Client Briefing September 2016

Walking the tightrope: Hong Kong banks warned not to be heavy-handed in AML checks

The Hong Kong Monetary Authority (HKMA) has warned authorised institutions (AIs) that applying overly stringent anti-money laundering and counter-terrorist financing (AML/CFT) checks when opening and maintaining customer accounts risks excluding legitimate businesses from basic financial services. The HKMA's comments come amid concerns voiced by the city's 29 chambers of commerce about foreign investors not being able to open company bank accounts in Hong Kong.

Overview

The HKMA's circular, "*De-risking and Financial Inclusion*" (the Circular) states that *"while it is important to ensure that AML/CFT controls are sufficiently robust and comply with all the relevant regulatory requirements, the HKMA expects AIs to adopt a risk-based approach (RBA) and refrain from adopting practices that would result in financial exclusion, particularly in respect of the need for bona fide businesses to have access to basic banking services."*

To help foreign investors open accounts in Hong Kong, the HKMA has also published a list of banks willing to offer services to foreign small and medium-sized enterprises (SMEs) and start-ups. The list of more than 20 banks will be provided to investors through InvestHK, the government's business promotion arm. However, not all of the city's major banks made the list.

The need for vigilance

Banks say they are enforcing stricter AML/CFT rules in response to heightened regulatory expectations amid efforts to protect the city's status as a global financial centre. An October 2012 report by the Financial Action Task Force (FATF) recognised that Hong Kong had made *"significant progress in addressing the deficiencies"* identified in the FATF's previous assessment in 2008 but that challenges remained.

The next FATF assessment is due in 2018, and pressure is building for Hong Kong to be seen as cracking down on illicit money flows from the PRC and elsewhere that remains a feature of banking services in the city.

Meanwhile, many international banks operating in Hong Kong remain subject to the exacting requirements of their home-country regulators, which may include additional compliance controls mandated by consent orders and regulatory settlements—leaving little appetite for taking on all but the lowest risk customers.

The HKMA, however, suggests that some banks seem to be going about this the wrong way, and in the Circular published a list of examples where banks have been over-zealous in their AML/CFT requirements.

Key issues

- The HKMA has warned banks against adopting overly stringent AML/CFT checks.
- The HKMA will carry out spot checks to ensure compliance.
- Among the measures banks should consider adopting are documenting a formal policy on the acceptance of accounts deemed higher risk and ensuring compliance and operations staff are applying consistent standards.

Over the top

The HKMA has cited the following as examples of customer due diligence (CDD) requirements that are disproportionate to the likely AML/CTF risk posed by customers:

- requiring all directors and beneficial owners of an overseas corporate to be present at account opening;
- mandating that all documents of an overseas corporate are certified in Hong Kong;
- requesting a start-up to provide the same degree of detail on its track record, business plan, and revenue projections as a long-established company;
- expecting a Hong Kong business registration certificate for all applicants or evidence of a Hong Kong office for all overseas corporates, irrespective of business model or mode of operation;
- requiring voluminous or very detailed information on source of wealth sometimes going back decades, irrespective of the risks presented by the relationship or type of service offered (eg MPF account, basic banking services with small balances) which is difficult or impossible for the customer to provide; and
- rejecting account opening based on unreasonably high benchmarks such as expected or actual sales turnover.

The HKMA will carry out spot checks to ensure that banks are observing the guidance in the Circular.

Speaking at a seminar hosted by the Hong Kong chapter of the Association of Certified Anti-Money Laundering Specialists on 14 September 2016, Stewart McGlynn, the HKMA's Head of AML and Financial Crime Risk, Banking Supervision, provided some context for the Circular. He said that Hong Kong needs to be "*open for business*".

According to Mr McGlynn, the HKMA does not expect perfection during its onsite examinations and is more focussed on whether there are systemic issues with a bank's AML/CTF controls.

As for offshore entities, the vast majority of offshore entities are doing legitimate business and should enjoy the provision of banking facilities, he said.

Tougher times ahead?

