注册合规师公会
Institute of Compliance Officers

Compliance Alert

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Compliance alert for entities regulated by the HKMA, SFC, HKIA, and TCSP licenscees, money lenders, money services operators, lawyers, accountants and real estate agents

OFAC sanctions 11 senior Hong Kong and mainland Chinese officials – Chinese name fields in sanction lists become the focal point; 'Translateral' AML with Artificial Intelligence is key; Institutional Risk Assessment (IRA) at your fingertips.

On 7th August 2020, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) announced US financial sanctions imposed on 11 senior Hong Kong and mainland Chinese officials[1], including Mrs. Carrie Lam (Chief Executive of the Hong Kong SAR).

On the following day, the Hong Kong Monetary Authority (HKMA) assured that Hong Kong fully implements targeted financial sanctions in compliance with United Nations Security Council Resolutions, which are in accordance with the United Nations Sanctions Ordinance (Cap.537) and the United Nations (Anti-Terrorism Measures) Ordinance (Cap.575)[2]. However, the HKMA does not issue or maintain any form of sanctions or

designation list over which it has a supervisory role within the targeted financial sanctions regime in relation to authorized institutions' systems or controls for complying with these legal requirements.

On a side note, the OFAC Specially Designated Nationals (SDN) and Blocked Persons lists apparently mentioned Mrs. Carrie Lam's obsolete address but did not disclose passport numbers of some sanctioned persons. Therefore, a person's name in English and native characters are undoubtedly the key identifiers in the SDN list as well as sanction lists of some countries.

Names in native characters as the primary identifiers in AML/CFT screening

There are always new and emerging trends that put compliance professionals in a difficult position (for instance, the evolution of virtual assets including cryptocurrencies). On the other hand, Regtech has rapidly adapted to embrace these challenges.

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1   https://home.treasury.gov/news/press-releases/sm1088
2   https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200808e1.pdf
3   https://home.treasury.gov/news/press-releases/sm924

On 2nd March 2020, OFAC sanctioned two mainland Chinese nationals for allegedly laundering stolen cryptocurrency through cyber-intrusion on a cryptocurrency exchange in 2018. In that case, the SDN List designated 田寅寅, Tian Yinyin (Tian), and 李家东, Li Jiadong (Li)[3].

Gone were the days when virtual assets deemed out of regulators' radar. Regtech experts have collaborated to develop the interVASP IVMS-101 Messaging Standard[4], which is a universal language for communication between Virtual Asset Service Providers (VASPs). Unlike SWIFT MT messages (which only consider Latin characters), IVMS-101 messages allow the inclusion of native characters (such as simplified Chinese characters) as primary identifiers, which is revolutionary.

Hence, names in native characters are now taking the centre stage as primary identifiers in AML/CFT screening.

Independent and regular testing of AML/CFT screening system is crucial

Regulators have acknowledged the importance of native characters in AML/CFT screening. For example, the HKMA has issued a guidance note that requires effective screening procedures for names that use non-Latin script (including Chinese characters) or commercial codes. According to the HKMA, such screening procedures should be reviewed periodically[5]. The testing process should be independent and provide the level of validation required[6].

Last year, the Financial Action Task Force (FATF) published the Mutual Evaluation Report (Hong Kong), noting that the HKMA carried out thematic examinations to test the efficacy of sanctions screening systems. This report included a specific review of authorised institutions' effectiveness in detecting relationships and transactions involving money laundering, terrorist financing risks, sanctioned persons or entities[7].

A surge of Native Character Fields in sanction lists increases sanctions risk

It is high time to revamp AML/CFT initiatives. The outbreak of COVID-19 pandemic has created new norms at an unprecedented scale: work from home, virtual conferences, touchless payments, etc. Meanwhile, the escalating tensions between the US and China call for AML/ CFT protocols that can take into account (and blending as necessary) specificities from both sides, expediting the transformation from mono-dimensional to a 'trans-lateral' process and technology (*trans-lateral is a new word we have coined. It is derived from the word 'multi-lateral').

Compliance professionals are now faced with complexities resulting from the fast-growing presence of names in native characters (for example, Chinese characters) on global sanctions lists. Today's highly connected world demands effective AML/CFT solutions capable of checking both Latin-based and native characters. Nevertheless, some international banking giants have indicated their intentions to apply cost-saving measures on 20-25% of compliance jobs in the next 12 to 24 months[8].

Unfortunately, existing AML/CFT screening and testing process (which focus on Latin characters check) remains western centric and largely manual. Such approach is outdated.

