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22 February 2017 By post

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sirs

Consultation on Revisions to the Annex on Correspondent Banking

We refer to the consultative document on revisions to Annexes 2 ("Correspondent banking") and 4 ("General guide to account opening") of the Basel Committee on Banking Supervision issued on 23 November 2016.

On behalf of our members, we set out in the enclosed annex our comments on the abovementioned consultative document for your consideration.

We hope you find our comments useful. Should you have any questions, please contact our Senior Business Manager, Ms Caris Wan, at (852) 2521 1855 or Officer, Ms Helen Ng, at (852) 2567 1363.

Yours faithfully

Celia Shing
Secretary

Enc.

c.c. Ms. Meena Datwani, Executive Director (Enforcement and AML), Hong Kong Monetary Authority

Basel Committee on Banking Supervision

Proposed revisions to Annexes 2 and 4 of the Basel Committee on Banking Supervision guidelines on the "Sound management of risks related to money laundering and financing of terrorism"

Submission of The Hong Kong Association of Banks

22 February 2017

Introduction

This written submission sets out the views of The Hong Kong Association of Banks ("**HKAB**") in relation to the proposed revisions to Annexes 2 (Correspondent banking) and 4 (General guide to account opening) of the Basel Committee on Banking Supervision ("**Committee**") guidelines on the *Sound management of risks related to money laundering and financing of terrorism* ("**Guidelines**") issued in November 2016 ("**Consultative Document**").

With the assistance of King & Wood Mallesons, we have examined the proposed revisions suggested by the Committee and the questions raised in the Consultative Document. We provide our views in the "HKAB's response" section of this written submission.

We would be pleased to engage in further discussions with the Committee in relation to the proposed revisions and to provide further industry input where necessary.

Unless otherwise defined, terms used in this written submission have the meaning given to them in the Consultative Document.

Executive summary

HKAB supports the Committee's proposed revisions to Annexes 2 and 4 of the Guidelines, which provide banks with a better understanding of the relevant requirements regarding anti-money laundering and countering the financing of terrorism ("**AML/CFT**"). The proposed revisions also help clarify certain matters, consistent with the Financial Action Task Force ("**FATF**") standards and guidance.

The following paragraphs summarise some of our key feedback on the Consultative Document.

(a) ***Box 1 in Annex 2*** – HKAB welcomes further details about the information a correspondent bank could acquire from a KYC utility on the respondent's customer base. However, HKAB has concerns about the collection of certain information and we would welcome further engagement with the Committee and our front-line regulator, the Hong Kong Monetary Authority ("**HKMA**") to determine what information is feasible and appropriate to acquire from KYC utilities.

(b) ***Box 2 in Annex 2*** – Paragraphs 21 and 22 of Annex 2 provide high level guidance to correspondent banks on assessing respondent banks' AML/CFT policies and procedures. We suggest that further guidance on the scope and form of such assessment would be helpful.

(c) ***Box 3 in Annex 2*** – HKAB welcomes the insertion of relevant content of the 2009 publication in Annex 2 to more clearly highlight the expectations for supervisors. We also ask the Committee to consider providing further guidance on its expectations with respect to the quality of payment messages, and make a small number of additional recommendations.

(d) ***Paragraph 6bis of Annex 4*** – HKAB agrees with the addition of paragraph 6bis of Annex 4, but would welcome further guidance (separately) from the Committee to assist banks in (i) drafting their policies pertaining to the use of KYC utilities generally and (ii) addressing cross-border data privacy issues.

HKAB's response

We provide the following responses to the questions raised in the Consultative Document and other comments on the proposed revisions.

Annex 2 – Correspondent banking

1 Box 1 – Information from KYC utilities on respondent banks' overall customer base or types of customers

Question

Would it be useful for this guidance to further detail the sort of information a correspondent bank could acquire from a KYC utility on the respondent's customer base? Do you agree that the information set out below could be useful and realistically obtained?

1.1 Yes. We strongly agree that further details about the information a correspondent bank could acquire from a KYC utility on the respondent's customer base would be useful. There is currently significant interest in KYC utilities, but also uncertainty about how best to integrate them into the risk assessment and due diligence process. A degree of standardisation would provide a valuable platform for the implementation of KYC utilities, the upshot being more efficient and effective AML/CFT controls and, ultimately, enhanced financial inclusion.

