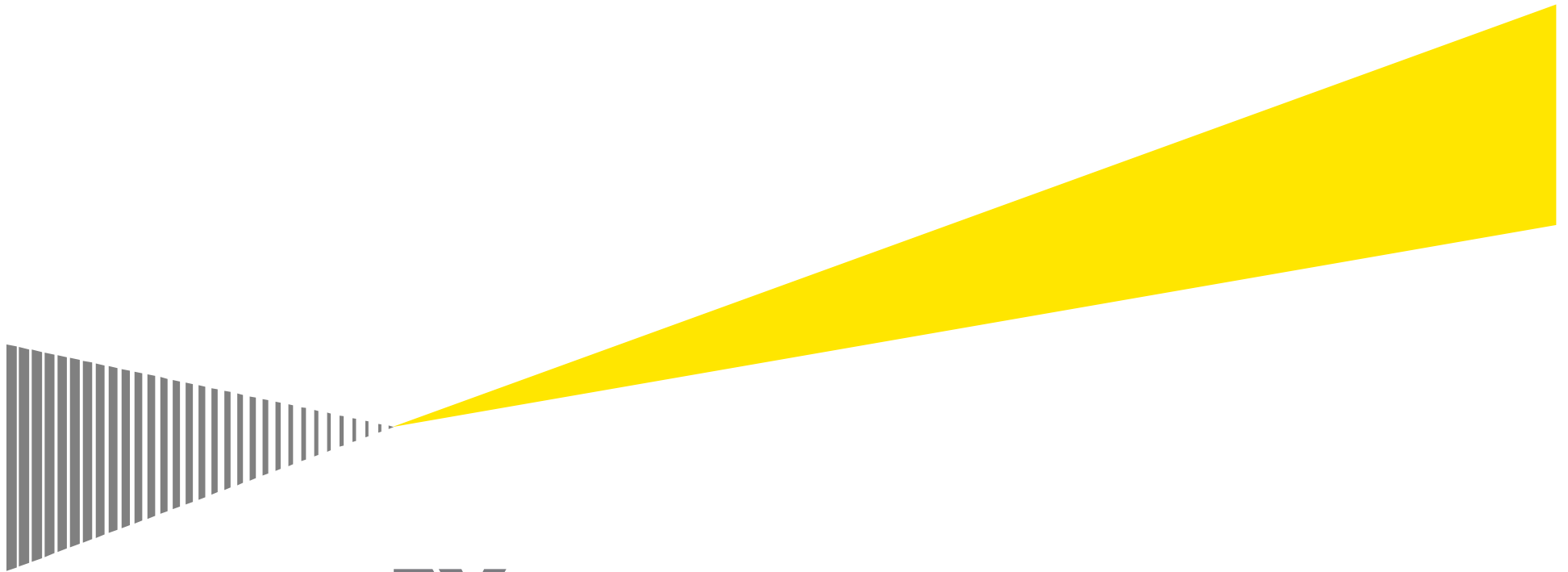


# SFC AML/CFT Seminar

Governance, PEPs & Transaction Monitoring

Philip Rodd



**EY** 安永

Building a better  
working world

# Agenda

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# ML/TF Vulnerabilities for the Securities Industry

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*“The securities market is a potentially attractive mechanism for money laundering and this stems from the variety and complexity of financial instruments available, the ease and speed of transaction execution and the ability to easily execute transactions across international boundaries.”*

MONEYVAL

- Use of securities in money laundering schemes

*“Products offered by the securities industry are vast, and many are complex, with some devised for sale to the general public and others tailored to the needs of a single purchaser. Moreover, the securities sector is perhaps unique among industries in that it can be used both to launder illicit funds obtained elsewhere, and to generate illicit funds within the industry itself through fraudulent activities.”*

