

**Speech by Mr. Jackie Liu
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Keynote Address on Anti-Money Laundering**

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**The Global Anti-Money Laundering Work
and Hong Kong's Commitment**

Distinguished guests, ladies and gentlemen,

Thank you for having me this afternoon here in this summit. I am heartened to see the size of experienced professionals and experts gathered these two days in Hong Kong to share perspectives on financial market regulations.

As I have just returned from Paris after a week-long plenary meeting at the Financial Action Task Force (known as the "FATF"), Mr. Roger Wilkins, the FATF's current President, has asked me to bring you up to date in relation to the current agenda and priorities of this international policy-making body to protect the global financial system from money laundering and terrorist financing.

I also plan to take this timely opportunity to give you an insight of where Hong Kong stands in this important global pursuit.

The Global Regulatory Arena

During the past decade, the global AML (anti-money laundering) landscape has changed tremendously. While financial institutions have ridden the highs and plunged to the lows of the economic cycles, AML as a regulatory focus has steadily increased in its importance.

Indeed, any compliance chief in a banking group or an investment house will tell you that "AML", or "KYC" (know your customer), is now the buzzword in daily operations.

In addition, AML measures applied by financial institutions cut across many areas of operations such as legal, tax, IT systems, and risk management.

Strong AML controls are at the heart of many financial institutions, in the light of the global regulatory experiences in recent years showing that reckless contraventions could result in regulatory fines running into billions of dollars, or sanctions becoming genuinely license threatening.

To this end, major financial centres, all being members of the FATF, look ultimately to this Task Force for guidance on a set of international standards to combat money laundering and terrorist financing risks, as part of the coordinated efforts to ensure market integrity.

Since its establishment in 1989, the FATF carries a recognised standard-setting function to establish robust “Recommendations”, and have them revised periodically, to address the evolving threats posed by money launderers and terrorist financiers.

The latest version of 40 Recommendations was adopted by the FATF in 2012, covering comprehensively a wide range of preventive measures, institutional requirements, enforcement and prosecution issues, sectoral controls, and obligations to achieve mutual legal assistance and international cooperation to freeze and confiscate criminal proceeds.

I feel it necessary to highlight that the most recent update of the FATF Recommendations emphasises the “risk-based approach” much more than previous versions of the standards.

This risk-based approach requires us - member jurisdictions and their institutions - to identify, assess and understand the money laundering and terrorist financing risks that affect them. This enables jurisdictions to use their resources wisely and sensibly by allocating them to the areas where the risks are the highest.

Just last week, the FATF plenary meeting endorsed a guidance document for a risk-based approach applicable to the banking sector. This document provides operational suggestions to assist banking regulators in integrating this “risk-based” philosophy into day-to-day supervision. It also helps banks strengthen internal risk assessments, as well as their due diligence process and risk mitigation controls accordingly.

I urge you to look into this piece of guidance now available at the FATF's website. The Hong Kong Monetary Authority is considering how to reflect the latest principles in its own AML Guideline although its supervisory approach already reflects much of the guidance.

It goes without saying that all 36 members of the FATF including Hong Kong are anxious about compliance with these Recommendations. You know well that we are subject to a very vigorous mutual evaluation process regularly conducted to assess how effective we are to install the jurisdiction-wide AML measures.

The same health-check process applies consistently to non-FATF members belonging to the FATF-style regional bodies, such as the Asia/Pacific Group on Money Laundering ("APG").

While Hong Kong is fortunate to have exited the third round evaluation process more than two years ago, we cannot be complacent as the FATF has just embarked on a new round of surveillance this year.

Last week, I represented the Hong Kong, China delegation to join others in considering and deliberating the evaluation reports of Spain and Norway, who are among the first few brave members to have their regulatory regime carefully scrutinised by a group of expert assessors. I must say I am deeply impressed by the assessments which will be made public later in the year.

And I hold the impression that the new round of evaluation is by no means easy – as the FATF has now strengthened significantly the assessment of effectiveness over and above the previous technical compliance assessment. Put it simply, that means asking not just whether the laws and policies are in place, but whether their application on the ground leads to the right results. A "real" reality check indeed.

As far as Hong Kong is concerned, we will be undertaking this challenging fourth-round assessment in 2017 tentatively, if not later. As an international financial hub, we need to continue our good efforts to showcase a firm commitment to the AML work, as well as the effective results of our robust supervision and enforcement. Our preparation in this regard has already commenced.

Other than that, there are two fundamental areas of work about the FATF which I would like to flag up today.

The first of these is the regular warning over high-risk and non-cooperative jurisdictions, which reveal strategic deficiencies of their AML framework and pose a threat to the integrity of the entire international financial system.

To this end, the FATF is engaging in an intensive review process by its International Cooperation Review Group to ring the alarm. This particular body has been a success story of the FATF, using peer pressure to ensure real improvements in many places' AML systems.

Second, the FATF's typologies work on the rapid advancements in business practices and payment technologies underpins the strong requirement for awareness building of the vulnerabilities and updated methods to detect potential loopholes.