1.2 Specifically, HKAB would welcome the Committee indicating the type of information that correspondent banks could collect ("**Basic KYC Information**") from a KYC utility.

1.3 This would encourage the use of KYC utilities and provide helpful guidance to correspondent banks to assess the level of risk of a particular correspondent banking relationship. In particular:

(a) ***from the perspective of correspondent banks*** – when designing the KYC questionnaire, correspondent banks could reduce the KYC information they would otherwise require directly from respondent banks, because the Basic KYC Information could be obtained through KYC utilities; and

(b) ***from the perspective of respondent banks*** –respondent banks could record the Basic KYC Information in their systems and that information could then be readily extracted and updated efficiently and consistently.

1.4 In Box 1, the Committee notes that correspondent banks may find it useful to gather information on respondent banks' profiles through KYC utilities. Useful information on respondent bank customer types could include: (i) a broad classification according to economic sectors such as the System of National Accounts classification; (ii) the proportion of resident and non-resident customers and countries of the non-resident customers; and (iii) whether certain high-risk categories (such as PEPs) are over-represented in the customer base compared to the general population.

1.5 In relation to this suggestion, HKAB has the following concerns that may affect the usefulness and feasibility of reliance on such information obtained from KYC utilities:

(a) ***Sensitive information*** – HKAB is concerned that it may be difficult to collect some of the information suggested in Box 1 of the Consultative Document due to the sensitive nature of that information. For example, it might be unrealistic to collect information about the respondent banks' proportion of resident and non-resident customers and concentration of high-risk / PEP customers on the basis that respondent banks might consider that such information relates to their business and sales strategy, and is therefore too commercially sensitive to disseminate through a KYC utility. Also, the KYC utility provider may face a challenge where the respondent banks refuse to provide information other than that which is publicly available.

(b) ***Interpretation of certain information*** – A clear explanation of certain concepts is essential to ensure that the collection of certain information is realistic and meaningful. For example, the interpretations of "residency"[1] vary across banks and jurisdictions. We therefore ask the Committee to consider adopting appropriate definitions to help reduce the risk of misinterpretations and potential biases through differences in the interpretation used by different banks and jurisdictions. While these definitions may still result in misalignments with local / internal requirements, we suggest these will be "known" misalignments and individual banks can supplement as needed and pinpoint areas where the applicable controls need to be further understood or examined.

(c) ***Usefulness of customer database/classification*** – HKAB stresses that the primary objective of conducting assessments on respondent banks is to understand their AML/CFT risk control systems and implementation. Information such as customer database or classification according to economic sectors may not add much value to the correspondent banks' understanding of the money laundering/terrorist financing ("**ML/TF**") risks to which the respondent banks are subject. This is because classifications such as those in the System of National Accounts do not provide sufficient granularity to make adequate case-by-case risk assessments, and may have the unfortunate result of certain respondents being rejected without adequate regard to the *actual* ML/TF risks involved. For example, strong government or non-profit sector representation could be misinterpreted automatically as being high risk. Further, we suggest that there are no commonly accepted standards of customer base classification across different jurisdictions.

(d) ***Information accuracy*** – as accuracy is fundamental to the implementation to any statistical tool, HKAB notes that the usefulness of KYC utilities is highly dependent on the accuracy of data provided by respondent banks. We expect this would be addressed as part of implementation by requiring respondent banks to certify accuracy and completeness, together with periodic updating, but this may be useful to be expressly articulated by the Committee.

1.6 Bringing this together, HKAB would welcome further guidance on the information that correspondent banks could acquire from a KYC utility, and would be delighted to engage with the Committee and the HKMA to assist in further developing this guidance.

1.7 Finally, HKAB notes that there are different KYC utility service providers available and that KYC utilities remain at the early stages of adoption by certain banks. HKAB believes the use of KYC utilities has cost implications, and requires careful commercial and compliance considerations, and therefore should not be made a mandatory requirement.

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[1] For example, in China, there is a prescribed definition of "Non-Resident Account".

