

MITIGATING AML COMPLIANCE CHALLENGES



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Hong Kong is an international financial centre. Its efficient financing and money transfer infrastructure may attract people involving in money laundering (ML) or terrorist financing (TF). The Financial Action Task Force (FATF) and the Asia-Pacific Group (APG) on Money Laundering assessed Hong Kong's anti-money laundering and counter terrorist financing (AML/CFT) system and issued an evaluation report in September 2019¹. According to the report, Hong Kong generally has a sound regime to fight money laundering and terrorist financing. Its effectiveness for combating ML and TF has been significantly enhanced due to the legislative amendments in 2018. However, the report also pointed out that the awareness of management of some smaller institutions and non-financial businesses regarding AML should be enhanced. Companies may encounter challenging obstacles when combating money laundering in this era of technology. Our Risk Advisory Services (RAS) team are here to help clients to embrace the challenges.

An overview of AML regulatory landscape in Hong Kong

Upon implementation of Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO), designated authorities, including Hong Kong Monetary Authority (HKMA), Securities and Futures Commission (SFC), established guidelines for their respective sectors. These included the update of the respective AML/CFT guidelines issued by HKMA (for both authorised institutions (AIs) and stored value facility (SVF) licensees), SFC, Insurance Authority and Custom and Excise Department (for money services operators) in October/November 2018.

As a result of the emerging of new products and services that associated with virtual assets (VAs) such as cryptocurrency and the increased growth on virtual asset service providers globally, HKMA also issued a letter to all AIs in December 2019 in relation to Financial Action Task Force (FATF) Recommendation on such matter². The circular provides guidance to AIs on managing ML/TF and taking appropriate risk measures when they establish and maintain business relationship with virtual asset service providers (VASPs). These, include, but not limited to, additional customer due diligence (CDD) measures and appropriate ML/TF risk assessment to be adopted prior to launching products and services which associated to VAs.

In November 2019, the HKMA hosted the first AML/CFT RegTech Forum with participants including regulators, banks and other stakeholders within Hong Kong's AML/CFT system. The forum gathered stakeholders to share the experience and identify the opportunity in learning how technology can be applied to further enhance the effectiveness of AML/CFT efforts.

With the ML/TF channel and methods getting more complex, technology nowadays play a vital role in assisting and making companies' AML/CFT ecosystem become more efficient and effective. According to an industry survey, 34% of HKMA-regulated financial institutions reported to adopt RegTech to manage ML/TF risks in 2019³. RegTech is defined as the applications or solutions used within AML/CFT programmes that leverage one or more of the following technologies: robotic process automation (RPA), optical character recognition (OCR), cloud computing, network/graph analytics, facial/voice recognition, natural language processing/generation (NLP/G), distributed ledger technology (DLT) and artificial intelligence/machine learning. AIs adopted RegTech can facilitate AML/CFT framework in processing customer onboarding, screening & monitoring, investigations & reporting, and exit management.



Recent AML non-compliance cases and lessons learnt

In 2019, the global fines and penalties against financial institutions hit US\$ \$36 billion⁴. 12 of the world's top 50 banks were fined for non-compliance in AML, know your customers (KYC), and sanctions violation by regulators. Two-thirds of all fines by US regulators aimed at European financial institutions (FIs) for AML breaches and sanctions violations in countries like Iran. FIs in Switzerland faced the highest fine amount: mainly due to the record €4.5 billion in penalties France's criminal court brought against UBS in February 2019 over money-laundering allegations and helping wealthy French clients evade taxes. AML compliance tools and technology is no longer a nice-to-have. It is essential to and an integral part of the future banking processes.

Case 1 – Actions of overseas authorities (US and UK)

Case details:

- In 2019, an international bank, Standard Chartered, was fined US\$1.1 billion by US and UK authorities on poor AML practices and breaching sanctions against countries such as Iran.
- The bank was fined US\$947 million by US agencies over allegations in violating sanctions imposed against Burma, Zimbabwe, Cuba, Sudan, Syria and Iran.
- The bank also agreed to pay GBP102 million to the Financial Conduct Authority (FCA) for breaches related to deficiencies around CTF controls in Middle East. The bank claimed: 'The bank accepts full responsibility for the violations and control deficiencies' and 'the vast majority of the incidents took place before 2012'.
- The US regulator has a clear message to FIs and their employees: 'if you circumvent US sanctions against rogue states like Iran, you will pay a steep price'.
- The UK regulator, FCA also highlighted 'serious shortcomings' in CDD by the bank and it failed to ensure its UAE branches applied proper CTF controls.

