

Anti-money laundering measures are consistent with the supervisor's objectives of maintaining banking stability and protection of depositors, as well as with the need to maintain Hong Kong's reputation as an international financial centre. The supervisory approach is based on compliance with international supervisory standards; the issuance of guidelines on internal controls against money laundering; monitoring of compliance with them; and cooperation with other interested parties. The Monetary Authority's guidelines incorporate the Basle Committee's Statement of Principles and the recommendations of the Financial Action Task Force. Particular importance is attached to the principle of "know your customer". The guidelines are currently being revised to take account of recent changes in legislation and consideration is being given to extending the net to cover non-regulated financial intermediaries.

The supervisory framework

My task here this morning is to offer the regulator's perspective in the fight against money-laundering. I shall be speaking as one particular type of regulator – a banking supervisor – and I cannot therefore comment in detail on what is being done by my supervisory colleagues in the securities and insurance sectors to deal with the money laundering problem. I know however that they take the issue seriously and are taking the appropriate action.

I am appearing as a representative of the Hong Kong Monetary Authority which was established on 1 April 1993 by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking to perform various central banking functions in Hong Kong. Put simply, the Monetary Authority is the central bank of Hong Kong. As such, our policy objectives include trying to ensure the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and through the supervision of authorised institutions.

We do this within a legal framework laid down by the Banking Ordinance. Among other things, this provides for the licensing of those institutions which are authorised to take deposits from the public; for the approval by the Monetary Authority of directors, controllers and managers of authorised institutions; and for the setting of

various ratios, relating to capital, liquidity and large exposures which are designed to ensure that institutions remain financially sound. More generally, the Ordinance places a duty on the Monetary Authority to promote and encourage proper standards of conduct and sound and prudent business practices amongst authorised institutions and to suppress or aid in suppressing illegal, dishonourable or improper practices. In fulfilment of this duty the Monetary Authority is empowered to issue guidelines which set out what it considers to be proper and prudent standards of conduct. This would include for example guidelines on the appropriate measures to combat money-laundering.

In a nutshell, the purpose of the supervisory framework of rules and guidelines is to ensure that authorised institutions are prudently managed by fit and proper persons. The ultimate objective is to ensure that problems in individual institutions do not threaten the stability of the banking system or the interests of depositors. In order to achieve this objective, it is necessary to ensure that adherence to the supervisory framework is monitored and enforced. In Hong Kong, our principal means of doing this is on-site examination of authorised institutions – in other words we actually go out to inspect the books and records and internal control systems of the banks we supervise. However, we also supplement this by off-site analysis of the financial position and business approach of institutions based on statistical returns and other

* This is the text of a speech given by David Carse, OBE, Deputy Chief Executive (Banking) to the conference on Money Laundering on 12 September 1995.

information. This is designed to obtain a broader picture of the strengths and weaknesses of individual institutions and to pick up early warning signs of problems. Another leg of our supervisory enforcement derives from cooperation with external auditors. In particular, we have the power under the Banking Ordinance to require institutions to commission reports from their auditors on the adequacy of their internal control systems, including those designed to combat money laundering.

The supervisory concern about money laundering

Before going on to talk about how our approach towards combatting money laundering fits into the general framework I have described, I will explain why I think that banking supervisors should be concerned about money laundering and what their particular responsibilities are.

Clearly, banks are in the main firing line so far as money laundering is concerned. In the case of drug trafficking and some other serious crimes, the proceeds will usually take the form of cash. The first problem faced by the money launderer is how to convert this cash into some other form of asset 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, the most obvious home for large amounts of cash is the banking system.

Once in the banking system, the next objective is to disguise the audit trail by undertaking a series of transfers, often cross-border in nature. The objective in this “layering” stage is to disguise the source of the ownership of the funds. Again, the banks with their international networks of branches and their systems for electronic funds transfer are liable to be exploited for this purpose.

This vulnerability of banks to attack by money launderers is a matter of extreme concern 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 bank concerned and indeed in the banking system as a whole. Apart from this, banks may expose themselves to direct risk of loss from fraud through association with

undesirable customers. From both points of view therefore concern about money laundering is consistent with the supervisor’s objective of trying to maintain the stability of the banking system and to protect the interests of depositors.

In addition, as the central bank of Hong Kong, the Monetary Authority must ensure that the reputation of the territory as an international financial centre is safeguarded. Given its proximity to the Golden Triangle, which is a major source of the world’s heroin supply, and its position as one of the world’s leading financial centres, it is inevitable that Hong Kong will be targeted by money launderers. There is however no toleration of such activities by the law enforcement or supervisory authorities, e.g. through excessive banking secrecy or light supervision such as exists in some other financial centres. Rather, we recognise that Hong Kong’s reputation as an international financial centre depends on it being seen to be taking effective action against money laundering. The Hong Kong Government’s initiatives in this respect were generally praised by the Financial Action Task Force in the evaluation report on Hong Kong which it issued last year.