HSBC's Asia-Pacific vice chairman and CEO Peter Wong Tong-shun has now said that opening bank accounts in Hong Kong is likely to get even more difficult.

In an interview in *Bulletin*, the monthly magazine of Hong Kong's Chamber of Commerce, Wong said: "*I think one of the things Hong Kong needs to understand is that the world has changed significantly from a few years ago. All the new standards coming out from the US, UK and so forth have to be met.*"

Mr Wong said that clients would have to make even greater disclosures about their businesses with supporting documents, including information as to the source of funds and the type of business carried out by the company.

The HKMA's guidance is in stark contrast to that of Singapore, where the Monetary Authority of Singapore (MAS) has issued no statements or guidelines concerning *"de-risking"* and on the contrary has issued various robust statements on strengthening its AML regime, as evidenced by the establishment last month of a dedicated AML enforcement department and recent high-profile enforcement cases.

Ticks in the boxes

Having been presented with a list of what not to do, banks and other AIs may ask what steps they *should* take to meet the apparently conflicting demands of AML/CTF regulators.

We suggest the following:

- document a formal policy on the acceptance of accounts deemed to be higher risk, including a statement on the bank's risk tolerance and commitment to inclusive banking in the context of AML/CFT controls;
- adopt procedures for compliance and operations staff for conducting due diligence to ensure consistent standards for decision making that are subject to periodic testing and auditing;
- inform prospective customers about the bank's Know-Your-Customer (KYC) policy, the bank's Customer Identification Programme (CIP), and the requirement to conduct Enhanced Due Diligence (EDD) in some cases as part of the bank's customer onboarding process;
- decisions regarding account opening should involve seasoned personnel, who are well trained in the bank's policies with a mix of commercial and compliance backgrounds;
- hold regular governance meetings where senior business managers can take part in decision making about prospective or existing accounts

that are deemed to be high risk by compliance;

- provide internal stakeholders with periodic reports on the number of account opening requests, including the number requiring EDD and the number of accounts rejected for AML/CFT reasons;
- maintain a balanced focus on AML/CFT compliance that encompasses elements of KYC account monitoring, and reporting of suspicious activity. For example, higher risk accounts can be permissible, subject to EDD, but should undergo more stringent monitoring;
- reserve the right to exit a relationship that exhibits unusual transaction activity or when customers refuse to adhere to the bank's ongoing, KYC, CIP or CDD requirements; and
- maintain meeting agenda, minutes, rationales for decisions and other documentation concerning account opening in order to respond to potential regulatory enquiries.

AML/CTF remains a hot topic with the Securities and Futures Commission announcing on 21 September that it is investigating a number of cases of SFC licensed brokerages with suspected inadequate AML internal controls and that it expects to bring a number of enforcement proceedings as a result.

The lesson to be drawn appears to be that balancing the competing demands of vigilance and the provision of basic banking services – to ensure that Hong Kong truly remains "open for business" – requires a nuanced and consistent approach to AML/CTF compliance.

Contacts

Matthias Feldmann
Partner

T: +852 2825 8859
E: Matthias.Feldmann @CliffordChance.com

Edward Johnson
Partner

T: +852 2826 3427
E: Edward.Johnson @CliffordChance.com

Mark Shipman
Partner

T: +852 2825 8992
E: Mark.Shipman @CliffordChance.com

Donna Wacker
Partner

T: +852 2826 3478
E: Donna.Wacker @CliffordChance.com

Wendy Wysong
Partner

T: +852 2826 3460 (Hong Kong)
+1 202 912 5030 (Washington)
E: Wendy.Wysong@ CliffordChance.com

Ali Burney
Senior Associate

T: +65 6410 2200
E: Ali.Burney @CliffordChance.com

William Wong
Senior Associate

T: +852 2826 3588
E: William.Wong @CliffordChance.com

Nicholas Turner
Registered Foreign Lawyer

T: +852 2825 8854
E: Nicholas.Turner @CliffordChance.com

Clifford Chance, 27th Floor, Jardine House, One Connaught Place, Hong Kong

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.