Lesson learnt:

- The US regulators are very serious on AML/CFT compliance. Circumventing US sanctions against rogue states will face serious enforcement actions.
- The UK regulator is also very serious on AML/CFT compliance, even for non-compliance in overseas operations.
- Even international FI can be fined heavily on AML/CFT control deficiencies. Stringent AML/CFT controls on both local and overseas operations and monitoring on their actual practices are essential.

Case 2 – Action by SFC in Hong Kong

Case details:

- In February 2020, the SFC has reprimanded and fined a locally incorporated licensed corporation (LC), BMI Securities Limited (BMISL), for failure in complying with AML/CTF requirements⁵.
- A number of LC's clients subscribed for the placing shares of two HK-listed companies and subsequently transferred most or all of these shares to third parties using bought and sold notes (BS notes) in a series of off-exchange transactions, ranged from HK\$4.4 million to \$855.9 million.
- The clients did not conduct any other transactions in their accounts apart from acquiring and disposing of the placing shares.
- Despite the unusual and/or suspicious circumstances of the transactions, the LC did not make appropriate enquiries to understand the reasons for, and the circumstances leading to, the clients' sale of shares to third parties by way of BS notes, nor did LC take any steps to ascertain the relationships between the clients and the third parties.
- LC in fact did not put in place any policies or procedures governing the handling of suspicious transactions conducted through BS notes.

Violation & fine:

- The SFC reprimanded and fined the LC HK\$3.7 million for failure in complying with AML/CTF requirements.
- The responsible officer's license under SFO was suspended for five and a half months.

Lesson learnt:

Licensed corporations should:

- identify, and conduct proper enquiries and sufficient scrutiny on suspicious transactions and consider reporting them to the Joint Financial Intelligence Unit where appropriate;
- perform appropriate CDD and keep all relevant customer information up-to-date; and
- put in place adequate and effective procedures for the identification of politically exposed persons and the screening of terrorist and sanction designations.



Common AML challenges and recommendations

Challenges

Increase in regulatory scrutiny

To deal with the ever changing tactics of ML/TF activities, global regulators are being urged to evolve their standards and requirements continuously. Regulators are tightening the AML/CFT requirements in different ways. The complexity may rise when it involves cross border operations, trade based money laundering, and multi-jurisdictional AML-compliance requirements.

Financial and other institutions need to be aware the changes and complexity from time to time and prepare to designate sufficient resources to cope with any potential impacts on their business and operation. Otherwise, they may need to face huge regulatory fines resulted from non-compliance.

Lack of competent staff

It may be difficult for companies to hire experienced staff to handle daily AML operation tasks and keep up with the ever changing regulatory requirements, especially for those small and medium firms. Different institutions can be very different needs on tackling AML risks. Finding the right staff with relevant AML knowledge can be a challenge to many firms.

Technological advancement

With the rise of technology, the technique of ML/TF becomes more sophisticated. It is more challenging for companies to detect and prevent ML activities. In countries like Japan and Switzerland, they have already adopted crypto assets for trade and investments. New payment methods such as e-payments, virtual assets, and mobile wallets are gradually adopted worldwide. Companies need to constantly adjust and review their AML/CFT framework in order to combat the potential ML risks associating with new technologies.

Recommendations

Information sharing

Information sharing is one of the key component of the recommendations set out by the Financial Action Task Force (FATF). FATF developed a guidance to promote exchange of information within a company, among financial institutions, as well as across different industries. It sets out requirements on the type of information that should be shared, the circumstances in which such information should be shared and the protections and safeguards which should apply to information sharing and exchange.

Competent third parties

After analysing the costs and benefits of outsourcing, some institutions may decide to mitigate their AML risks by leveraging a competent third party. The views from independent expertise may at times more insightful and practical. Regular monitoring and review on performance of these outsourced activities would be recommended.

Adoption of new technology

It is recommended that firms should start considering adopting new technology like RegTech to facilitate their AML monitoring processes. It can release existing manpower from repetitive tasks and thus enhance companies' operating efficiency and effectiveness. Since it was found that 34% of the HKMA-regulated FIs adopted RegTech, this can help institutions to maintain its competitiveness in the industry.

How can BDO help?

The Risk Advisory Services of BDO in Hong Kong has extensive experience in providing AML/CFT advisory and support services to different regulated and financial institutions. We aim at assisting you in reviewing compliance in AML/CFT and other regulatory requirements.

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