / good guy / white lists

- Understanding relationship between effectiveness and efficiency

  – e.g. Monitoring levels of false positives while maintaining accuracy

- Demonstrating reasoning for rules or threshold changes implemented to deal with levels of false alerts

Concluding Remarks

- Significant legal and reputational risk of operating ineffective sanctions screening systems

- Cost of inefficient screening systems should not be underestimated

- The objective of this exercise is to provide AIs with the right information needed to optimize system performance

- Regular system testing is vital for AIs

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Use of New Technologies

- New technologies have created opportunities for criminal activity

- The same technologies, when used for good, have huge potential to **detect** and **disrupt** crime
  - Machine learning
  - Artificial intelligence
  - Robotics

Regulatory Thinking

- Risk-based / technology-neutral approach to supervision

- Objective is to ensure adequate protection for sector integrity and for customers while retaining appropriate flexibility so as not to hinder the development of Fintech

    - No fixed way of doing things, open minded – *interested in what works and is effective*
    - Ability to maintain close contact with the industry and other stakeholders to understand latest developments

Regulatory Engagement

- Collaboration – with internal, external partners and with the technology sector is important

- HKMA's response:

  - Fintech Supervisory Chatroom
  - Banking Made Easy initiative
  - Greater flexibility under amended AMLO
  - FMLIT

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Encouraging Innovation

- Response must recognize the increasingly proactive role of AIs
  - The nature of that role has also changed as crime increasingly moves "online"

- Threat in ML/TF risk assessment:
  - Cybercrime threats, together with rapid advances in financial services technology, which have created new avenues for ML

- Efficiency and the willingness to innovate
  - How can we get better at achieving the desired outcome?

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Hong Kong's Mutual Evaluation (ME)

- Assess technical compliance with the FATF Standards and level of effectiveness of AML/CFT systems

- H2/2018 to H1/2019 (last ME 2007 – 2008)

- Work with Government and other agencies in preparation including
  - published Hong Kong's ML/TF Risk Assessment Report in April
  - Update of information on technical compliance and effectiveness
  - Preparatory work for the on-site visit of the assessment team

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Hong Kong's ME – Banking Sector

- Expected to be a major focus given the size and importance in Hong Kong's economy

- HKMA continues to accord a high priority to AML/CFT work
  - Work closely with all relevant stakeholders, domestically and internationally, to develop and provide responses that are agile and adaptable
  - Recognise innovation and making the best use of technology
  - Ensure response always relates to effectiveness

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Hong Kong's ME – On-site Visit

- October to November 2018
  - Process has already started

- Assessors will meet with representatives of banking sector
  - To assess the effectiveness and discuss risks
  - Not an investigation nor an inspection of individual private sector entities
  - Briefings will be arranged for selected representatives

- How well do FIs and DNFBPs
  - Understand their risks and obligations and apply mitigation measures commensurate with these risks?
  - Apply CDD and record keeping measures?
  - Apply the enhanced or specific measures for (a) PEPs, (b) correspondent banking, (c) new technologies, (d) wire transfers rules, (e) targeted financial sanctions relating to TF and (f) higher risk countries identified by the FATF?

Q&A