As banking supervisors, therefore, we have a clear responsibility to participate in the fight against money laundering. However, we are not policemen. It is not our principal role to detect crime. Rather, it is our job to ensure that banks have introduced appropriate measures to prevent themselves from being used by money launderers and to offer them guidance in this respect. Having said this, if we come across evidence of money laundering within a bank, we would not only take the appropriate supervisory action, but also ensure that a report was made, either by the institution or ourselves, to the law enforcement authorities.

The supervisory approach towards money laundering in Hong Kong

Our 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 compliance with those guidelines
- cooperation with other interested parties in Hong Kong, such as the Joint Financial Intelligence Unit and the Hong Kong Association of Banks

I will now go on to explain the specific steps which we have taken under each of these headings.

Compliance with international supervisory standards

As is generally the case with international supervisory standards, we tend to look first at the recommendations of the Basle Committee on Banking Supervision. 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 money laundering by application of the following 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
- *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

I have quoted the Basle Committee's Statement in full since it sets out in a reasonably concise manner the principles on which the supervisory approach is based both in Hong Kong and elsewhere. In particular, the importance placed on "know your customer" acknowledges the point that money launderers are particularly vulnerable to detection when cash enters the banking system or the funds are subsequently transferred within it. It is therefore vital that banks should be aware of the real identity of the persons undertaking such transactions.

The principles laid down by the Basle Committee have subsequently been developed by the Financial Action Task Force whose recommendations were described earlier this morning. I will not therefore describe them in detail except to note that, inter alia, financial supervisors are recommended:

- to ensure that institutions they supervise have adequate programmes to guard against money laundering
- to co-operate with and offer expertise to enforcement authorities
- to develop guidelines to assist financial institutions in recognising suspicious transactions

As a member of the Financial Action Task Force since March 1991, Hong Kong subscribes to its recommendations. This was tested in 1994 when Hong Kong was subject to the mutual evaluation on the adoption and implementation of the Task Force recommendations which is regularly carried out on individual members by their peers. The Monetary Authority participated in this exercise in its capacity as the banking supervisor in Hong Kong. I can say from direct experience that the

evaluation is not a formality: it requires the country being examined to take a hard look at what it has actually done to fulfill the Task Force recommendations and to justify its actions to the evaluation team. In Hong Kong's case I believe we received a generally favourable report, including with respect to the supervisory measures which we have taken. There were however some recommendations for improvement which either have been or are being addressed. These included the opinion that the banks themselves could do more to increase the level of staff awareness of the money laundering problem and to improve staff training. It was also pointed out that despite the steps already taken, the number of reports of suspicious transactions made to the Joint Financial Intelligence Unit was disappointingly low. These are both areas where substantial improvements have since been made as I will explain later on.

The Monetary Authority's guidelines

The principles and recommendations of the Basle Committee have been incorporated into the guidelines issued by the Monetary Authority in July 1993. These replaced earlier guidelines issued in March 1989 by the former Commissioner of Banking. The general thrust of the guidelines will be evident from what I have already said, but specifically they provide that institutions should have in place the following policies, procedures and controls:

- there should be a clear statement of the institution's policies in relation to money laundering which should be made available to all management and relevant staff and be reviewed on a regular basis
 - there should be an instruction manual which sets out the institution's procedures for:
 - account opening
 - customer identification
 - record keeping
 - there should be a single reference point within the institution to which staff are instructed promptly to report suspicious transactions. This reference point should have a clear means of liaison with the Joint Financial Intelligence Unit
- staff should be educated and trained on matters contained in the Monetary Authority's guidelines as part of their induction procedures and at regular future intervals. The objective should be to generate and maintain a level of awareness and vigilance among staff on the need to report suspicious transactions
 - internal auditors should verify on a regular basis compliance with the institution's policies, procedures and controls against money laundering
 - institutions should ensure that their overseas branches and subsidiaries are aware of group policies concerning money laundering

Apart from these recommendations which are fleshed out in the guidelines, advice is also given on how to recognise suspicious transactions and specific examples of money laundering are provided.

The guidelines are currently being revised to take account of subsequent developments including the passage of the Organised and Serious Crimes Ordinance which has extended the money laundering offence to the proceeds of serious crimes other than money laundering. Both this Ordinance and the Drug Trafficking (Recovery of Proceeds) Ordinance have also recently been amended to make it an offence if anyone fails to report knowledge or suspicion of money laundering transactions to the appropriate authorities within a reasonable period. This will impose a specific requirement on banks and other financial institutions to make such reports and will thus correct a defect in the previous arrangements. Our new guidelines will spell out this statutory reporting obligation.

