Identification and Reporting of Suspicious Transactions in Banks

David Hsu
Country Compliance Officer
Citibank, N.A., Hong Kong
AGENDA

• Identification of Suspicious Transactions
• Case Sharing
• Suspicious Transactions Reporting – Other Issues To Consider
FINANCIAL INSTITUTIONS CAN PROTECT THEMSELVES BY DEVELOPING AN EFFECTIVE AML PROGRAM

- Develop a comprehensive Know Your Customer (KYC) program: Customer identification requirements, identification of High Risk Businesses and accounts, profiling of customer, identification of politically exposed persons.
- Enhanced Due Diligence (EDD) process for high risk accounts.
- Monitoring of account activities.
- Procedures to review and report suspicious transactions to management and government authorities.
- Staff training to increase money laundering awareness.
- Well documented Compliance/Internal Control procedures.
- Quality Assurance/Internal Audit Review Program.
- An experienced Anti-Money Laundering Compliance Unit.
- Support from senior management of the organization.
- Close interaction with law enforcement, Central Bank and regulators.
SUSPICIOUS TRANSACTION IDENTIFICATION AND REPORTING

• How to decide that a transaction is suspicious?
• Consider using the SAFE approach......
THE SAFE APPROACH

The four steps are:

- Screen for suspicious activity indicators
- Ask appropriate questions
- Find out the customer’s record
- Evaluate all the above information.

If still suspicious or unsure, make a Suspicious Transaction Report.
STEP ONE:
Screen for Suspicious Activity Indicators

Suspicious Activity Indicators are entities or transaction patterns which are commonly seen in money laundering...
RED FLAGS – ACCOUNT OPENING

- A business that is reluctant to provide complete information regarding the purpose of the business, prior banking relationship, references etc.
- A customer who presents unusual or suspicious identification documents that the bank cannot verify.
- A business that presents financial statements noticeably different from those of similar businesses.
- A customer who insists on meeting bank personnel at a location other than their place of business.
- A business that the business address that is located in a residential building, or provide inaccurate telephone numbers.
- Involve a shelf company, i.e. one which has no actual business.
- A shelf company whose beneficial owners are difficult to trace.
- Accounts referred to the bank by an intermediary (e.g. law firms, accounting firms etc.) who did not perform any KYC/source of funds checking.
RED FLAGS – ONGOING MONITORING

• Large cash deposits made by an individual or company whose business activities do not normally generate substantial amount of cash.
• Sudden and inconsistent change in currency transactions or patterns.
• A customer who suddenly pays down a large problem loan with no reasonable explanation of the source of funds.
• A depositor who purchases cashier’s checks, money orders, travelers checks etc. with large amount of cash.
• ‘U-turn’ transactions, i.e. money passes from one account to another and then back to the first account.
• Numerous cash deposits/withdrawals/transfer in a personal account in a day; especially if most of these transactions were made through ATMs.
• Account used as temporary repository for funds.
• Payments or receipts with no apparent links to legitimate contracts, goods, or services.
• The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally engage in, and the bank knows of no reasonable explanation for the transaction after examining the available facts including the background and possible purposes of the transaction.
STEP TWO: Ask Appropriate Questions

If practical, the staff should ask the customer:

- The reason for the transaction
- The source and/or beneficiary

The level of suspicion is raised if the customer cannot give a legitimate and reasonable explanation for the activity.
ASK APPROPRIATE QUESTIONS

• Bank staff may be unwilling to ask questions as customers may be offended and go elsewhere

• Overcome the problem by indirect questioning, for example:-
  – If a customer carries out large and / or frequent cash transactions, ask questions on the pretext of offering a secure alternative to cash transaction and further ask related questions.
ASK APPROPRIATE QUESTIONS

- Indirect Questioning
- Some customers will admit to unlawful activity
- Legitimate customers may actually use the additional services offered
STEP THREE: Find Out the Customer’s Record

Personal Account Holders
The following should already be known:

- Stated employment and/or salary
- Residential address
- General appearance
- Age
- Previous level of financial activity
- Type of previous financial activity
FIND OUT THE CUSTOMER’S RECORD

Corporate Customers
• Level of previous financial activity
• Type of previous financial activity

If the customer’s activity is unexpected, the level of suspicion is raised.
STEP FOUR: Evaluate All the Information from Three Previous Steps

• For example:
  – One or more of the suspicious indicators is present (Step One);
  – The customer cannot give a reasonable, legitimate explanation (Step Two);
  – Considering what is known about the customer, the activity is unexpected (Step Three);

• ... Is it suspicious? YES – make a REPORT
IMPORTANCE OF CDD AND KYC

Introduction

The banking sector is a vulnerable sector to be abused by the criminals in laundering the ill-gotten gains and further used the illicit funds to perpetuate other illegal activities. In this regard, the banking sector is required to be vigilant to their customers by conducting proper Customer Due Diligence (“CDD”) and Know Your Customer (“KYC”) in particular the background of the customers and the source of fund cannot be verified.

