



HONG KONG MONETARY AUTHORITY
香港金融管理局

Regulatory Update on AML/CFT

Understanding Source of Wealth Requirements

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Objectives

- Clarify AIs' understanding of the requirement
- Assist AIs to better understand, manage and mitigate risk and apply a Risk-based Approach
 - Supports other ongoing work streams
 - Means by which greater flexibility is provided to AIs
- Understand barriers and share industry best practices
- Identify need for any future work
- *No objective to either tighten or relax how this requirement is implemented*
 - *consistent understanding and consideration of risk is the key takeaway*



Why Collect SOW?

- Part of a range of KYC measures which seek to address the ML risks that arise in wealth management
 - Acting for another, family member of corrupt official etc.
- AI should not focus design of controls simply to meet regulatory requirements
 - Objective should be based on fact this information drives risk process
 - KYC background information goes beyond a single AML control
 - Informs monitoring, ability to spot what is not right
 - Helps to drive private WM customer relationship, better understand needs, provision of better service



Source of Wealth (SOW) defined

- The *Source of Wealth* refers to the origin of the entire body of wealth (i.e. total assets)
 - This information will usually give an indication as to the volume of wealth the customer would be expected to have, and a picture of how the customer acquired such wealth
 - Although AIs may not have specific information about assets not deposited or processed by them, it may be possible to gather general information from commercial databases or other open sources

Source: FATF Guidance on Politically Exposed Persons, Para. 86-88



Source of Fund (SOF) defined

- The *Source of Funds* refers to the origin of the particular funds or assets which are the subject of the business relationship between the customer of the AI (e.g. the amount being invested, deposited or remitted)
 - Easier to obtain than SOW but this is not simply restricted to knowing from which FI it may have been transferred.
 - The information should be substantive and establish a provenance or reason for being acquired
 - *[note: Detail / granularity based on risk]*

Source: FATF Guidance on Politically Exposed Persons, Para. 86-88



Where does SOW requirement arise

- AMLO – Section 10 of Schedule 2

10. Special requirements when customer is politically exposed person

- (1) If a financial institution knows, from publicly known information or information in its possession, that a customer or a beneficial owner of a customer is a politically exposed person, it must, before establishing a business relationship with the customer—
 - (a) obtain approval from its senior management; and
 - (b) take reasonable measures to establish the customer's or beneficial owner's source of wealth and the source of the funds that will be involved in the proposed business relationship.
- (2) If a financial institution comes to know, from publicly known information or information in its possession, that an existing customer or a beneficial owner of an existing customer is a politically exposed person or has become a politically exposed person, it must not continue its business relationship with the customer unless it—
 - (a) has obtained approval from its senior management; and
 - (b) has taken reasonable measures to establish the customer's or beneficial owner's source of wealth and the source of the funds that are involved in the business relationship.



Where does SOW requirement arise

- AML Guideline 4.13.11

s.5(3)(b) & s.10, Sch. 2	4.13.11	<p>When FIs know that a particular customer or beneficial owner is a PEP, it should, before (i) establishing a business relationship or (ii) continuing an existing business relationship where the customer or the beneficial owner is subsequently found to be a PEP, apply all the following EDD measures:</p> <ul style="list-style-type: none">(a) obtaining approval from its senior management;(b) taking reasonable measures to establish the customer's or the beneficial owner's source of wealth and the source of the funds; and(c) applying enhanced monitoring to the relationship in accordance with the assessed risks.
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What does “reasonable measures” mean?

