Ensuring Effective AML/CFT Controls

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Framing the discussion

- ➢ Focus
  - – AML systems and controls

- ➢ Nexus
  - – Hong Kong legislation

- ➢ Understanding
  - – funds become proceeds upon the "act" of evasion
  - – commonalities shared with some other types of money laundering, and the vehicles used
    - • non-transparent, complex legal entities, structuring etc.

Objectives

➢ Reinforce the status of tax evasion as a predicate offence under Hong Kong's AML/CFT regime
  – already caught under the ML offence (OSCO)
  – already caught under the STR reporting ordinance (OSCO)
  – <u>risk should already be addressed in AIs AML/CFT controls under AMLO</u>

➢ Raise institutional awareness
  – issue of tax evasion is on global agenda and here to stay
  – increased focus and scrutiny = aggravated risk

➢ Reiterate responsibility to monitor new and aggravated ML/TF risks lies with senior management
  – risk must be assessed and proportionate controls applied
  – consistent with message in high-level AML/CFT seminar in April 2013

Observations from
Recent On-site Examinations
- *Tax Evasion*

Observations - Tax Evasion

➤ No one-size fits all
  – HKMA does not mandate any particular measure
  – AI to determine on the basis of its business activities and risk profile
  – judgement required

➤ Policies and Procedures – detailed vs non-detailed
  – variations in approach
    • e.g. is voluntary disclosure addressed? Declarations?
  – customer declarations may form part of any system of controls but the responsibility to conduct CDD rests with the AI
  – P&P will continue to be a focus area in HKMA exams

➤ Consistent regional application
  – different regional standards / different risks?

➤ New + existing relationships
  – existing customers must be subject to any revised tax related risk assessment, but reasonable process and timeline, e.g. upon periodic review

Observations - Tax Evasion

➢ Does the AI have a well-developed AML/CFT risk assessment and has it identified tax evasion as a specific risk?

  – essential to applying appropriate and proportional AML/CFT controls
  – HKMA does <u>not</u> specify any method or format, but whatever format is used, it must be clearly understood by all parties

➢ How does the customer risk assessment / review process capture the risk, if at all?

  – how are customers who might pose a higher risk for tax evasion identified?
  – what measures have been considered?
    • what additional information has to be obtained or actions performed?
    • should supplement existing CDD obligations, such as proposed source of funding, the purpose and nature of the relationship (esp. where offshore)
    • what tax-specific red flags have been provided to staff?
      » how have these been developed? Has assistance from AIs tax experts been sought?

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Observations - Tax Evasion

➢ Are escalation procedures in place for a more detailed review?

– where customers are assessed to present a higher risk of tax evasion, then EDD measures would need to be applied [para 4.11.1 of AMLO Guideline] *to ensure the AI is able to understand / better assess the tax risk profile*

– additional measures **may** include:

- obtaining additional information on customer and the nature of relationship, to fully assess the tax-risk profile
  » e.g. asking the customer to provide verifiable information that tax affairs are in order and assets / income declared
- obtaining senior management approval
- conducting enhanced monitoring
- additional controls to manage the risk while the review is being undertaken

Observations - Tax Evasion

➢ Has appropriate and adequate staff training been provided
  – training an important element of an effective control system
  – will need to be tailored for different staff

➢ Beyond training and controls senior management must ensure there must be a culture in which RMs take responsibility for making ethical decisions based on their :
  – knowledge of the client relationship
  – the ultimate (true) beneficial owners
  – the account activity
  – proactive clarification of unusual activity
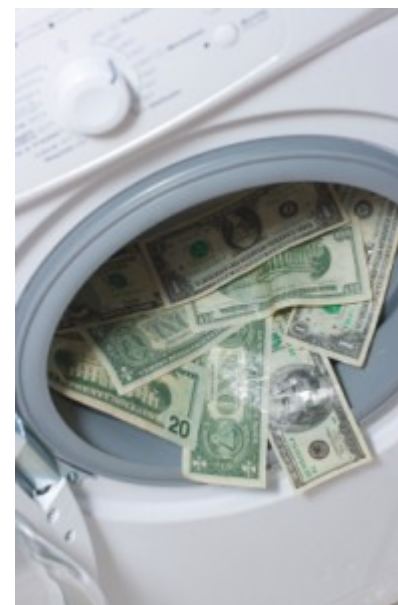
Observations - Tax Evasion

➢ Is such an ethical culture evidenced – are internal and external STRs being made (and/or relationships being exited where there is unacceptable risk of ML/TF)?