This area of work at the frontline of our AML efforts will serve insightful guidance for us to identify new risks and criminal trends, not just for preventive work, but also for the sake of supervision and enforcement activities.

The Hong Kong's Commitment

Ladies and gentlemen, Hong Kong takes our participation in the FATF, and our international commitment against money laundering and terrorist financing, seriously. Protecting our reputation as a well-regulated and clean financial centre is not negotiable.

In fact, the longstanding confidence in the integrity of Hong Kong's financial system is a necessary condition for a sustaining growth of the markets, which comprise a vibrant banking sector with a total asset size of over US\$2 trillion, a strong stock market with a total capitalisation of over US\$3 trillion, and a mature insurance industry dominated by foreign-owned insurers.

Our market openness, and its size and depth, inevitably warrants systematic initiatives against money laundering and terrorist financing.

1 April 2012 should be one of our hallmarks in the AML history of Hong Kong, as starting that date the new Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance came into force.

Benchmarking against the FATF Recommendations, the Ordinance introduces a set of comprehensive customer due diligence and record-keeping requirements for financial institutions, covering not only banks, insurance companies and agents, securities firms, but also remittance agents and money changers, i.e. what we now call the “money service operators” in our law.

The new law is no doubt a game changer. To move to this regime, the regulatory authorities, including the Hong Kong Monetary Authority, the Securities and Futures Commission, the Insurance Authority, and the Customs and Excise Department (which license money service operators), have made a great deal of efforts to engage the financial industry as critical gatekeepers against illicit fund flows.

For the culture of compliance to be strong among our financial institutions, the business side and the line departments inside the institutions need to take the AML controls seriously. And this comes from the top - a message you will have heard many times from our regulators. Indeed, I know from many of you that AML has never been higher on senior management’s agenda. And I recognise that many of you have spent a great deal of time and resources to meet the strengthened requirements.

For the regulators, their supervision work has been intensified, now that we altogether have accumulated compliance and regulatory experiences over quite some years or so. Offsite reviews and on-site examinations are being conducted regularly to ensure that, at the institution level, the AML controls work meaningfully, and breaches rectified promptly.

This robust approach starts to bear fruit. And it has been acknowledged by the International Monetary Fund when it conducted the Financial Sector Assessment Programme for Hong Kong earlier this year.

Among other indicators, our Financial Intelligence Unit has received almost 33,000 suspicious transaction reports last year, representing a jump of more than 40 per cent over the previous year. And over 95 per cent of such reports that contained information important to law enforcement were initiated by financial institutions having installed the enhanced AML systems following the implementation of our new laws. These increases are largely as a result of growing awareness and increased resources being applied in the AML space, rather than an increase in money laundering per se.

At the other end, there is the proactive prosecutorial work undertaken by the Department of Justice to seek restraint and confiscation orders from the court in relation to crime proceeds. The Government confiscated an asset size of almost US\$100 million last year, and restrained a total sum of more than US\$170 million, in enforcing the laws against money launderers who attempted to abuse our financial system.

Looking ahead, we need to sustain our efforts to stay ahead of the curve. To this end, we need to step up relevant risk assessments at the institution level, at the industry level, and at the territory level. This goes back to the risk-based approach I mentioned earlier, as the FATF now requires a regular self-assessment to mitigate risks. The Government and our regulators are now planning ahead to assess the work required, and we must build a collaborative partnership with the industry to accomplish this in due course.

I have emphasised “risk” time and again, but I heard that another fashionable word in town now is “de-risking”. It basically means a situation when financial institutions terminate, or restrict, business relationships with clients, or categories of clients, to avoid, rather than manage, risk.

The issues surrounding de-risking are somewhat complex. De-risking may be driven by AML compliance, but may go beyond that. We hear that some aggressive de-risking is a result of concerns about profitability, prudential requirements, anxiety after the global financial crisis, or reputation risk.

We need to handle this carefully and avoid any misconception. At the FATF Plenary meeting last week, many members have reflected that they have observed a certain extent of de-risking by institutions in their places causing inconvenience or hardship among those being affected.

While we always respect commercial decisions, let us not forget that proportionality is a central consideration when implementing AML controls.

A risk-based system does not involve an indiscriminate application of control measures, or the automatic closure of relationship with certain commercial sectors, businesses or customers, to achieve a perceived regulatory outcome. A wholesale cutting loose of an entire

client class without due regard to the level of risk and the risk mitigation measures is not what the FATF and our home authorities expect or require.

This “de-risking” phenomenon is on both the FATF’s radar and that of our own regulators.

While there is no black and white with this, what is clear is the requirement for engagement, for outreach, for understanding to ensure that AML/CFT requirements are applied in a truly risk sensitive manner, and that we all have fair and reasonable access to financial services.

Concluding Remarks

Ladies and gentlemen, I guess I have covered quite a bit of ground today, and I hope you may find my updates helpful in understanding the determination of the FATF and the Government of Hong Kong to address these pertinent AML issues.

It is important that we build a strong AML compliance culture to safeguard the integrity of our financial system. There is still much work to be done, and there will always be new threats to migrate. We need to work together to send very strong signals that money laundering and illicit finance is not welcome in our city. On that note, I thank you.
