Monetary Authority of Singapore

Effective AML/CFT Controls in Private Banking

Strengthening AML/CFT Controls in Private Banking

Given the client attributes, size of transactions and complexity involved, Private Banks (PBs) have inherently higher exposure to money laundering and terrorism financing ("ML/TF") risks, particularly in the areas of foreign tax evasion and corruption.

PBs need to remain vigilant to these risks and implement robust controls at key stages of the account lifecycle, including at on-boarding and ongoing monitoring.

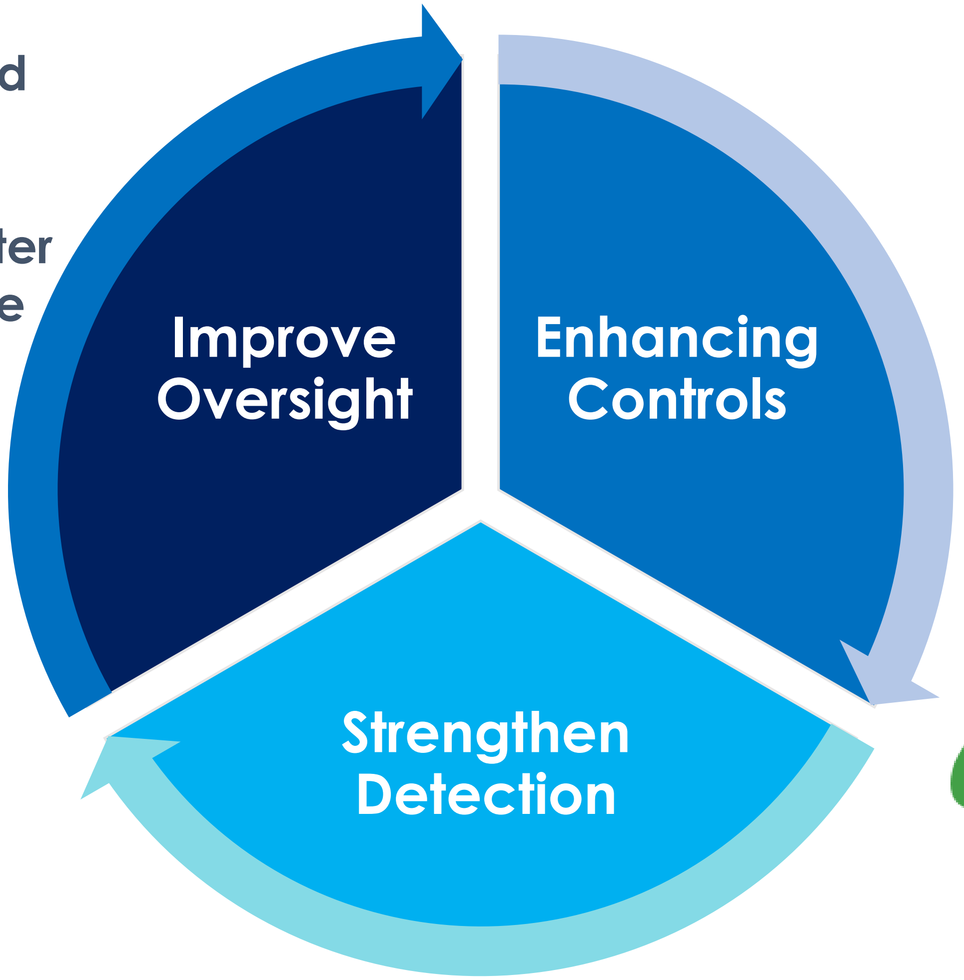
The MAS conducted a series of inspections of PBs from 2019 to 2020. This paper summarises the key inspection findings, elaborates on sound practices observed, and supplements the MAS' Guidance on Private Banking Controls issued in 2014.

Note: This paper sets out MAS' supervisory expectations of effective AML/CFT controls in the private banking Industry. The paper does not impose new regulatory obligations, and is derived from MAS' inspection findings. FIs should study and incorporate the learning points in a risk-based and proportionate manner, giving proper regard to the profile of their business activities and customers.

