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New Hong Kong onboarding guidelines may not lessen compliance burden

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Expected new guidelines from Hong Kong's banking regulator to ease regulatory requirements for account opening may lead to greater clarity but will not significantly lessen know your customer and anti-money laundering compliance burdens at banks, sources said.

The Hong Kong Monetary Authority (HKMA) is expected to issue the guidelines within the coming months amid a growing chorus of complaints from small-and medium businesses in the territory that opening a bank account has become much more difficult. With authorities worldwide focused on clamping down on money laundering abuses, regulators and banks have in recent years sought to introduce a stricter client onboarding process for new accounts. Some banks have reduced their exposure to lines of business associated with a higher risk, such as small businesses and foreign clients.

A rise in complaints to the HKMA over the cumbersomeness of opening a local bank account has now prompted the regulator to consider issuing more specific guidelines, to avoid banks closing the door on too many potential clients.

"The compliance picture should be more clear. This has been a problem for a number of years now," said Padraig Walsh, a partner at law firm Bird & Bird in Hong Kong. "There was a vacuum in respect of regulatory guidance. Banks were free to apply their own criteria by and large. Now there is a chance that a more consistent approach will be applied in respect of compliance issues."

Walsh said by allowing local banks so much latitude, there was a risk that they would adopt stringent interpretations of compliance standards required by international regulations or, more cynically, only accept immediately valuable business.

Indeed, some said the institutions with the most lax KYC and enhanced due diligence screening across Asia were the large, multinational U.S. banks.

"They [large banks] frequently hide behind a lot of legalese and mostly consider it [non – compliance] to simply be the cost of doing business. No real penalties to individual employees exist," said Steve Vickers, chief executive of Steve Vickers &

Associates, a political and corporate risk consultancy in Hong Kong.

Vickers said the potential new guidelines would not radically alter compliance burdens at the city's banks despite good intentions.

"The big banks are terrified of further huge fines and given that the compliance genie is so far out of the bottle, it will be difficult to fix," he said.

In late July, Sarah Kwok, head of the HKMA's banking conduct department, told the South China Morning Post that her office had received nine complaints in the past six months involving account openings; the total in 2015 was 59.

Compliance implications

The potential impact of the guidelines remains to be seen, although sources expressed hope that the guidelines would help banks avoid adopting a tick-box mentality for new account openings and instead help instil a more pragmatic AML culture.

According to Walsh, the guidelines would contain a degree of bank discretion. "There is no natural right for a company to have a bank account. There is a risk that banks will still have internal guidelines and policies that require business of a minimum level before it will take on the cost of operating a corporate bank account. We can be justifiably optimistic, though, that the HKMA will be emboldened and will seek to eliminate the unsustainably rigid application of bank policies we currently see."

It is unlikely the guidelines will much alter the compliance landscape, said James Comber, a partner with law firm Ashurst in Hong Kong.

"The HKMA will not want to see the banks that it regulates being embroiled in the money laundering scandals of the future due to more flexible client on-boarding standards," he said.

Client on-boarding, however, is only part of the picture as banks must be vigilant in client monitoring for suspicious activity after an account has been opened and report concerns to the authorities.

"Failure to do so will continue to give rise to potential sanctions against banks under Hong Kong law and the other jurisdictions in which they operate," Comber said.

Ultimately, any changes in AML and counter-terrorist financing directives and guidelines will impact compliance officers the most.

To begin with, said Billie-Jo Dixon, director of regulatory consultancy Bovill Asia in Singapore, compliance professionals would have to carefully assess their institution's internal KYC policies and procedures, and perform a gap analysis against the new guidelines followed by revising their existing KYC policies and procedures, and training staff on the changes. "Going forward, some specialization and expertise will also be required on the part of compliance officers to on-board small-to-medium enterprises (SMEs), as their business and operating models are different from larger corporations. As such, compliance officers will have to change their mind-set and not measure every customer with the same yardstick," she said.

In recent months, the HKMA has requested banks to adopt a more balanced "risk-based" approach to their AML and KYC procedures when opening new accounts.

The issue for banks, therefore, is that they need further guidance from the HKMA. Without that information, said Michael Yau, a partner with law firm Eversheds in Hong Kong, it was difficult for institutions to understand what changes the HKMA was recommending.

