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HK$7 million AML fine against Coutts shows HKMA is strong regulator

Apr 13 2017 Ajay Shamdasani, Regulatory Intelligence

Compliance staff at banks in Hong Kong should tighten their anti-money laundering (AML) controls and be ready for targeted enforcement by the Hong Kong Monetary Authority (HKMA), industry officials said. Their comments followed the HK$7 million ($900,790) fine against the local branch of private bank Coutts & Co earlier this week for breaching AML and counter-terrorist financing (CTF) rules.

"As is the trend globally, regulators in Asia, mainly the HKMA and the Monetary Authority of Singapore, have amped up their efforts to ensure strict enforcement of AML laws and regulations. One way to do that is through enforcement actions. With the recent Coutts fine, [the] HKMA is sending a message to all banking and financial institutions, and their senior management, to focus on having holistic and robust AML programme and controls in place," said Hemali Mehta, a consultant at regulatory compliance firm Bovill Asia in Singapore.

The HKMA's latest action indicated that any complacency in AML compliance would invite a strong regulatory response, "even if such complacency dates back a few years," as was the case with Coutts, she said.

The enforcement action might prompt the financial sector to continue to increase investment in AML compliance infrastructure, both in terms of people and systems, said Manhim Yu, a partner at EY in Hong Kong.

"We are seeing the HKMA stepping up enforcement actions with very specific and targeted control requirement, for example relating to politically exposed persons (PEPs) and 'senior management approvals [for] high-risk customers'," he said.

The HKMA said Coutts had failed between April 2012 and June 2015 to set up and maintain procedures for determining if its customers or the beneficial owners of its customers were PEPs. The HKMA probe also found the bank's local branch failed to identify PEPs, despite relevant information being publicly available. Additionally, the bank did not follow up promptly on "PEP alerts received from a commercially available database," to which Coutts subscribed, the order said, adding the firm had taken remedial measures to address the deficiencies identified.

In an email response, Joanna Thorne, an RBS spokeswoman in London said: "We welcome the conclusion of the investigation by the HKMA into the Hong Kong branch of our legacy international private bank business and its finding that we have 'taken positive and intensive remedial measures' to address the failings identified. We regret any historic failings in our anti-money laundering processes and are in the process of winding down this Swiss-incorporated business, following the sale of the majority of the assets last year. As announced in 2014, this sale reflects the revised risk appetite of RBS and its subsidiaries."

FATF evaluation

The HKMA's enforcement action is relevant given the upcoming mutual evaluation of Hong Kong by the Financial Action Task Force (FATF) next year, which is expected to focus on the efficiency of the territory's AML regime.

"The 2018 mutual evaluation will go beyond verifying whether sufficient laws are on the books and delving into whether the country is actually enforcing those laws as well," said Heather Lowe, legal counsel at Global Financial Integrity, an advocacy group in Washington, D.C.

The city's authorities are under pressure from international bodies to clamp down on illegal money flows, following a number of high-profile cases involving local firms, including a corruption scandal that engulfed soccer body FIFA in 2015. The Panama Papers leak also drew attention to how wealthy individuals use offshore companies, many of them structured by intermediaries based in Hong Kong, to conceal assets.

Royal Bank of Scotland sold the majority of Coutts' international assets to Union Bancaire Privee (UBP) in March 2015, after splitting the bank into a British and a Swiss-based arm.

"UBP acquired a portion of Coutts International's client base, but not the legal entity itself — it was an asset only deal. As such, UBP has not inherited any of Coutts' legal liabilities," a spokeswoman for Coutts said in a statement.

Under UK regulations, a British parent entity is responsible for all its foreign branches and for that reason, "RBS is, or should be, under detailed scrutiny from head office down," said Nigel Morris-Cotterill, an independent money laundering specialist. "RBS has had its own problems around the world in this area and has closed many outlets ostensibly because of de-risking, but one has to question whether at least some of those closures were pre-emptive strikes," he said.