Background Information

• Law enforcement has noticed that a group of Mainlanders, normally in 6 to 10 persons, led by a ringleader and came to Hong Kong just for the purpose of opening bank accounts. In general, they reported themselves to be professionals with high income and told the bank staffs that significant amount of monies will later be deposited to their accounts for investment purpose. One of the bank accounts would then receive a significant amount of cash deposits. Afterwards, the account holder would apply for a credit card and requested for a high credit limit. The significant sum was then transferred to another account in the group to obtain the credit card and credit limit as before. The same transfers happened until all the account holders had been issued with the credit cards and credit limits were approved. Finally, the sum was withdrawn in cash or outward remitted to an account in the Mainland.
IMPORTANCE OF CDD ANF KYC (cont’)

Background Information (cont’d)

• By reviewing the credit cards transactions, it is found that most of the credit cards have been used up the credit limit either by overdrafts or purchase of luxury items. After the payments were defaulted, the bank failed to contact the account holders and the outstanding payments become the bad debts.

Conclusion

• It is imperative for the bank to conduct a proper CDD and KYC in respect of customers who opened the bank accounts and request for the issuance of credit cards apparently acting in a group. In addition, the bank should be cautious and vigilant if significant cash deposit is used solely for the purpose of obtaining credit limit and circulated among different accounts for the same purpose. The integrity of fund should be carefully examined to determine the source. Ongoing transaction monitoring should also be done to ensure the account transactions are commensurate with their background and profile. In dubious situations, the bank should make the business decision forthwith whether to continue the client relationship or/and make a STR filing.
Introduction

This feedback demonstrates the value of individual ‘Suspicious Transaction Reports’ from financial institutions to combat money laundering and criminal activities.

Suspicious Transaction Report

• In January 2009, law enforcement received a disclosure from a local bank (“Bank A”) reporting that a Hong Kong incorporated company, ‘Company X’, both directors of which were resident in Mainland China, was under investigation by Mainland Authorities on suspicion of fraud. The Company had originally reported its business to the bank as the provision of free software to mobile phone users for the purpose of advertising.
• Bank A had subsequently reviewed Company X’s account and found that it had deposited two cheques amounting to HK$7 million to one of the directors’ bank accounts for an unknown purpose. Based on their suspicion that the whole or part of this money represented the proceeds of an indictable offence, Bank A filed a suspicious transactions report.
• Around the same period, law enforcement received a disclosure from another local bank (“Bank B”) reporting that the same two Mainlanders had transferred HK$161 million from their savings accounts to Company X’s account. The funds were subsequently transferred to another company’s bank account in Shenzhen. This apparently unnecessary movement of funds aroused the suspicion of Bank B, which also filed disclosure.
Actions Taken by Law Enforcement

- After analysis, law enforcement referred the intelligence to the Mainland authorities and following an investigation, in October 2009, the two directors of Company X were arrested in the Mainland for deceiving over 320,000 people in the Mainland of proceeds amounting to CNY$1 billion.

Conclusion

- It is emphasized that every properly considered disclosure is of value to law enforcement. While some individual disclosures do not display the whole picture of criminality, taken together with other disclosures they present law enforcement with the information to take appropriate action and thereby safeguard Hong Kong’s interest. All stakeholders can play a part in this by making detailed, well-considered disclosures whenever appropriate.
GOOD CDD & KYC

Introduction

Suspicious transaction reporting is internationally recognized as a cornerstone of any anti-money laundering regime. Suspicious transaction reports are an invaluable source of financial intelligence and law enforcement encourages the submission of well considered reports. Reporting entities may not be in a position to see the ‘bigger picture’ with regard to criminal activities. The true worth of a report is sometimes only revealed when combined together with other reports and other forms of intelligence. That is why it is vital that wherever knowledge or suspicion exists, a report should be filed.

Suspicious Transaction Report

• An Indonesian domestic helper maintained a saving account for more than five years with a bank. The transaction pattern of the account was straightforward and very consistent with the customer profile, i.e. deposit of HK$3,000 odd on a monthly basis and small infrequent amounts of cash withdrawal via ATM.
• However, on one occasion, the domestic helper approached the branch in order to deposit HK$1.5 million into her savings account. As part of KYC/CDD the bank staff made enquiries with the domestic helper concerning the deposit, as the transaction was incommensurate with her background.
GOOD CDD & KYC (cont’)

Suspicious Transaction Report (cont’d)

• It was subsequently discovered that the source of funds was the employer of the domestic helper who had requested the funds to be remitted out of Hong Kong. The bank then filed an STR to law enforcement who conducted further analysis before disseminating the report to a law enforcement agency for follow up action. It transpired that the employer was running a small import / export business and had been using a number of personal accounts of family and employee’s, possibly committing offences of tax evasion and or money laundering.