4   https://intervasp.org/
5   https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/aml-cft/Gudiance_Paper_20131216.pdf
6   https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2018/20180412e1.pdf
7   https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Hong-Kong-China-2019-Executive-Summary.pdf

Regulated entities, including banks, payment institutions, securities firms, insurers, law firms, accounting firms, money lenders, money service operators, company secretarial, trust services providers and real estate agents, are looking for smart AML/CFT solutions to support them to discharge their obligations under enhanced AML/CFT regulatory regimes, and to prove them worthy of the trust placed by regulators in the grant of their licences.

> *"… International/cross-border criminals are likely to exploit name manipulation loopholes, in both English and native characters, to create harm to customers and to the integrity of the financial system. Compliance managers are now facing added compliance complexity due to the fast-growing presence of native characters (for example, names involving Chinese characters) on global sanctions lists and international/cross-border transactions which demand effective AML/CFT name and transaction screening and testing in both English and native characters. "Translateral" AML technology must be adopted in lieu of Unilateral ones."*

- **Andre Leung** (CEO of Aereve, a HK-based Regtech solution provider)

"Translateral" AML technology (hereinafter 'TRANSLAML') use case: Institutional Risk Assessment (IRA) at your fingertips

Advanced smart AML/CFT solutions are just at our fingertips. Regulated entities should adopt the institutional risk assessment (IRA) to consider all relevant inherent money laundering risk factors in order to determine their respective risk profile and corresponding mitigating control measures, both from design and operational effectiveness standpoints[9]. It is worth noting that, the HKMA published a letter on 8th August 2020 to remind authorised institutions of the need to establish and implement for their Hong-Kong businesses policies that are informed by a thorough assessment of any legal, business and commercial risks involved and based on a balanced approach.

Regarding IRA, one suggested approach is to leverage on technology in AML/CFT screening and testing process covering both English and Chinese characters using sandbox functionalities. For example, customising AML/CFT screening test scenarios with carefully selected sanction sources or designated lists according to the risk appetite of the authorised institution, coupled with English and Chinese language manipulation algorithms:
For example,

Sanction sources/Designated lists:

UN – List from United Nation
HKMA – List from Hong Kong Monetary Authority
HMT – List from United Kingdom HM Treasury
CIA-COS – List from US Central Intelligence Agency
Taiwan's Sunshine –
List from Taiwan's Sunshine Law (陽光法案)
China's Fugitive List –
List from China's most wanted fugitives (中國紅色通緝令)

Name Types:

Primary name
Weak alias (A.K.A Weak)

Languages:

English
Simplified Chinese (簡體中文)
Traditional Chinese (繁體中文)
Chinese Commercial Code (中文電碼)

Manipulation Algorithm:

English Word Manipulation –
Abbreviated Dot, Word Delete and Add
English Text Manipulation – Text Character Delete
Chinese Word Manipulation –
Similar Pinyin (同音字), Similar Shape (形近字)

8   https://www.fnlondon.com/articles/banks-next-big-target-for-job-cuts-compliance-20200817
9   https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2015/20151007e1a3.pdf

Run the test with the above parameters against a test environment with Business-As-Usual (BAU) settings of AML/CFT screening system. The resulting factual-based performance analysis generated can then be leveraged as part of the IRA, which in turn provides tangible steps of efficacy optimisation of AML/CFT screening using "translateral" technology.

Regtech and Artificial Intelligence

Consequently, the increasingly stringent AML/CFT regulatory requirements worldwide demand compliance professionals from headquarters, local and overseas branches to adopt enterprise-grade Regtech solutions, equipped with "translateral" technology and powered by Artificial Intelligence[10] (for instance, machine learning, natural language process and robotic processing automation), so as to curb financial crimes, boost productivity and reduce cost and human errors in repetitive tasks[11].

Regtech and smart AML/CFT solutions do not completely replace compliance professionals. Instead, they will empower compliance professionals by handling most mundane tasks, leaving the sophisticated and value-added jobs to trained compliance professionals who are skilled at working alongside new technology.

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https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200612e1a1.pdf
11
https://www.hkma.gov.hk/eng/news-and-media/press-releases/2020/08/20200821-3/

"…Regtech's innovation has brought about new common standards on AML/ CFT compliance internationally. For example, new messaging standards have been developed to facilitate compliance with FATF's recent recommendations to enhance compliance in transactions involving virtual assets. Technology such as Artificial Intelligence and Machine Learning tools may be applied to blockchain transactions to enable regulators monitor transactions within their jurisdictions more effectively."

- **Frankie Tam** (Technology Lawyer of Eversheds Sutherland)

"…Review of the effectiveness and efficiency of a financial institution's sanctions and name screening system has never been more important. Overall, systems testing is a critical component of any review of a screening program in order to assess the system's capabilities and regulatory compliance. Regulators have also highlighted the growing need for Chinese character and local language testing across the Greater China and the APAC region."

- **Josh Heiliczer** (Managing Director of Protiviti)