

ITEM FOR ESTABLISHMENT SUBCOMMITTEE OF FINANCE COMMITTEE

HEAD 148 – GOVERNMENT SECRETARIAT: FINANCIAL SERVICES AND THE TREASURY BUREAU (FINANCIAL SERVICES BRANCH)

Subhead 000 Operational expenses

Members are invited to recommend to Finance Committee the creation of the following supernumerary post in the Financial Services and the Treasury Bureau (Financial Services Branch) for a period of 24 months with immediate effect –

1 Administrative Officer Staff Grade C
(D2) (\$122,700 - \$130,300)

PROBLEM

We need additional support at directorate level to follow up the recommendations of the Financial Action Task Force (FATF) against a pressing implementation timetable.

PROPOSAL

2. We propose to create a supernumerary post of Administrative Officer Staff Grade C (AOSGC) (D2) in the Financial Services Branch (FSB) under the Financial Services and the Treasury Bureau for a period of 24 months with immediate effect¹ to undertake timely follow-up actions in response to the recommendations of the FATF.

/JUSTIFICATION

¹ Subject to the agreement of this Subcommittee, our plan is to put the staffing proposal to the Finance Committee for approval at the meeting on 13 February 2009.

JUSTIFICATION

Mutual Evaluation on Hong Kong

3. In 2003-2004, FATF, an international standard setter on anti-money laundering (AML) and counter financing of terrorism (CFT), promulgated a revised set of AML/CFT recommendations which are generally known as the FATF Recommendations. FATF has since conducted mutual evaluations (ME) on its member jurisdictions against the FATF Recommendations with a view to ascertaining the effectiveness of the AML/CFT systems of these jurisdictions and putting forward proposals on improvement measures. The ME on Hong Kong was conducted in November 2007 and the ME report published in July 2008.

4. While the ME Report on Hong Kong highlighted that our existing AML/CFT regime is generally effective, it has identified certain deficiencies which include, among others, the lack of a proper regulatory regime for remittance agents and money changers as well as for designated non-financial businesses and professions (such as accountants and lawyers), the lack of statutory backing for customer due diligence and record keeping requirements for financial institutions, and the gaps in our legal provisions to fully implement the United Nations Terrorist Financing Convention in Hong Kong, etc. The key findings of the ME report on Hong Kong are summarised at Enclosure 1.

Encl. 1

5. Under FATF's ME procedure, member jurisdictions are encouraged to make significant progress in addressing the deficiencies identified in the ME report within the initial two to three years and then seek removal from the follow-up process. If the improvement measures taken by the concerned member jurisdiction during this period are considered inadequate, FATF will consider the need for enhanced monitoring, including activating another on-site review on the concerned member jurisdiction. In terms of reporting back to FATF, Hong Kong is required to submit the first progress report in June 2010, setting out our follow-up actions in rectifying deficiencies identified in the ME report. Depending on the progress reported in the first progress report, FATF may require Hong Kong to provide further progress report(s).

6. The following two years are therefore crucial to our AML/CFT work. We need to coordinate a review of the effectiveness of our AML/CFT regulatory regime governing various financial services sectors (including banking, securities, insurance, remittance agents and money changers). Based on the results of this review and the major deficiencies identified in the ME report, we will formulate

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legislative proposals to enhance the effectiveness of our regulatory regime. The initial phase of the legislative exercise is expected to focus on developing an AML/CFT regulatory framework for remittance agents and money changers, and providing statutory backing for customer due diligence and record keeping requirements for financial institutions. We also need to take timely follow-up actions to ensure that our first progress report due in June 2010 will be as thorough as possible in terms of addressing the deficiencies identified in the ME report.

Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism

7. To better steer the strategic directions for the enhancement of the AML/CFT regime in Hong Kong and coordinate internal efforts in following up the FATF recommendations, the Government set up the Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism (CCC) in April 2008. It is chaired by the Financial Secretary (FS) and comprises members including the Secretary for Justice, the Secretary for Financial Services and the Treasury, the Secretary for Security, the Commissioner of Police, the Commissioner for Customs and Excise as well as representatives of the financial regulators. The terms of reference of the CCC are at Enclosure 2.

