

Exploration of Enhancing the Quality of Suspicious Transaction Reports for Anti-Money Laundering and Countering Financing of Terrorism in the Securities Industry of China

Li Jia, Huang Liang

Nanjing Securities Co., Ltd, Nanjing, Jiangsu, 210019, China

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Abstract: Reporting suspicious transactions is a fundamental obligation for Chinese financial institutions in preventing and combating money laundering crimes. This article examines the evolution of China's suspicious transaction reporting system and potential strategies to enhance the efficacy of Suspicious Transaction Reports, accounting for various variables that influence the reporting process.

1. Research Background

Reporting suspicious transactions is a fundamental obligation for Chinese financial institutions in preventing and combating money laundering crimes ^[1]. Improving the quality of suspicious transaction reports (STRs) is crucial for AML/CFT efforts, as high-quality STRs is one of the most important achievements of AML/CFT in financial institutions, and is a concentrated reflection of the level of AML/CFT work in financial institutions. It can provide more valuable clues for law enforcement and investigation authorities to investigate, so as to effectively combat money laundering crimes.

2. Definition of the Concept of STR and the Development Process of its System of China

2.1. Concept analysis

According to the Financial Action Task Force (FATF) 40 recommendation on money laundering, *if a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to TF, it should be required to report promptly its suspicions to the Financial Intelligence Unit. Financial institutions should be required to report all suspicious transactions, including attempted transactions, regardless of the amount of the transaction* ^[2]. Reporting institutions may have different reporting elements for suspicious transactions based on their respective industries. The 48-item suspicious transaction reporting elements for the Chinese securities and futures industry mainly involve information related to reporting institutions, suspicious entities, basic reporting information, and transaction information.

2.2 The Development Process of its System of China

The STR work of financial institutions in China has gone through two stages of development, from following the legal reporting standards to the self-defined reporting standards. The provision of comprehensive guidance to financial institutions on the types of transactions that warrant reporting had a positive impact on the reporting of suspicious activity during the initial implementation of AML/CFT systems. However, the resulting large number of "defensive" reports not only caused waste of AML/CFT resources, but also seriously affected the effectiveness of AML/CFT work. In 2012, the People's Bank of China launched a comprehensive pilot project on reporting large-value and suspicious transactions by financial institutions, guiding financial institutions to independently establish standards for reporting suspicious transactions, and to establish a model for reporting suspicious transactions on the basis of "reasonable suspicion".

3. Suspicious Transaction Reporting Mechanisms and Processes for Financial Institutions in China

Since 2007, China's securities and futures companies and insurance companies began to fulfill anti-money laundering obligations. Starting from 2008, based on the parallel implementation of hierarchical reporting and aggregate reporting, financial institutions' reports of large-value and suspicious transactions are submitted directly by their headquarters to the Chinese AML Monitoring Analysis Center (CAMLMAC). With the implementation of the risk-based approach in AML/CFT efforts, Decree No.3 (2016) of the People's Bank of China is currently the suspicious transaction reporting system being enforced in China's securities industry. To address the issue of insufficient effectiveness of suspicious transaction reporting by financial institutions, there is a clear requirement for suspicious transaction reporting based on "reasonable suspicion". Additionally, there are new requirements for establishing and improving autonomous transaction monitoring standards, transaction analysis and identification, monitoring of controlled lists, establishment of monitoring systems, and retention of records, which replace the industry-specific suspicious transaction reporting standards that are no longer needed due to the development of the situation and further align with international standards.

Pursuant to Decree No. 3(2016), financial institutions are required to establish trading monitoring standards for their organization and take responsibility for their effectiveness. Transaction monitoring criteria include, but are not limited to, the identity and behavior of clients, and anomalies in the source, amount, frequency, direction, type and other aspects of transactional funds. Financial institutions should report to the local People's Bank of China or its branches, either electronically or in writing, any suspicious transaction which meets any of the following conditions, and simultaneously submit a suspicious transaction report to the CAMLMAC: (1) obvious suspicion of money laundering, terrorist financing and other criminal activities; (2) serious damage to national security or social stability; (3) other serious or urgent circumstances". The People's Bank of China or its branches or the CAMLMAC shall confirm the suspicion and refer it to the investigating authority according to law.

4. Critical Factors Influencing the STR Process

4.1 Conflict and Balance between Information Sharing and Privacy

Information sharing is necessary for the smooth operation of the financial system, the detection and prevention of financial crime, and the overall interests of society. The FATF states that "effective information sharing is a cornerstone of a well-functioning AML/CFT framework"^[3]. Law on the Prevention of Money Laundering of China stipulates that *the administrative department in charge of combating money laundering under the State Council may obtain necessary information from*

relevant departments and institutions of the State Council in order to fulfil its duty of supervising funds for combating money laundering. However, based on the current cooperation status of China's anti-money laundering organizational structure, the lack of supporting implementation regulations has led to a slow progress in information sharing among various government departments. It is imperative to establish platforms for "inter-industry information", "cross-departmental information", and "international information"^[4]. Only by digging out valuable data from various government agencies and analyzing the types of money laundering, criminal trends and the flow of funds from a societal perspective can we improve the efficiency of investigating cases and combating money laundering crimes. It can also provide a basis for law enforcement agencies and financial institutions to formulate anti-money laundering policies and decisions.