"To be effective, the HKMA should provide detailed guidelines on how this balanced, risk-based approach would be applied in day-to-day practice. For example, the HKMA could explain the proposed changes to customer due diligence (CDD) requirements and what steps banks will need to take to demonstrate their compliance. Issuing draft procedures and guidelines would have the added benefit of allowing the banks' legal and compliance members to comment and suggest further enhancements. Once agreed the banks could review, revise and possibly relax, their existing client on-boarding procedures in line with the new guidelines," Yau said.

The tone set by the HKMA seems similar to that being adopted in other jurisdictions when banks are faced with "de-risking" or "off-boarding" decisions — either with respect to their own customers or by correspondent banking centers in the U.S. and in Europe.

"The one size fits all complaint and concern being voiced by customers is really tied to one overriding issue of ultimate beneficial ownership (UBO) of accounts, bearer share companies and trusts," said accountant Stanley Foodman, founder of Foodman & Associates in Miami. "Without knowledge of UBO, there is no effective method of compliance with the Organisation for Economic Co-operation and Development standards or the [U.S. Treasury Department's] Office of Foreign Assets Control (OFAC) specially designated nationals (SDN) list standard. In other words, either the HKMA and Hong Kong banks are willing to follow the OECD ultimate beneficial ownership standards and be viewed as transparent, or be viewed as non-transparent and risk losing overseas correspondents and risk sanctioning in other jurisdictions," he said.

FATCA and CRS are game changers

Some see greater compliance burdens as a sign of the times, most notably following the implementation of the U.S. Foreign Account Tax Compliance Act (FATCA), which was a milestone event for thwarting tax evasion and money laundering.

"For the banking industry, compliance requirements have increased ever since the onset of FATCA. Banks have been carrying greater costs and compliance burdens. And now with Common Reporting Standard [for automatic exchange of information from the OECD] coming online in Hong Kong in 2017 and the first reporting [under the new regime] to begin in 2018, all banks will need to upgrade their systems yet again to expand the scope of their compliance to multiple countries and jurisdictions," said Patrick Yip, partner at Deloitte in Hong Kong.

It was understandable, he said, that local institutions may hesitate to take on new customers, because not only do they have to worry about AML sanctions for accepting the wrong kind of business, but Hong Kong's draft CRS implementation legislation also contains provisions that, in certain circumstances, impose personal liability upon employees of financial institutions for non-compliance. FATCA has no such personal liability for individual employees.

"Therefore, bank employees here must be more than reassured that a client opening an account is completely 'kosher'. That may cause some bank staff to be overly cautious and careful, because if they are not, there is a possibility that they might be [personally] liable. Sometimes the banks that seem to be the most stringent are usually those that have suffered some bad press or other [regulatory and financial] penalties in this area around the world," Yip said.

Many banks have strengthened internal due diligence requirements in recent times, after several received hefty fines for AML and CTF lapses.

"It would be sensible for banks to be cautious where U.S. persons or U.S. dollar transactions are involved, especially for companies that may be used for tax structuring purposes," said Nigel Morris-Cotterill, founder of the international Anti-Money Laundering Network. "I suspect that the companies that are having problems opening accounts are offshore business corporations and holding companies of tiny outfits. These are, of course, the primary targets of those seeking to create a global common tax structure, including the United States, Australia, Germany and the OECD, in its various forms and guises," he said.

Under CRS, no specific country is more dangerous or risky than another, said Yip, eschewing such discrimination by local banks against overseas firms. Many Hong Kong banks were concerned about companies based in tax havens, which were early adopters of CRS.

Regulatory rationale

An HKMA spokeswoman said in recent years, the strengthening of international efforts in AML and CTF, sanctions regimes and other regulatory requirements had also reached Hong Kong's shores.

"Some banks are adopting more stringent customer due diligence measures in accordance with their group level compliance

requirements. The HKMA is collaborating closely with the business community on this subject and will also issue guidance to remind banks to continue to suitably implement the risk-based approach in carrying out CDD measures, maintain high transparency and treat customers fairly in their dealings with customers and formulate customer-friendly account opening procedures, so that legitimate businesses, big or small, can have access to basic banking services," she said.

Bill Majcher, president of EMIDR, a corporate risk firm in Hong Kong, still saw an AML gap. Under the current risk-based model, as advocated by the Financial Action Task Force (FATF), the global standard setter, entire industry sectors have been designated as high risk and accordingly, Hong Kong banks have responded with shutting out all businesses, no matter how legitimate, he said.

"The problem with the approach that some leading banks in Hong Kong have taken is that we are forcing legitimate and proper businesses to exit the legitimate banking system if they wish to stay in business."

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