FATF

- Money Laundering and Terrorist Financing in the Securities Sector

# ML/TF Vulnerabilities for the Securities Industry

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<b>Private Equity &amp; Hedge Funds</b>	<ul style="list-style-type: none"><li>• Some customers are high net worth individuals who may require extra consideration in client acceptance and risk assessment</li><li>• Funds may be provided for companies which operate across unregulated territories</li><li>• Administrators may take on responsibility for red flags screening, however, LCs should monitor and test that it is being performed effectively</li></ul>
<b>Corporate Finance</b>	<ul style="list-style-type: none"><li>• Corporate finance businesses attract money launderers as the transaction can be used for layering or integration</li><li>• Transactions could be used to conceal use and possession of criminal property</li><li>• Transactions could also be structured for the purpose of disguising the source or destination of criminal funds</li></ul>
<b>Securities Brokerage</b>	<ul style="list-style-type: none"><li>• Services/ products facilitate the rapid transfer of ownership and the ability to change the nature of an asset</li><li>• Third party payments</li><li>• Deposits of low priced security certificates could be indicative of placement</li></ul>
<b>Asset Management</b>	<ul style="list-style-type: none"><li>• ML/TF risks could be increased when dealing with certain types of customer with heightened ML/TF risks, namely trusts, PEPs or customers associated with PEPs</li><li>• Relationship Managers may have a strong relationship with the customers which may increase the risk of conflicts of interest</li></ul>

# Governance & Culture

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- Risk Assessment is a driver of all overall AML risks and resource allocation
- Is senior management a “rubber stamp”?
  - Has senior management identified and assessed the ML/TF risks before sign-off?
- AML Compliance Officer and MLRO’s knowledge and experience
- Any risk committee which is chaired by senior management to oversee the AML function AND determine whether the relationship should be exited for those customers who pose high ML/TF and/or reputational risks to the institution?
- Is training sufficient to raise staff awareness of AML/CFT?
- Three lines of defense

# Governance & Culture

## Leading Practices

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### AML Committee

- Review and discuss the monthly MI reports
- Review, approve/ exit the customers with high ML/ reputational risk or significant sanction exposures
- Oversee the periodic review of the transaction monitoring systems capabilities and functionality, i.e. scenarios and thresholds setting and review
- Oversee the progress of remediation for ML/TF related issues identified by internal and/or external parties

### MI Reporting

- Establish MI reporting systems which may include, inter alia:
  - Number of customers in each risk rating category
  - Number of transaction monitoring alerts/ backlog
  - Number of name screening alerts/ backlog
  - STRs filed
  - Planned and/or delayed ML/TF reviews
  - Deficiencies identified during internal and external reviews
  - Dispensations
- Ensure data quality soundness and completeness for reporting

### Training

- Detailed training plan for:
  - New hire staff
  - Existing staff ML/TF refresh
  - Staff with specific ML/TF roles and responsibilities, e.g. CDD, transaction monitoring, etc.
- Periodic review of the training materials and contents to ensure it is up-to-date and relevant