On the other hand, the protection of personal privacy is a fundamental human right that is a guarantee of an individual's dignity and freedom. *The Technical Specification for the Protection of Personal Financial Information* issued by the People's Bank of China in 2020 sets out clear requirements for financial institutions to establish a security system for the protection of personal financial information and standardize the workflow, and sets out compliance requirements such as "Without prejudice to the fulfillment of anti-money laundering and other legal obligations, the institution shall formulate the authority of the institution's personnel to retrieve personal financial information and the scope of its use, and formulate a special authorization and approval process", "set up an organizational structure for the protection of personal financial information", and "regularly conduct internal and external training and awareness-raising activities on the protection of personal financial information and maintain the relevant records. "

The collection of basic data for STRs inevitably involves the collection and processing of personal data. As citizens attach increasing importance to personal data and privacy, the proper resolution of conflicts between the information sharing mechanism and the protection of personal privacy in AML/CFT work is a key concern for financial institutions in order to carry out AML/CFT work in a prudent manner in the future. By balancing the interests of information sharing and personal privacy protection, financial institutions can ensure compliance with legal requirements, protect individual rights and interests, and fulfill their social responsibilities.

4.2 Suspicious Transaction Monitoring Models Validity Affects the Quality of STRs

Experience has shown that the quality and efficiency of suspicious transaction reporting can be effectively improved through the effective use of modern information technology, the establishment of accurate and efficient suspicious transaction monitoring models, the full mobilization and integration of data from various business systems, and the comprehensive screening and accurate alerting of suspicious transactions^[5]. However, from a practical point of view, there is still much room for improvement in the establishment of financial institutions' anti-money laundering systems, the improvement of their functions and the application of such systems, and there is still a long way to go to achieve the integration and interoperability of data from business systems and anti-money laundering systems and the accurate screening of suspicious transaction data.

In the process of establishing monitoring models, financial institutions can widely access various guidelines and risk alerts issued by regulatory authorities, and effectively implement case characterization, characteristic indicatorization and indicator modernization^[6]. They can also regularly or irregularly evaluate the indicator rules, parameter thresholds, model structures, and even the entire suspicious transaction reporting mechanism based on the alert rate, reporting rate, and success rate. Additionally, financial institutions can continuously optimize, update, and refine monitoring standards, metrics, rules, and thresholds by sharing with peers, receiving feedback from branch operations, and more.

4.3 Professionalism of AML staff affects the quality of STRs

Suspicious transaction information is collected at CAMLMAC for centralized data analysis and comparison, enabling a more thorough understanding of the origins, pathways, and trends of such transactions, but there are two limitations arising from a lack of sensitivity and basic AML expertise among AML practitioners: (1) the large volume of data available makes it difficult to make immediate, standardized, and accurate judgments. A large amount of invalid data submitted to the CAMLMAC directly impacts the quality of data and dilutes the value of intelligence information, seriously affecting the effectiveness of anti-money laundering work; (2) The specialized staff who deal with AML data are out of touch with the grassroots AML work, as they cannot directly contact clients and can only understand clients through paper materials and image materials. Objectively, the limitations of their function lead to limitations in client's due diligence, which make it difficult to take immediate action and achieve precise blocking and suppression of criminal activities.

5. Exploration of Improving the Quality of STRs

The country's determination and strength to combat corruption and economic crime is steadily growing in the face of a tougher domestic and international counter-terrorism situation. It is particularly important to do a good job of analyzing suspicious transactions and improving the quality of suspicious transaction reporting under the new normal, given the reality of diversified money laundering methods and complex procedures, and the contradiction between limited regulatory resources and an expanding scope of supervision.

Securities company should strengthen internal management measures, update technological tools, gradually improve relevant information systems, and take practical management measures to ensure complete and accurate transaction records and customer identity information, facilitate the implementation of capital monitoring, and cooperate with AML supervision and case investigation. In addition, securities company should establish appropriate authorization mechanisms, clarify operating procedures and provide client identification information and transaction records to regulators, law enforcement agencies and other authorities promptly, conveniently and accurately in accordance with regulations.

5.1 The Use of Modern Information Technology to Improve the Efficiency of the Monitoring and Analysis of Computer Systems for AML Purposes

The securities company should ensure the necessary technical conditions for the reporting of large-value and suspicious transactions, actively use information systems to enhance the efficiency of work, establish and improve large-value and suspicious transaction monitoring systems, and detect and analyze transactions on a client basis, collect client identity information and transaction information from various business systems in a comprehensive, complete and accurate manner, and ensure the data requirements for the monitoring and analysis of large-value and suspicious transactions.