- consideration will need to be given to what constitutes *'reasonable grounds'* for making a STR in the context of tax evasion
    - for AI to determine, based on the guidance in Chapter 7 of AMLO Guideline
    - threshold for reporting same as other predicate offences - *business as normal*
- clarification with the customer
    - staff should have been trained how to communicate with customers to avoid the risk of tipping off – old requirement with which AIs should be familiar
- Para. 7.33 of AMLO Guideline applies (post reporting matters)
    - review and determine risk mitigation required – many factors will need to be taken into consideration, not least of which is the <u>level of suspicion</u>
    - no particular action mandated, for AI to determine
- where an STR is made and the relationship retained
    - management will be critically involved in decision
    - rationale and grounds should be properly documented
    - EDD measures, enhanced monitoring etc. would apply

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Observations - Private Banks

➢ 'Complex Structure' should be defined in P&Ps
  – essential to ensure that the AI understands the rationale for complex structures and is able to identify high-risk customers and apply EDD where appropriate

➢ Identification [and verification] of intermediate layers
  – AMLO Guideline requirements
    • Para. 4.9.16 & 4.9.17 clearly articulated at time of AMLO
  – verification or EDD on intermediate layers might be required in some high risk relationships
  – guidance should be codified in P&P

➢ Understanding changes in ownership/control of a corporate customer
  – confirming corporate still exists/registered (i.e. not wound-up, dissolved, struck-off, suspended, etc.) at time of periodic review

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Observations - Private Banks

➢ Source of wealth, source of funds and background of customer
 – requirements at Para. 12.5 of AMLO Guideline apply

➢ Records of meetings with clients
 – AIs must be able to substantiate what steps have been taken
 – important control to identify potential tax evasion red flags

➢ Annual / Regular review
 – where delayed reasonable explanation should be recorded
 – where delays are resource driven, record of internal discussion or escalation should be kept

➢ Trigger events
 – HKMA requirement clarified in AMLO exercise
 – must be defined, to ensure review of customer profile is conducted upon trigger events

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Observations - Private Banks

➢ Trusts - where reliance is made on a declaration from a trust company which is a subsidiary or affiliate, declarations should still contain sufficient information (e.g. details of the legal form and parties to it)

   – (settlor, beneficiaries, protector, date of establishment of trust, jurisdiction under whose laws the trust is created etc.)

➢ Role of Internal Audit

   – some IA playing a strong role, identifying control failures
   – IA should be able to identify significant shortcomings, where they arise

AIs' AML/CFT controls over Transaction Screening, Transaction Monitoring and Suspicious Transaction Reporting

Guidance Paper

➢ Consulting with HKAB on a draft for a new Guidance Paper

➢ Guidance paper provides best practices in

- transaction monitoring systems

- STR related controls

  • decision making process

  • clearance of alerts

  • completion of STRs – articulation of the analysis undertaken and suspicion

- implementation of Para 7.33 of the AMLO Guideline – *post reporting risk mitigation*

  • application of principles contained in Para. 7.33 of AMLO Guideline, risk review etc.
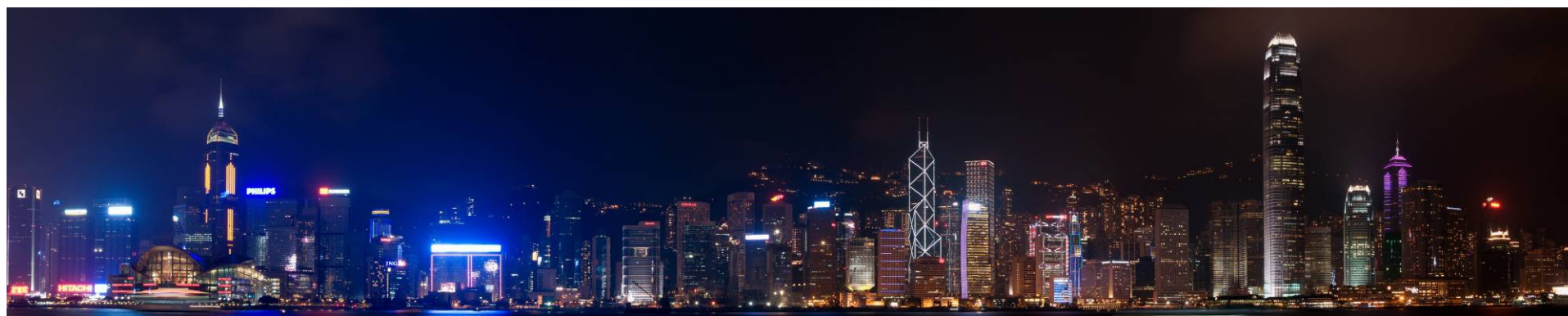
Guidance Paper

- ➤ Timing of the paper
- ➤ What actions are expected of AIs
- ➤ How will the HKMA use the guidance paper

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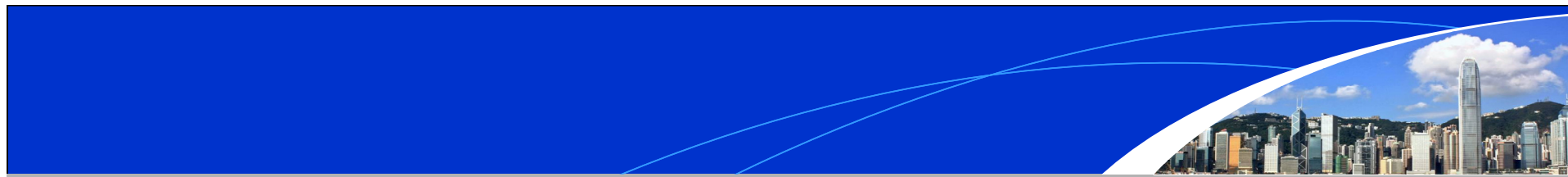
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