Comments / Conclusion

• This feedback serves as a good example of how the bank conducted efficient CDD/KYC to assist in the identification of criminal abuse of Hong Kong’s banking system. It is appropriate for all sectors to adopt such efficient CDD/KYC measures.
• This feedback also raises a question that is regularly encountered during outreach seminars conducted with the various sectors, though especially the accounting sector. Is there a requirement to report tax evasion by way of suspicious transaction reports? As the money laundering offence refers to the proceeds of an indictable offence, this offence usually included in many jurisdictions.
IMPORTANCE OF EFFECTIVE CDD & KYC

Introduction

The securities sector is considered to have a large number of corporations and banks licensed to deal in securities and futures. Given this importance, Customer Due Diligence (‘CDD’) and Know Your Customer (‘KYC’) are important safeguards that equip financial institutions dealing in securities and futures with the tools to combat illegal activities and money laundering.

Background Information

• This is an example of a high quality Suspicious Transaction Report (‘STR’) from the securities sector that is a good example of the effective application of those tools. An overseas resident (the Subject) had maintained a securities trading account with a securities company in Hong Kong. During the account opening, the Subject indicated that he was a core-managing official of an overseas listed company (Company A).

• The Subject maintained an active securities trading record since account opening in 2006. In late 2009 the Subject purchased a large amount of shares in a Hong Kong listed company (Company B). While no suspicions were raised by this action, as the trading volume was commensurate with the Subject’s background, nevertheless the securities company continued to conduct periodic reviews on the Subject.
IMPORTANCE OF EFFECTIVE CDD & KYC (cont’)

Background Information (cont’d)

• Such reviews identified that in mid 2010 Company A made a public announcement that it had secured a business contract with a subsidiary company of Company B. This appeared based on price sensitive information and the Subject thereafter sold all shares in Company B, thereby realizing a significant profit. Having identified the relationship between Company A and Company B, the securities company filed a Suspicious Transaction Report (STR) with law enforcement which was later referred for follow up action by a law enforcement agency.

Conclusion

• The adoption of effective and on-going Customer Due Diligence (‘CDD’) and Know-your-Customer (‘KYC’) standard is an important part of risk management practices in all sectors, including the securities business.
IMPORTANCE OF CDD & KYC

Introduction

Customer Due Diligence (CDD) and Know-Your-Customer (KYC) are an essential part of any banks risk management practice and their application often result in banks making Suspicious Transaction Reports (‘STR’).

Background Information

• Law enforcement recently received a STR from Bank A regarding a newly opened account of Company B, which received a significant cash deposit of HKD4 million shortly after the account had been opened. However, under details of suspicion, only the following simple information had been provided: ‘Large cash transaction’

• Further enquiries undertaken by law enforcement found that the financial institution could not provide background information regarding Company B or indeed an explanation for the large amount cash deposit from the account holder. It appears that the STR was filed based on limited suspicion. Furthermore, the bank was unable to contact the account holder due to very limited information that had been obtained during account opening. This reflected poorly on the CDD and KYC undertaken by Bank A. No clarification was sought from the account holder. In all likelihood, there would probably be a perfectly legitimate reason for this transfer that should have been established by the bank prior to filing a disclosure. This clarification stage is an essential part of any risk-based approach.
IMPORTANCE OF CDD & KYC (cont’)

Conclusion

• Law enforcement considered this to be a below standard filing, with only very limited information contained in the STR. It was apparent that the bank had conducted inadequate CDD and KYC when Company B’s account was first opened. The due diligence requirements required of banks should be of a higher standard.

• Bank must take steps to ensure that its customer records are up-to-date and relevant. Sound CDD polices and procedures not only contribute to a bank’s overall safety and soundness, they also protect the integrity of the banking system by reducing the likelihood of banks becoming vehicles for money laundering, terrorist financing and other unlawful activities.
SUSPICIOUS TRANSACTIONS REPORTING
– Other Issues To Consider

• To file or not to file – Quality vs. Quantity of Reporting
• How much due diligence/research/pattern analysis should be performed and documented in the reporting?
• Extent of business involvement to determine if a report should be filed
• Action to take following the filing of a report, e.g. enhanced monitoring
• Should an account be closed following the filing of the report?
• Communication with the law enforcement or Regulator
THANK YOU!