Securities firms should use a risk-based approach to continuously optimize the functioning of the system and gradually improve the relevance and effectiveness of the STRs. To extract valuable financial intelligence from massive transitional data and detect suspicious transactions, it is necessary to establish a scientific and effective data storing and analyzing system to improve the efficiency of suspicious transaction analysis^[7]. Using big data, cloud computing, and artificial intelligence, an up-to-date AML screening system can be established by establishing a two-way communication channel between anti-money laundering monitoring and business data systems. This system will allow analysis and monitoring both before and after the event, along with during the event. It will also use new technological methods to improve the reporting and analysis of data, enhance information sharing and optimize client risk assessment. Furthermore, the AML detection model can be continuously improved, increasing the efficiency of risk identification. In addition, it can also explore

the promotion of information sharing mechanisms with supervisory authorities and within and outside enterprises, realize the sharing of money laundering-related client information among different financial institutions, establish mechanisms for sharing and exchanging AML information with advanced domestic and foreign counterparts, exchange and grasp sensitive information in a timely manner, break down national barriers, and enhance the efficiency and effectiveness of anti-money laundering screening among financial institutions^[8].

5.2 Enhancement of the Suspicious Transaction Reporting System and the Surveillance Analysis Process to Improve the Quality of STRs

Securities companies should adhere to the principle of a risk-based approach and comprehensively collect regulatory guidelines, risk warnings and typical cases of money laundering and terrorist financing in various business lines, based on a comprehensive review of the institution's asset size, geographical distribution, business characteristics, client groups, transaction characteristics and risk assessment conclusions^[9]. We need to extract distinctive and recurrent deviant attributes from the client's identity, behavior, transactional patterns, attributes, and other pertinent factors in the case, which can serve as typical and identifiable markers of abnormality. We need to develop distinct criteria and metrics to identify anomalies in a given case. We need to determine relevant transaction monitoring indicators for the institution and create a comprehensive monitoring model that encompasses all business areas. We need to ensure a seamless transition from legal reporting standards to customized reporting standards for suspicious transactions. We continuously improve our ability to identify potential risks for suspicious transactions, gather and analyze data, conduct multidimensional analyses of various types of money laundering, and dynamically update and refine the points at which we identify suspicious transactions that warrant concerns. Let's broaden our monitoring for suspicious transactions and be especially vigilant in detecting money laundering risk factors and patterns based on actual cases. We need to align our information on money laundering with current risks and their evolution while maintaining a forward-thinking and representative perspective. We should refine our indicators and thresholds to accurately reflect the distinct characteristics of individual cases, effectively meeting the demands of "case characterization, feature indicatorization, and indicator modelization".

In the course of setting up business relations with clients and managing their affairs, departments and branches should make the most of their interactions with clients by detecting doubtful transactions and actions through careful investigation and analysis of unusual transactions. The AML software should be employed to scrutinize any suspicious transactions, augmenting the outcome of manual identification. Transactions and behaviors suspected through manual identification, but not detected by the AML system, should be manually recorded in the AML system for reporting suspicious transactions. Data processing personnel involved in AML must analyze, assess, and verify suspicious transactions flagged by the system but missed by manual identification. They should combine this with client identity information to ensure the authenticity and efficacy of the analysis and identification process. The institution's headquarters uses its system, information, and professional advantages to efficiently monitor and process suspicious transactions. This includes unifying the management and control of suspicious transaction reports across all business departments and branches. A clear division of labor among internal personnel, information, technology, and other resources ensures high-quality reporting of suspicious transactions.

5.3 Increase Investment in AML Resources to Improve Safeguards for Suspicious Transaction Reporting

Financial institutions should invest more resources in AML efforts commensurate with the scale and development of their business. To achieve this, they should strengthen their infrastructural systems, cultivate their employees' sense of responsibility regarding AML, and maintain a high

number of full-time AML position holders. Further, institutions must provide comprehensive training programs and sustain an awareness of AML risks by regularly reviewing the understanding and proficiency of their staff with regards to common money laundering offences and the latest supervisory policies. It has bolstered its training and remains attuned to risks surrounding money laundering by acquiring expertise on prevalent money laundering offenses and up-to-date regulatory policies. It has garnered pertinent AML experience through active practice, comprehensively elevating its ability to execute work in this domain. It has availed adequate personnel and technical measures to facilitate suspicious transaction reporting and fulfill human resource and technological requirements of AML work.

5.4 Establish a Reward Mechanism to Promote the Efficient Fulfillment of the Obligation to Report Suspicious Transactions

A strong internal system should be established to monitor and report any potentially suspicious transactions, with each business department serving as the fundamental unit. This will implement a responsibility system by effectively incorporating the duty to analyze and report suspicious transactions into the institution's performance evaluation indexes. A professional capacity building and promotion mechanism will also be established to better meet the requirements of AML work. This will ensure the stability and professionalism of the AML team. It is important that the evaluation of suspicious transactions remains objective regardless of external influences. Further enhancing the AML incentive mechanism and boosting rewards for departments and individuals who make outstanding contributions to investigating and prosecuting AML cases. Expanding the AML incentive mechanism and enhancing the rewards for outstanding contributions made by both departments and individuals towards AML investigations is essential. By establishing a sound AML incentive mechanism, staff across all business lines involved in AML work can be motivated, leading to further success in transforming STRs into concrete case results and elevating the rate of efficient completion of STRs^[10]. This will fully utilize the value of AML financial intelligence and enhance the effectiveness of STRs.

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