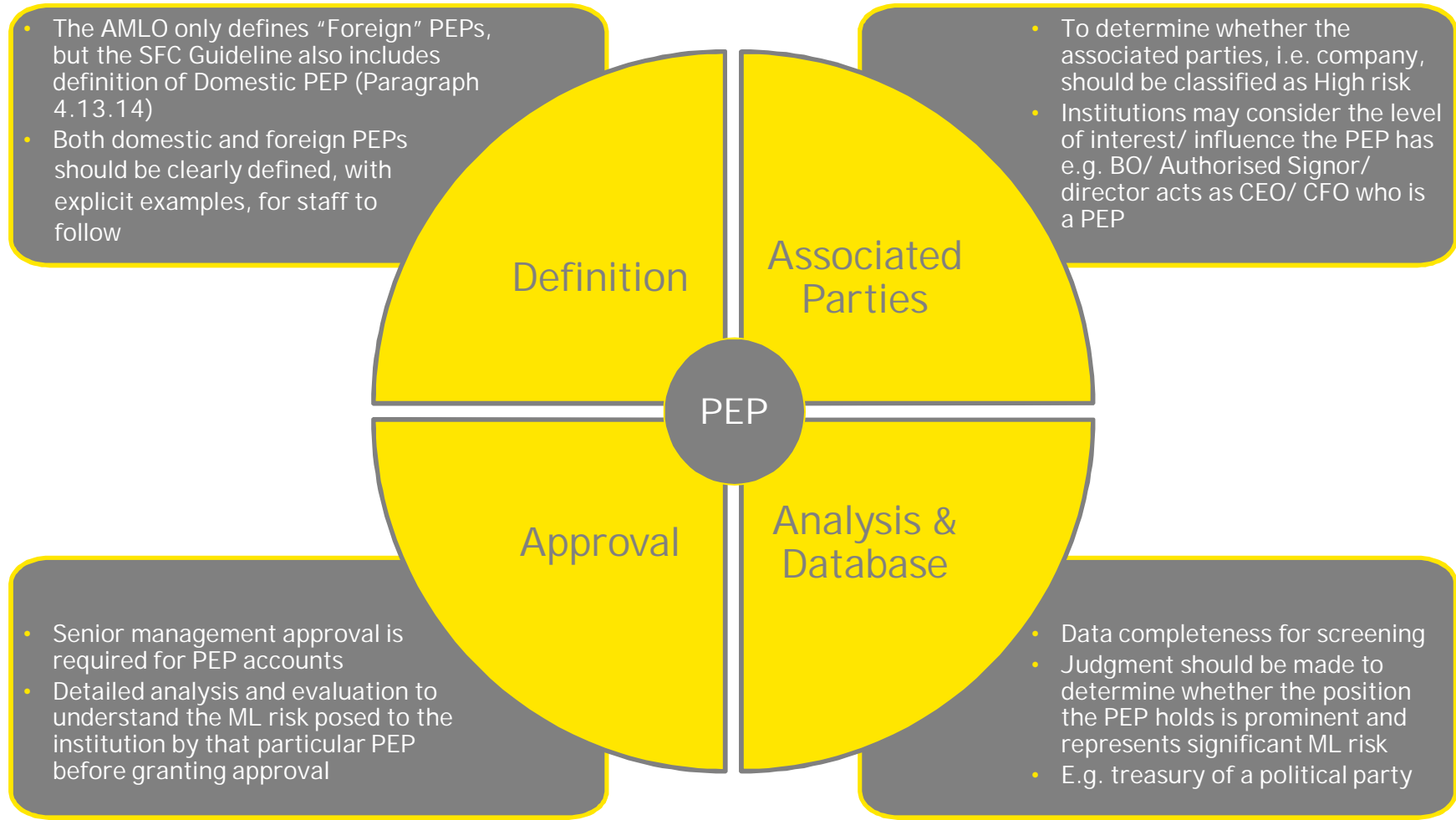
# Politically Exposed Persons (PEPs)

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- PEPs and customers associated with PEPs create higher risk for financial institutions because of their prominent political profile which may increase exposure to bribery and corruption
- Examples of information sources to identify PEPs
  - Internet search
  - Commercial database
  - In-house database
  - Customer self-declaration and Relationship Manager knowledge