Apart from these changes arising from the new legislation, we are taking the opportunity to refine the recommendations in relation to such matters as accounts opened in the name of third parties or in the name of shell companies. This is an important area because while many shell companies are perfectly legitimate they can be used as a vehicle for money laundering. We hope that the new guidelines will be issued before the end of this year.

The status of our guidelines should be made clear. They do not themselves amount to secondary legislation. We would however take them into account in deciding whether an institution had adequate controls to combat money laundering. In this context, it should be noted that the 1995 Banking (Amendment) Ordinance which was enacted in June and which will come into effect later this year, lays down more explicit criteria for authorisation to take deposits. These include that an institution should have adequate internal controls and that these should be working effectively. Since the authorisation criteria impose a continuing requirement after authorisation this means that in theory an institution could be liable to lose its banking licence if it failed to maintain adequate controls against money laundering.

A different provision in the revised Ordinance would allow us to revoke the licence of an institution if it is engaging in business practices which would be likely to prejudice the interests of Hong Kong as an international financial centre. Such practices would in our view include money laundering.

I should stress that normally we would see removal of a banking licence as a last resort. We would usually try to persuade or require an institution to adopt remedial measures, such as improving its internal controls or changing its management. However, the power of revocation is there to be used in the case of persistent or blatant offenders.

Monitoring of compliance

Guidelines which look good on paper are of limited value unless compliance with them is monitored and enforced. In our case, we have required all institutions to report to us on the steps which they have taken to comply with our guidelines on money laundering. We have also made controls against money laundering an item for examination in all our on-site examinations and it is a topic for discussion in our regular interviews with the senior management of banks and in our tripartite meetings with banks and their external auditors. In a number of cases, we have required institutions to commission special reports by their external auditors on their anti-money laundering controls.

Cooperation within Hong Kong

In focusing our supervisory effort, we have found it extremely helpful to have regular reports from the Joint Financial Intelligence Unit on the number and type of suspicious transactions which are being made by authorised institutions. However, we recognise that the flow of information has to be two-way. That is why, in response to a point made by the Financial Action Task Force in its report on Hong Kong, we have recently amended our rules on confidentiality to allow the Monetary Authority to disclose information to the Joint Financial Intelligence Unit. This would enable us for example to report suspected cases of money laundering which we had come across in our role as banking supervisors. Of course, we would only need to do this if the institution concerned failed to make the report.

Apart from the Joint Financial Intelligence Unit, we keep closely in touch with the Banking and Deposit-taking Company Associations on the subject of money laundering. The fruits of this cooperation were clearly evident last October when the Hong Kong Association of Banks (HKAB) produced a training package for authorised institutions, consisting of a video and booklet. This is aimed at bank staff who are in the front line in the fight against money laundering. The package was launched at a press conference attended by HKAB, the Monetary Authority and the Commissioner for Narcotics. The Monetary Authority has actively encouraged all authorised institutions to acquire the package.

The training package, together with the more intensive supervisory effort by the Monetary Authority, has prompted a substantial increase in the number of suspicious transactions reported to the authorities. In the nine months to June 1995, the number of suspicious transactions reported to the Joint Financial Intelligence Unit rose to 1089, compared with 301 in the previous nine months to September 1994. Not only has the number of reports gone up, but a wider range of institutions is now making reports. This favourable trend probably also reflects the fact that the suspicious transactions need no longer be drug-related. But in my view it does demonstrate the results that can be achieved by increasing the training effort and the level of

awareness among both staff and management of banks. This is why I welcome conferences of this type.

The way forward

I will close by saying something about our future regulatory effort. In the banking supervisory area, our policy will essentially be “more of the same” since that seems to be producing results. This means that we will continue to encourage authorised institutions to improve their internal controls and to be alert for opportunities to report to the Joint Financial Intelligence Unit. In particular, we will continue to stress the importance of effective staff training programmes. We will look at means by which we can assist in this effort, for example by organising training

seminars in cooperation with the industry associations.

We are also reviewing whether the anti-money laundering net should be extended to non-regulated financial intermediaries such as bureaux de change, remittance houses and money changers. This reflects the concern of the Financial Action Task Force that such institutions could be targets for money launderers. I should stress however that we are still at the very early stages of examining this issue in Hong Kong and we are mindful of the need to adopt a cost-effective approach.

In summary, therefore, we have tried to place Hong Kong in the mainstream of the international supervisory effort to combat money laundering and our firm intention is to keep it there in the future. ☉