Key Control Areas for Improvement

5. Instituting Sound Performance Management Framework to foster Strong Risk Culture

4. Exercising Active Senior Management Oversight



1. Corroborating Customers' Source of Wealth and Funds

2. Detecting and Mitigating Tax-related ML Risks

3. Detecting and inquiring into Commercial/Third-party transactional flows

1. Robust Corroboration of Source of Wealth and Funds

To be Assured that the Clients’ Assets are Legitimate

- Obtain a clear understanding of how the clients’ assets are derived:
  - Ask the right questions to assess legitimacy of customer's wealth and the source of funds.
  - Obtain adequate information/documents to support this assessment.

- Set the right expectations for client relationship:
  - FIs have zero tolerance for illegitimate funds.
  - To continue the relationship, clients should provide adequate information to enable the FI to robustly assess the legitimacy of their source of wealth and funds.

Corroborating Source of Wealth

✓ Understand customers’ total wealth and how it was acquired.

✓ Inappropriate to rely solely on clients’ representations.

✓ Objective information should be obtained (e.g. from the customer, commercial databases or other credible sources) to substantiate the assessment.

Corroborating Source of Funds

✓ Enquire into the activity that generated the funds.

✓ Information obtained should be substantive and facilitate this assessment.

✓ Additional scrutiny should be placed on funding from third parties.

Case Study: Good Practices Observed

Detailed Establishment of Journey to Wealth

✓ Account A is owned by 4 beneficial owners (BOs), whose source of wealth (SOW) is represented to be from their car distributorship business based in a Southeast Asian Country.

✓ The BOs represented that the company was set up more than 30 years ago, and their wealth was largely accumulated during the boom periods in the past.

✓ As part of SOW corroboration, the bank:
- ❑ Obtained the company's financial statements and documentation to verify the BOs' ownership in the business.
- ❑ Conducted market research into the market share and vehicle sales in the country over the past 30 years.
- ❑ Validated the net profit and revenue assumptions using industry benchmarks.
- ❑ Documented the BOs' journey to wealth based on detailed calculations.

Corroboration using Objective Information Sources

✓ Account B is beneficially owned by a couple whose net worth is represented to be largely derived from the husband's employment income.

✓ The husband was said to be a senior management member of a global bank stationed in a Middle Eastern country between 1985 to 2012. As his employment was dated, the client could not produce past income statements.

✓ In corroborating the customer's net worth, the bank:
- ❑ Verified the husband's previously held position at the global bank through online searches.
- ❑ Obtained salary benchmarks of finance professionals in the Middle East.
- ❑ Documented his estimated annual income and applied a conservative return on investments (with basis documented) to arrive at the net worth.

Adequate Inquiry into the Source of Funds

✓ During on-boarding, Client C indicated that the account would be funded with an initial amount of US$30m, which would be transferred from another bank.

✓ Beyond ascertaining that this was a first party transfer, the bank obtained supporting documents showing that the funds were derived from the sale of his properties.

Case Study: Inadequate Corroboration

Over-Reliance on Client's Representation

× Client D represented that his net worth of USD200m was derived from his business, which was represented to have an annual turnover of more than USD150m with a net profit margin of about 3% to 4%.

× The bank accepted the customer's representations and did not obtain any documentation or objective information to substantiate his net worth.

Failing to Establish Source of Funds

× Client E informed the bank at on-boarding that the initial funding of USD80m would be transferred from his account from another bank.

× The bank did not obtain additional information to establish the legitimacy of the funds.

Inadequate Due Diligence Performed

× Client F represented that his net worth of USD200m was mainly derived from a 50% stake in his family business.

× Although the financial statements obtained by the bank showed that the business had been loss making over the years, no further due diligence was conducted to substantiate his wealth. The bank also did not verify his ownership in the business.

× Client G attributed her source of wealth to accumulated employment income from senior management roles.

× While online searches showed that she indeed held senior management positions in public-listed companies, the bank did not obtain any salary benchmarks nor supporting documents to corroborate her salary earnings.