Robust PEP Policy & Procedure

# Politically Exposed Persons (PEPs)

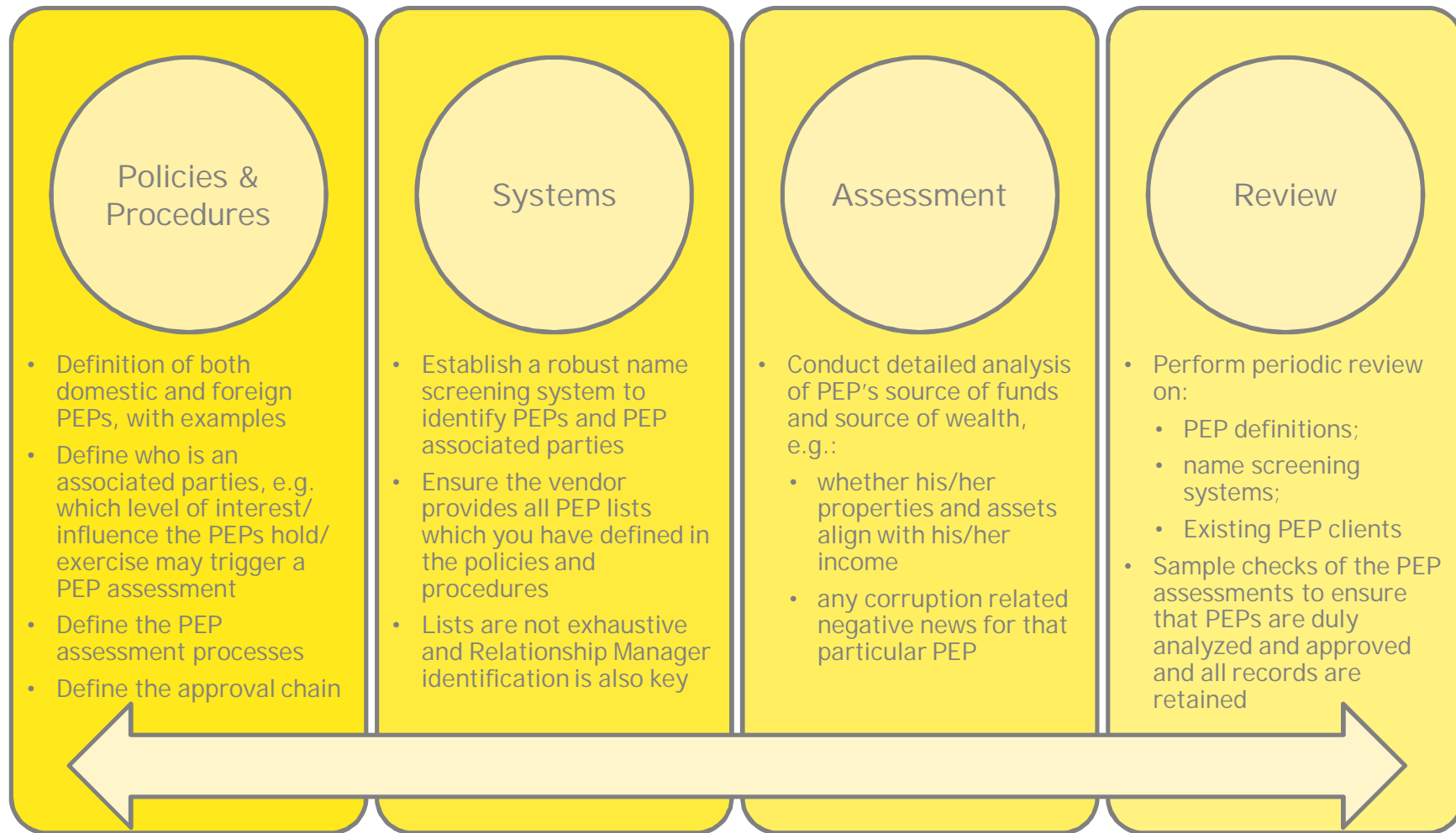




# Politically Exposed Persons (PEPs)

## Leading Practices

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# Politically Exposed Persons (PEPs)