- Appropriate measures which are commensurate with the money laundering or terrorist financing risks

FATF Recommendations – Glossary, Page 120



Where does SOW requirement arise

- AMLO – Section 15 of Schedule 2

15. Special requirements in other high risk situations

A financial institution must, in a situation specified by the relevant authority in a notice in writing given to the financial institution and in any other situation that by its nature may present a high risk of money laundering or terrorist financing—

- (a) where a business relationship is to be established—
 - (i) obtain approval from its senior management to establish the business relationship; and
 - (ii) either—
 - (A) take reasonable measures to establish the relevant customer’ s or beneficial owner’ s source of wealth and the source of the funds that will be involved in the business relationship; or
 - (B) take additional measures to mitigate the risk of money laundering or terrorist financing involved;
- (b) where a business relationship has been established—
 - (i) obtain approval from its senior management to continue the business relationship;
 - (ii) if there is a beneficial owner in relation to the relevant customer, take reasonable measures to verify the beneficial owner’ s identity so that the financial institution is satisfied that it knows who the beneficial owner is; and
 - (iii) either—
 - (A) take reasonable measures to establish the relevant customer’ s or beneficial owner’ s source of wealth and the source of the funds that are involved in the business relationship; or
 - (B) take additional measures to mitigate the risk of money laundering or terrorist financing involved;
- (c) where an occasional transaction is to be carried out, take additional measures to mitigate the risk of money laundering or terrorist financing involved.



Where does SOW requirement arise

- AML Guideline 4.11.1

4.11 High-risk situations		
s.15, Sch. 2	4.11.1	<p>Section 15 of Schedule 2 specifies that an FI must, in any situation that by its nature presents a higher risk of ML/TF, take additional measures to mitigate the risk of ML/TF.</p> <p>Additional measures³³ or EDD should be taken to mitigate the ML/TF risk involved, which for illustration purposes, may include:</p> <ul style="list-style-type: none">(a) obtaining additional information on the customer (e.g. connected parties³⁴, accounts or relationships) and updating more regularly the customer profile including the identification data;(b) obtaining additional information on the intended nature of the business relationship (e.g. anticipated account activity), the source of wealth and source of funds;(c) obtaining the approval of senior management to commence or continue the relationship; and(d) conducting enhanced monitoring of the business relationship, by increasing the number and timing of the controls applied and selecting patterns of transactions that need further examination. <p>For avoidance of doubt, all high-risk customers should be subject to a minimum annual review with reference to paragraph 4.7.13.</p>



Where does SOW requirement arise

- AML Guideline 12.5

Due diligence process for private banking		
	12.5	<p>AIs should exercise a greater degree of diligence throughout a private banking relationship, beyond the standard requirements expected for normal retail banking purposes as set out in Chapter 4. AIs should obtain comprehensive customer profile information for each of their private banking customers, including:</p> <ul style="list-style-type: none">(a) purpose and reasons for opening the account;(b) business or employment background;(c) estimated net worth;(d) source of wealth (where possible and appropriate, corroboration of major economic activities that gave rise to the wealth);(e) family background, e.g. information on spouse, and where appropriate (e.g. in the case of inherited wealth), parents;(f) source of funds (i.e. description of the origin and the means of transfer for monies that are acceptable for the account opening);(g) anticipated account activity including nature and level of business and transactions; and(h) references (e.g. introduced by whom and when and the length of relationship) or other sources to corroborate reputation information where available. <p>The AI should be satisfied that a customer's use of complex business structures and/or the use of trust and private investment vehicles, has a genuine and legitimate purpose.</p> <p>All the above information relating to the private banking customer should be properly documented in the customer file.</p>



Summary: Where does SOW requirement arise

- AML Guideline references:
 - 4.6.2 Purpose and intended nature of business relationship
 - 4.11 Additional measures or EDD on high-risk situations
 - 4.13.10b Specific risk factors to consider in handling relationship with a PEP
 - 4.13.11 EDD measures on PEP
 - 4.13.12 Reasonable measures to establish SOW
 - 12.5 Due diligence process for private banking



SOW is part of EDD

- SOW requirement arises where AIs need to do more
 - Part of EDD requirements
 - Part of due diligence for private banking, where expectations are higher
- Risk-based concept: ‘Reasonable Measures’ = AI decides detail / granularity
- What are the considerations; how to obtain SOW?
 - How much wealth - *information*
 - How wealth was acquired - *information*
 - Extent of validation / corroboration
- May be established thro’ a combination of sources, provided by customer, documents or other
 - Evidence of title, Copies of trust deeds, Audited documents (detailing dividends)
 - Documents confirming salary, Tax returns, Bank Statements