2 Box 2 – Assessment of the respondent bank's AML/CFT programme

> **Question**
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> Would it be useful for the Committee to elaborate further on how a correspondent bank should conduct the assessment of a respondent bank's AML/CFT policies and procedures, eg via the use of internal audit reports, or are paragraphs 21–2 sufficient in that respect?

2.1 HKAB agrees that the assessment of a respondent bank's AML/CFT policies and procedures is an important element of the overall assessment of a respondent bank's ML/TF risk.

2.2 While HKAB considers that paragraphs 21 and 22 of Annex 2 provide some useful high level guidance to correspondent banks on conducting assessments of respondent banks' AML/CFT policies and procedures ("**Assessment**"), HKAB believes it would be helpful if the Committee provided further guidance on the following areas, to ensure the consistency of AML/CFT measures and to set clear expectations on how to conduct the Assessment:

(a) the scope or criteria for the Assessment; and

(b) in addition to the type of information that could be used, *how* the Assessment should be conducted, for example, whether it can be conducted via detailed questionnaires, verbal communications with the respondent banks or conducting on-site visits. We expect that all three options (or combination) would be permissible, but would be grateful for this to be clarified,

2.3 HKAB notes that its members often come across situations where respondent banks are unwilling to provide internal audit reports due to the sensitive nature of the information. As such, the use of internal audit reports should not be made a mandatory requirement.

3 Box 3 – Quality of payment messages

> **Question**
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> Considering the existing Committee publication, would it be useful to: (i) insert the content already included in paragraphs 37–40 of the 2009 publication in this Annex, or (ii) detail further the expectations with respect to quality of payment messages, and, if yes, do you have suggestions?

3.1 Yes. HKAB considers that it would be useful to insert this content of the 2009 publication in Annex 2, to more clearly highlight the expectations related to the application of sound KYC procedures and to properly maintain their application.

3.2 HKAB also welcomes further detail about the standard for payment messages, such expectations with respect to the inclusion of name, address and Legal Entity Identifier ("**LEI**") in payment messages. It is also important to highlight that respondent banks remain solely responsible for complying with customer due diligence ("**CDD**") requirements regarding the originator of the payment messages.

3.3 That being said, HKAB emphasises that, in Hong Kong, the use of LEI is not mandatory and the prevalence of LEI varies by jurisdiction. As such, we support the proposal in paragraph 35 of the Guideline that the inclusion of LEI in payment messages is optional.

4 Other comments

Paragraph 3 of Annex 2 - Clarification

4.1 HKAB considers that it is important to elucidate that there is no direct business relationship between correspondent banks and customers of respondent banks and that there is no *prima facie* "know your customer's customer" requirement. As such, HKAB recommends revising paragraph 3 of Annex 2, as follows (suggested revision made **bold**):

> "*Correspondent banks execute and/or process transactions for customers of respondent banks. Correspondent banks generally do not have direct business relationships with these customers* ***of the respondent banks****, which may be individuals, corporations or financial services firms, established in jurisdictions other than that of the correspondent bank. Thus the customers of the correspondent bank are the respondent banks. Correspondent banks are therefore required to conduct appropriate due diligence on the respondent banks and are not generally required to do so on respondent banks' own customers.* "

4.2 This will be helpful to put beyond doubt that "know your customer's customer" is not a mandatory requirement applicable to the correspondent banks. The final sentence noted above is consistent with the point raised in paragraph 3 of the FATF Guidance on correspondent banking services (dated October 2016)to the same effect.[2]

Paragraph 7 of Annex 2 - Risk indicators and risk assessment

4.3 Paragraph 7 includes a non-exhaustive list of risk indicators that correspondent banks should consider in their risk assessment of a particular correspondent banking relationship. HKAB considers that there are circumstances where not all the risk indicators listed are applicable. As such, HKAB asks the Committee to consider clarifying that the list of risk indicators may be taken into consideration *as applicable*. In other words, we suggest that the list expressly contemplate a certain degree of flexibility for correspondent banks when conducting risk assessments.