## Source of Wealth / Source of Funds

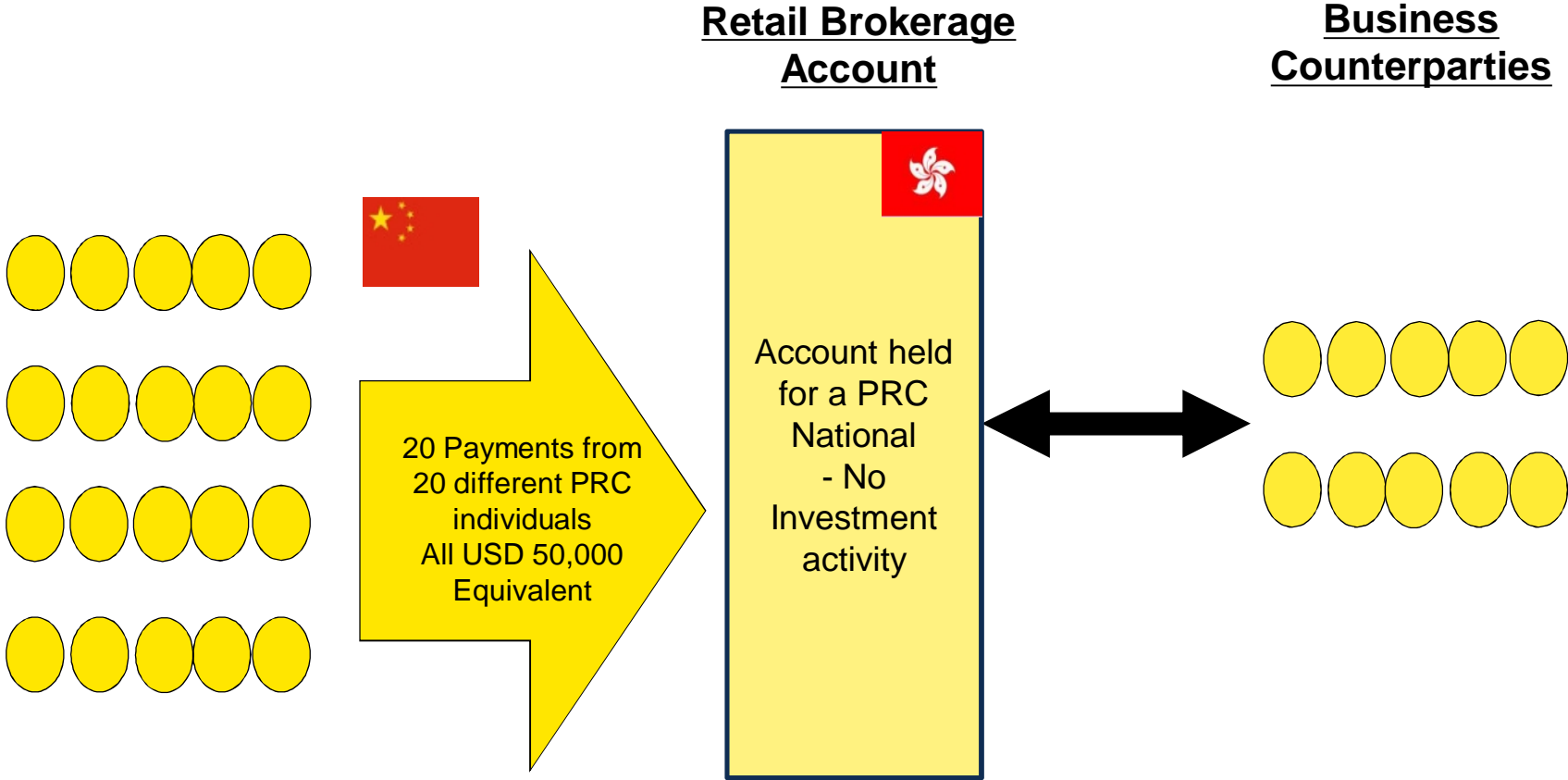
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- Establish PEPs' source of wealth and source of funds even when obstacles are encountered
- Verify the source of wealth and source of funds by reliable and independent sources, reducing the reliance on customer/RM
- Examples of information sources to establish source of wealth and source of funds:
  - Property registers
  - Land registers
  - Company registers
  - Past transactions
  - Internet searches
  - Customer self-declaration
  - Enhanced Due Diligence Reports from a third party vendor
  - Stock Exchange Filings (i.e.: HKEX annual reports)

# Case Study

## Structuring of Cross Border Transfers

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# Transaction Monitoring

## Common Deficiencies

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- Ineffective suspicious detection scenarios and thresholds
- Justifications for alerts clearance were too superficial
- Timeliness of alert investigations and closure
- Excessive investigation timeframe stated in Policies & Procedures
- Lack of post-STR filing management policies & procedures