Obtain “information” on net worth

- Some indication as to customers’ total net worth should be obtained
- Exact figures not required and impractical
 - inexact sum or figure expected
 - Income, especially where generated from investment, also likely to be inaccurate



Obtain “information” on where that net worth came from

- Having obtained the ‘figure’, information needs to be obtained on where it came from; inheritance, employment, business, investment etc.
 - For corporate/legal entities this is normally the income generated from commercial activity
- Generally, no single source will account for total net worth
 - But categories are few and generally well understood and identified by industry
 - Often difficult to pull apart the different sources, and no expectation to do so
- What level of detail constitutes reasonable measures is risk-based

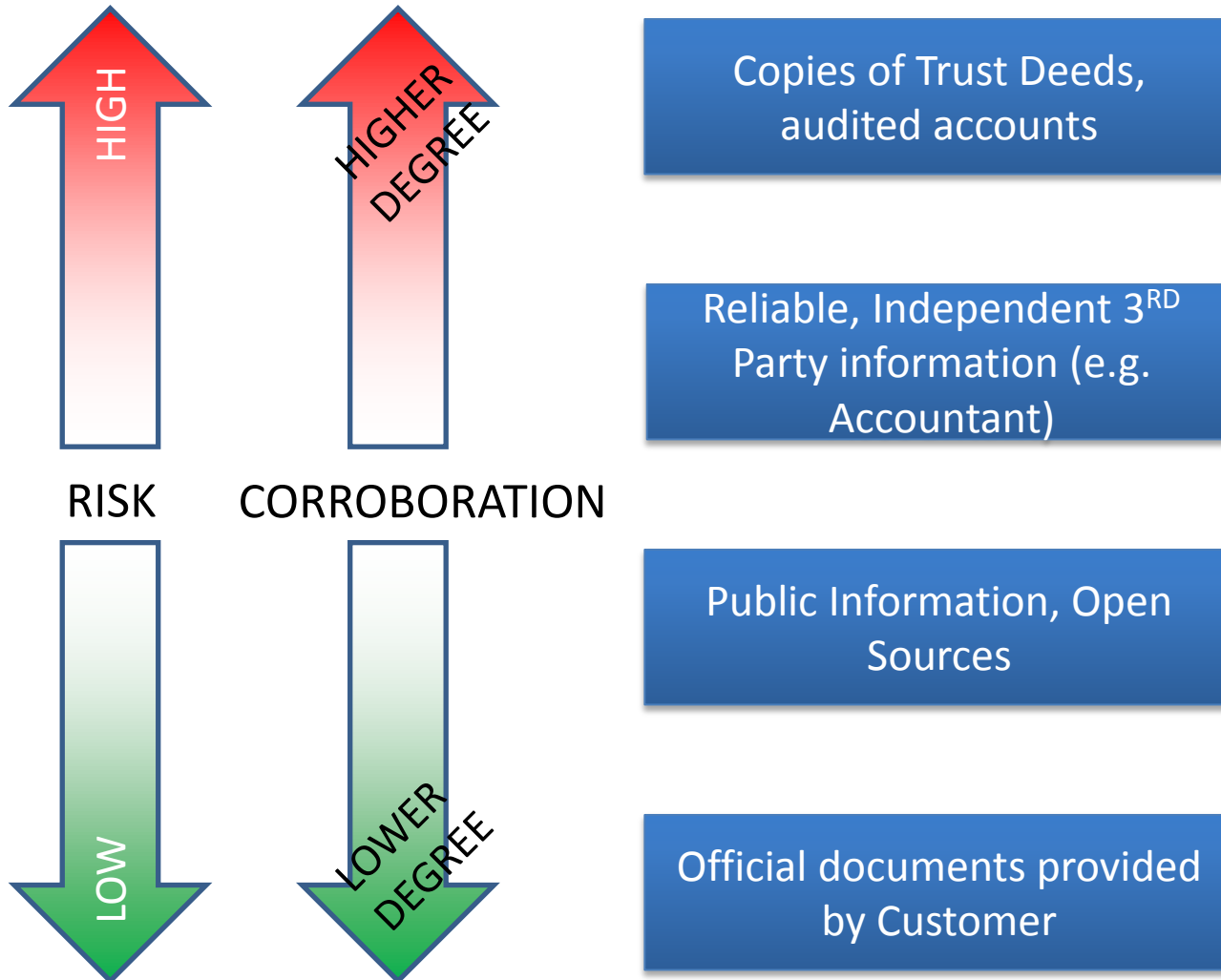


On a risk-sensitive basis verify the information

- Once the AI has information on how the wealth was generated and a description of it, AI must consider the validity – is it true?
- Not necessary to find evidence to corroborate every source or to verify their net worth (which is most likely impossible)
- Subject to the level of risk most AIs seek to find some evidence from a reliable, independent source that corroborates the gist of the story
 - Normally a focus on the sources that generated the majority portion of the wealth
 - Difficult to pull apart; generally, no single source will account for total net worth
- Examples:
 - Reputable sources on the internet
 - Confirmation from professionals with knowledge of the customer (accountants etc)
- Guidance should be provided to staff, particularly where corroboration might be required
 - Must reflect risk-based principle
 - Resolving red flags



Level of corroboration increases with risk





How far to go?

- Expectation is reasonable measures – risk-based
 - such an approach can meet both the letter and spirit of the requirement
- Risk should be the primary, not secondary consideration
 - Some AIs processes are driven by practical matters of difficulty and lack a consistent approach
- Not expected to know or verify all
 - Attempting to answer what may be impossible questions on SOW not required
 - Some AIs try to collect detailed information from years ago regarding salary or investments: very difficult and not required