All regulators are watching

In February, Coutts was ordered to pay 6.5 million Swiss francs ($6.6 million) by Swiss regulator FINMA for breaching money laundering regulations in its relationships with Malaysian sovereign wealth fund 1MDB. Singapore's central bank last December imposed a penalty of S$2.4 million ($1.7 million) on Coutts due to money laundering breaches also related to the 1MDB saga.

Once a bank is found to have systemic failures in one jurisdiction, regulators elsewhere will start to pay it attention, Morris-

Cotterill said. "Coutts got tied up with 1MDB, which was also for PEP failures."

Others queried whether the HKMA would have even looked at Coutts had it not been for its penalties in Switzerland and Singapore.

"This fine and the nature of the violation almost seem like it was an effort in public relations by the HKMA to demonstrate they are on top of things regarding Coutts, simply because they felt compelled to act in light of the fines and findings of more serious wrongdoings elsewhere. If in fact, HKMA found these violations through routine inspections, then why has there been no announcement that someone in compliance or private banking at Coutts has been deemed responsible and held to account?" said Bill Majcher, president of EMIDR, a corporate risk firm in Hong Kong.

He also said if PEP clients had been onboarded and Coutts had profited from those accounts via transaction fees, there had been no disgorgement orders for Coutts to relinquish whatever funds had been earned from such customers.

"This is pretty standard operating procedure in many jurisdictions, so I am curious why it didn't happen here," Majcher said.

Compliance lessons

Coutts' failure to identify PEPs by performing required background checks or seeking senior management approval for the onboarding of high-ranking foreign public officials — some of whom might have been identified by a routine web search — seemed deliberate, Majcher said.

"There was no excuse for Coutts not to have run clients through available databases that would have allowed them to know if they were dealing with PEPs," he said. "Someone at Coutts deliberately chose not to make a basic inquiry for an answer they already knew, as it would have meant they would have a paper trail of being tasked with knowledge, and thus a little willful blindness aids in the prevention of losing the client and the fees."

The most important aspect of Coutts' transgressions was its employees' decision to accept such business with no questions asked, GFI's Lowe said. "For three years, Coutts threw its doors wide open to welcome the proceeds of corruption," she said.

"How many accounts were opened during this period? How much money went through those accounts? Which countries were those foreign officials from? Are they permitted by law in their own countries to have bank accounts abroad?" she said.

Reliance on commercially available databases with PEP alerts is insufficient, sources said.

"You need to proactively respond [to] any breaking news or media information in handling PEPs," said Josephine Chung, director of CompliancePlus Consulting in Hong Kong. She said that compliance burdens for banks would naturally increase, as each PEP case required a detailed compliance assessment and judgment on its own merits.

Previously, significant penalties for AML compliance failings was limited to cases brought in the United States and UK but no longer, said Tom Delaney at Mayer Brown in Washington, D.C.

"Jurisdictions that historically have been regarded as maintaining less aggressive enforcement environments are coming in line with standards that have long been advocated by the FATF and other international bodies. This means that banks have little choice but to adopt compliance procedures that are consistent with international standards, or risk being the focus of an unwanted and potentially reputation-damaging enforcement action," he said.

Hong Kong needed to keep its position as separate from that of mainland China as possible in order to maintain its U.S. dollar-peg advantage, Morris-Cotterill said.

"We can expect to see an increase in enforcement and larger fines when breaches are discovered. Note, too, that some regulators are going further and further back when looking for breaches and weaknesses and punishing them, even when they have been remedied: Hong Kong is moving towards that," he said.

Low fines are no deterrent

The relatively low financial penalty makes it debatable how much of a deterrent effect the HKMA expects to create.

"A fine of less than $1 million is not exactly a dissuasive fine for a bank like Coutts and other Hong Kong-based banks, but of course, fines should be proportionate to the infraction," Lowe said.

The regulator failed to provide sufficient information for outsiders to assess whether or not Coutts' fine was proportionate, she said.

This was a case of a bank flouting basic laws which it fully understood, Lowe said. "The penalty needs to ensure that those types of business decisions do not pay off. I am less than confident that the fine in this case has that effect."

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