# Transaction Monitoring

## Red Flags

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- Redeeming a long-term investment within a short period
- Customer's inflow of funds / assets are not consistent with the expected income/ resources of the client
- Transactions with no business sense / legitimate purposes or inconsistent with the customer's strategy
- Customer demonstrates a lack of concern of risks, costs or even, losses
- Third party payments / transfers, with no apparent business purpose

# Transaction Monitoring

## 3<sup>rd</sup> Party Payments / Transfers

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- 3<sup>rd</sup> party payments / transfers are commonly found in the brokerage businesses
- A third party makes payments / transfers to the institution's customer account OR the customer makes a funds deposit followed by an immediate transfer request to a third party
- Controls deficiencies for 3<sup>rd</sup> party payments / transfers can be present in each of the phases:



# Transaction Monitoring

## Leading Practices

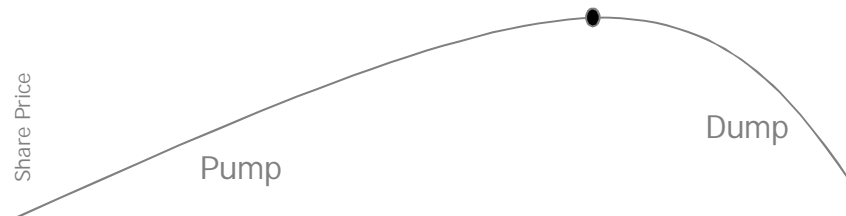
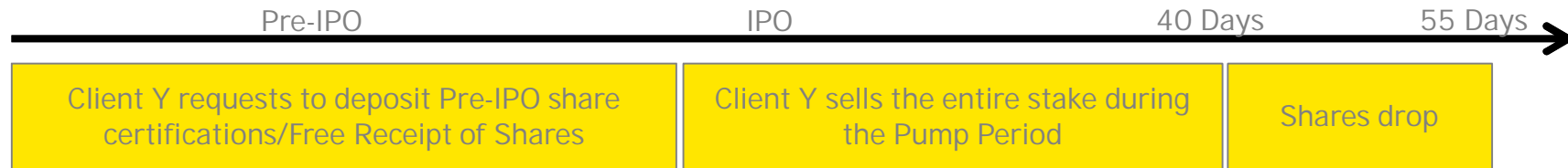
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- Assess the inherent risk (e.g. trade volume, size of LC) to determine whether an automated transaction monitoring system to detect suspicious transactions / activities is the optimal solution
- Test the scenarios, rules and thresholds before the roll out of the systems to confirm the capabilities and functionality
- Review the scenarios, rules and thresholds periodically, e.g. semi-annually, by analyzing the historical data
- Conduct samples testing for the alerts clearing processes to ensure alerts are properly investigated and justifications are not superficial

# Case Study

## Pump & Dump

Mechanism:



### Potential Red Flags/Concerns

Low priced securities/illiquid securities	Share Certificates	Pump and Dump through an IPO	Pump and Dump through existing listed security	Monitoring
<ul style="list-style-type: none"> <li>Penny Stock transactions, e.g. value below US\$5</li> <li>Low daily trading volume</li> </ul>	<ul style="list-style-type: none"> <li>Large amounts of share certificates were deposited into the brokerage firm</li> <li>This may be a red flag of placement</li> </ul>	<ul style="list-style-type: none"> <li>IPO - priced high or subsequently pumped up</li> <li>Insiders sell out with involvement of an underwriter and auditors</li> </ul>	<ul style="list-style-type: none"> <li>Potential channels:               <ul style="list-style-type: none"> <li>Email</li> <li>Media</li> <li>Cold Calls</li> <li>Texts</li> </ul> </li> <li>False Information:               <ul style="list-style-type: none"> <li>Valueless mergers</li> <li>False news on profits</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Understand from the customers about the means to obtain low-priced securities</li> <li>Generate an alert for those transactions with significant profit obtained from low-priced stocks</li> </ul>



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