4.4 Paragraph 7(2)(g) provides that when conducting risk assessments, correspondent banks should consider the characteristics of the respondent banks, in particular, "*whether any civil, administrative or criminal actions or sanctions, including public reprimands, have been applied by any court or supervisory authority to the respondent bank[s]*". While HKAB recognises that this characteristic of the respondent banks is important and should be taken into consideration as part of the risk assessments, we suggest it is important to highlight in the Guideline that correspondent banks should understand the *implications* of those enforcement actions, rather than the fact that the respondent banks have been subject to enforcement actions in the past. This is because, in reality, many large banks have been subject to enforcement actions in different jurisdictions, but they vary in nature, seriousness and relevance.

4.5 Paragraph 7(3)(j) suggests that correspondent banks should consider the environment in which the respondent bank operates; in particular, the quality and effectiveness of the banking regulation and supervision of that country. We believe it may be helpful to further elaborate on the appropriate manner in which correspondent banks should conduct such an assessment. For example, we suggest it would be appropriate for correspondent banks to consider and rely upon statements issued by the FATF on countries or jurisdictions as being subject to countermeasures or having

[2] FATF Guidance on correspondent banking services (dated October 2016), available at http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf.

strategic AML/CFT deficiencies, or refer to publicly available information from relevant national authorities – rather than seeking detailed legal opinions in each jurisdiction.

Paragraph 25 of Annex 2 - Ongoing monitoring

4.6 The Committee recommends that correspondent banks "should establish appropriate policies, procedures and systems to detect ***any*** financial activity that is not consistent with the purpose of services provided to respondent banks". While we strongly support effective monitoring controls, we suggest the word "any" be deleted, so as not to create a misunderstanding that the Committee expects a "zero-tolerance" approach, which can foster a culture of risk avoidance and reduce financial inclusion. We suggest this is also consistent with the risk-based approach as noted in the Background section of the Consultative Document.

4.7 We also believe that additional guidance in the form of examples and suggested practices would be helpful to help ensure the uniform application of the risk-based approach for conducting ongoing monitoring of correspondent banks, especially in the areas of monitoring and detecting nesting activities.

Annex 4 – General guide to account opening

5 Paragraph 6bis

5.1 HKAB welcomes the addition of paragraph 6bis, which acknowledges the use of KYC utilities in obtaining customer information.

5.2 HKAB suggests that the Committee may wish to consider, and undertake further work on:

(a) the types of criteria and parameters that banks should adopt when using, and drafting policies pertaining to the use of, KYC utilities generally; and

(b) any expectations with respect to cross-border data privacy issues. Since the data privacy laws in each jurisdiction differ, challenges may arise in the use of KYC utilities when there is cross-border sharing of customer information. We acknowledge that each relevant regulatory regime would generally need to be addressed, but we would welcome the Committee's views on the most efficient way to do so. For example, on whom the Committee believes the onus should fall and any pragmatic and streamlined solutions that could be developed. We would be pleased to discuss this point further.

We appreciate that this may fall outside the scope of the Guideline and could be addressed separately.

5.3 In paragraph 6bis, the Committee suggests that "*banks should also be alert to the risk of identity theft, and take into account the fact that a database may help establish that a customer exists and gather information on that customer.* ***However, the database may not necessarily confirm that the person the bank is dealing with is that customer***". We understand that the sentence in bold refers to one of the potential limitations of KYC utilities and would welcome a further elaboration of the Committee's expectations with respect to countering the risk of identity theft. We appreciate that this is a broader question (beyond KYC utilities and correspondent banking generally), and suggest that the Committee consider addressing it separately.

6 Paragraph 6ter

6.1 HKAB generally agrees with paragraph 6ter.

6.2 However, HKAB stresses that KYC utility providers are responsible for assuring the data quality and reliability and should be held accountable if they fail to do so. Banks should not be obliged to conduct sample checks to verify the data provided by the KYC utility providers, otherwise, to certain extent, it would defeat the purposes of using the KYC utility service (i.e. *facilitating* banks to conduct CDD in order to comply with the legal requirements). Of course, we recognise that should banks become aware of data quality or reliability issues, then it would be appropriate to conduct further enquiries.

Next steps

Thank you for the opportunity to provide feedback on the proposed revisions. We would be delighted to discuss any aspect of our comments or to provide feedback on any further proposals.