Record Keeping

- Requirement is to obtain/ collect and record
- Records maintained should enable an independent reviewer (whether internal or external to the AI) to understand the SOW on the basis of the information recorded
- How a summary is presented is important, assessment, rationale for assessment, justification



Examples - Poor Practice

- SOW requirements, particularly around verification, are not sufficiently risk-based
 - applying the same measures to customers of varying risks
 - collecting too little or too much information
- Always accepting a customer's explanation for SOW at face value
 - do not probe further, even where multiple red flags are raised
- Over-reliance on undocumented information
- Not distinguish between a customer's source of funds and their source of wealth
 - this can be because of poorly designed forms or software or procedures which offer no real guidance to staff



Examples - Good Practice

- Establish and document the source of wealth for high risk business relationships
- Effective escalation and advisory procedures
- Able to provide evidence that relevant SOW information is challenged (where appropriate) during the CDD process
 - there will be odd cases where compliance requires more objective information
- Proactively follow up gaps in, and updates, SOW information for higher risk relationship during the course of the relationship



Examples - Good Practice

- Have clear risk-based policies and procedures
 - e.g. setting out the EDD required for higher risk and PEP customers, particularly on SOW
- Demonstrate risk-based approach, but on occasions do more on validation and corroboration, and from time to time there is evidence of challenge
 - easy for regulator to see system works and that component parts discharge roles



Reference

- FATF Guidance – politically exposed persons (Recommendations 12 and 22) (Jun 2013)
(<http://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-PEP-Rec12-22.pdf>)
- Wolfsberg paper – Wolfsberg Anti-Money Laundering Principles for Private Banking (May 2012)
(<http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Private-Banking-Principles-May-2012.pdf>)
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(<http://www.wolfsberg-principles.com/pdf/faq/Wolfsberg-FAQs-on-Beneficial-Ownership-May-2012.pdf>)