- <u>**Learning Points:**</u>
  - **FIs should obtain objective supporting information when establishing sources of wealth, and not rely solely on customers' representations. Further due diligence should be conducted where discrepant information is noted.**
  - **In establishing customers' source of funds, FIs should obtain substantive information to establish the activity that generated the funds to ensure that they are legitimate and not proceeds of crime.**

2. Instituting an Effective Tax Risk Management Framework

FIs should remain vigilant and implement effective controls to detect and prevent the laundering of proceeds from serious tax crimes

On-boarding Controls

- Strengthen ability at on-boarding to identify customers presenting higher tax-related ML risks, for enhanced due diligence.
- Provide adequate guidance and training to staff to recognise tax red flags[1] at on-boarding.

Ongoing Monitoring

- Institute ongoing monitoring controls to enable prompt detection of tax-related red flags of customers' behaviour and transaction patterns for timely risk mitigation.

Continually Enhance Staff Risk Awareness

- Enhance staff awareness of emerging tax evasion typologies and related red flags.
- Continued vigilance over customers' behavior indicative of tax concerns.

[1]In 2013, the Private Banking Industry Group (PBIG) published an Industry Sound Practices paper relating to the designation of serious tax offences as predicate offences to money laundering in Singapore. It sets out the common tax-related red flags, and highlights the need for FIs to institute robust controls to detect and deter the laundering of proceeds from serious tax crimes.

Case Study: Good Practices Observed

Use of Multi-Factor Tax Risk Assessment at On-boarding

✓ Bank A conducts a comprehensive tax risk assessment of customers at on-boarding and periodic reviews using a multi-factor approach, including:
- ❑ Use of hold mail services
- ❑ Type of customer and purpose of account
- ❑ Presence of tax-related adverse news
- ❑ Use of complex structures
- ❑ Country of tax residence

Tax Due Diligence Measures required of Higher Risk Customers

✓ As part of on-boarding customer due diligence (CDD) measures, Bank B requires the conduct of additional tax due diligence measures on customers assessed to present higher tax risk.

✓ Such measures include:
- ❑ Completion of an in-depth tax due diligence questionnaire
- ❑ Obtaining official tax documentation
- ❑ Securing legal advice or tax attestations from an independent party, as appropriate

Detecting Tax Red flags during Ongoing Monitoring

✓ As part of ongoing monitoring, Bank C requires the RMs to pay attention to tax risk red-flags, including:
- ❑ Large/frequent transfers to high tax risk jurisdictions
- ❑ Re-deposit or reinvestment of funds into original jurisdiction after being transferred to a high tax risk jurisdiction
- ❑ Purchase of large amounts of precious metals.
- ❑ Any tax adverse news

Case Study: Control Deficiencies and/or Lapses

Insufficient Guidance for Robust Tax Risk Assessment and Mitigation

- × While Bank D's policy required staff to pay attention to a list of tax red flag indicators, the guidance lacked clarity on the additional due diligence measures to perform on customers exhibiting these red flags.
- × This resulted in differing quality of tax risk assessment and mitigation measures for those customers.

Inadequate Staff Risk Awareness

- × A customer in Bank E had indicated at on-boarding that he was a Singapore tax resident.
- × While the bank noted at on-boarding that the client's substantial income was instead sourced from another country, the bank staff did not initiate a tax review nor conducted additional tax due diligence on the customer to understand whether the customer had other tax obligations, and whether these were in order.

Failure to detect and follow-up on Tax Red Flags

- × At on-boarding, the customers informed Bank F that they were moving the account relationship from another jurisdiction due to the onset of Common Reporting Standards (CRS) in that jurisdiction, citing confidentiality considerations.
- × Bank staff failed to pick up the apparent tax red flag, and no additional tax due diligence was conducted on the customers.

- **Learning Points:**
  - **FIs should provide clear guidance on its tax risk assessment management framework to ensure consistent application of standards.**
  - **FIs should put in place effective training programmes to inculcate strong tax risk awareness among staff.**

3. Subjecting Commercial / Third Party transaction flows to Necessary Scrutiny

Maintaining Vigilance Over Commercial/3^{rd} party Flows

- PBs must monitor customers' transactions to ensure they are consistent with the wealth management purpose of the account.
- PBs must be alert to dealings and/or transactions that deviate from this intent and assess their legitimacy.

Detection of 3^{rd} party or Commercial Flows

✓ Institute effective controls to detect 3^{rd} party and/or commercial flows for required scrutiny.

Setting Clear Follow-up Actions

- Clear guidance should be formalised to set out the required follow-up actions when such flows are detected.
- Customer exit should be considered with the assessment documented if behaviour remains unexplained and/or suspicious.

Case Studies: Good Practices/Areas of Enhancement

Clear Guidance for Enhanced Monitoring

- ✓ Bank G requires the on-boarding of accounts involving operating companies to be approved at a senior management forum.
- ✓ Such accounts are categorised as High Risk and subject to enhanced monitoring.

Additional Emphasis on 3rd Party Flows during Periodic CDD Reviews

- ✓ As part of the periodic CDD review process, Bank H requires staff to review past transactions to determine if they were consistent with the customer's profile and the purpose of the account, with particular emphasis on third party flows.

Execution Weaknesses

- × A Personal Investment Company (PIC) account was set up in Bank I for the purposes of holding the client's investment assets.
- × Even though the bank's staff noted persistent commercial-related transactions in the account during routine transaction alert reviews, this was not escalated to Compliance in accordance with the bank's policy.
- × Consequently, the account was not subjected to enhanced monitoring, as required under the bank's policy.

- × Bank J requires a look-back of customers' transactions to be performed during periodic CDD reviews. Any 3rd party flows noted are to be flagged and explained.
- × Although several 3rd party transactions were observed in an account, the staff failed to inquire into these third party flows and instead concluded without justification that they were consistent with the customer's profile and purpose of the account.

4. Right Tone from the Top and Strong Risk Culture

Right Tone from the Top

- Management should set a clear risk appetite for managing key risks including tax and corruption-related ML risks, and build a firm-wide compliance culture that prioritises effective ML/TF risk management.

Strong Management Oversight

- Exercise close management oversight over the FI's key risk areas, by establishing:
  - Adequate management reporting structures to ensure that key risks are surfaced in a timely and effective way.
  - Reporting metrics with sufficient granularity to monitor key risk exposures, control weaknesses and to facilitate effective intervention where necessary.

Strong AML/CFT Risk Culture

- Incentive structure should be geared towards fostering strong AML/CFT risk awareness and control execution through all three lines of defence.
- Establish clear accountability for execution of key AML controls.
- Continually strengthen risk awareness and competencies of staff.

5. Strengthening Performance Management Framework

Incentive Structure to Foster Right Risk Culture and Behaviour

- An effective performance management framework is essential to driving the right culture and behaviour in the organisation.
- Performance Management framework should provide an adequate balance of incentives and penalties to drive the right risk culture and staff behavior.

Commonly Observed Weaknesses

- Performance indicators for RMs are purely financials driven.
- Inadequate AML-related indicators in performance assessment, e.g. using the completion of the mandatory AML/CFT training as the sole indicator.
- Assessment solely driven by quantitative indicators (e.g. backlogs and timeliness) without any emphasis on quality of execution.
- Inadequate feedback of past performance lapses and incidents in the staff's performance scorecards.

Learning Points

✓ Sufficient weightage of AML-related indicators in the performance management process.

✓ Assessment should be holistic and focus on both the quality of AML/CFT execution on top of quantitative-based measures.

✓ AML-related performance lapses should be specifically taken into account in staff's performance scorecards, without delay.

✓ Appropriate action should be taken against staff with recurrent AML/CFT lapses.

In Summary…

- MAS' thematic inspections showed that PBs have generally put in place the necessary frameworks and controls to detect and mitigate ML/TF risks. Given the inherently higher risks, PBs need to continually strengthen controls to maintain their effectiveness.

- FIs should assess the effectiveness of their controls against MAS' inspection findings and the good practices highlighted in this guidance. Appropriate steps should be taken to address any gaps.

- PBs should continue to be alert to evolving risk and typologies, and ensure that effective controls are in place to detect and mitigate these risk concerns. Particular attention should be placed on tax and corruption-related ML risks.

- MAS expects PBs' senior management to provide close oversight and maintain high risk management standards. MAS will continue to engage PBs in improving their AML/CFT controls, as part of our ongoing supervision programme.