8. Before October 2008, the Narcotics Division (ND) of the Security Bureau was in charge of the overall coordination for AML/CFT policies within the Administration as an ancillary to its anti-drug efforts. In a normal year, the responsibility for AML/CFT issues took up about 20% of the Commissioner for Narcotics' resources, and she was supported by non-directorate staff of the ND in overseeing the AML/CFT portfolio. Supernumerary directorate posts had been created in the past to meet the upsurge in workload arising from time-limited assignments and exercises².

9. As the trends and typologies of money laundering and terrorist financing activities have been fast changing, the modern financial systems are facing increasing threats of being abused by criminals for money laundering and other illicit purposes. Enhancing the preventive measures in financial institutions

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² For example, to deal with the increased workload and complex issues arising from the ME on Hong Kong in 2007-08 and to coordinate efforts both within and outside the Government for this particular exercise, a supernumerary AOSGC post was created for six months from November 2007 onward. Another supernumerary AOSGC post was created for four months from May 2008 onward to support the CCC chaired by FS and to formulate a priority strategy and work plan.

has become an essential component of an effective AML/CFT regime. To ensure that the proposed AML/CFT measures will work in tandem with the policies of promoting Hong Kong as an international financial centre, the CCC decided that FSB should take over from the ND the overall coordinating role for AML/CFT policies, while ND will continue to deal with the AML/CFT matters relating to non-financial sectors under FSB's coordination. The transfer was effected in October 2008.

Need for Additional Directorate Support

10. In the past when AML/CFT policies were coordinated by the ND, financial services-related input to the AML/CFT policies and the FATF process was collated and provided by the policy team overseeing banking policies in FSB. There were no designated staffing resources at FSB to take care of AML/CFT policies. Upon taking up the overall coordination role over AML/CFT policies in October 2008, FSB has immediately commenced preparation for the new AML/CFT legislation as mentioned in paragraph 6 above. Specifically, we would review the detailed recommendations in the ME report, examine the current AML/CFT regime against the FATF Recommendations, draw up proposals for the enhancement of AML/CFT regulation for specific sectors, coordinate consultation with stakeholders (including the Legislative Council (LegCo) and the business sector), draft legislative proposals for introduction into LegCo and take the draft legislation through the relevant Bills Committee. We aim to complete the legislative exercise substantially by around June 2010 when we submit our first progress report to the FATF. Upon enactment of the legislation, FSB will oversee the initial implementation of the enhanced regulatory framework, including setting up the regulatory regime for remittance agents and money changers, and coordinating the modifications to the regulatory guidance concerning the new statutory requirements for customer due diligence and record keeping for financial institutions, with a view to having the enhanced regulatory framework ready for operation by January 2011. FSB will also be responsible for compiling the first progress report to FATF, which calls for considerable coordination across bureaux/departments and financial regulators. In view of the range, complexity and sensitivity of the duties as well as the need for accomplishing the tasks within a tight timeframe, there is a need for a full-time dedicated AOSGC post to oversee the AML/CFT portfolio in the next two years. We propose that a supernumerary AOSGC post be created in FSB for a period of 24 months with immediate effect.

11. The proposed supernumerary AOSGC post, designated as Principal Assistant Secretary (Financial Services)⁷ (PAS(FS)⁷), will head a new policy team in FSB to assume overall coordination of AML/CFT policies. The new team will be

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staffed by five non-directorate officers, comprising one Senior Administrative Officer (SAO), one Superintendent of Police (SP), one Executive Officer (EO) I and two Personal Secretaries (PSs) I/II. The SAO and the two PS posts will be created on a time-limited basis for two years, mainly to assist the proposed PAS(FS)7 post to follow up the FATF recommendations and to take forward the associated legislative exercise. The other two posts (i.e. SP and EO I) are permanent positions responsible for handling the AML/CFT-related matters on an on-going basis. These include conducting threat assessments on different business sectors in conjunction with concerned bureaux/departments and regulatory authorities, collating relevant statistics and information pertaining to the enforcement of AML/CFT regulations and AML/CFT awareness amongst the regulated sectors, organising outreaching publicity and training programmes for the financial services sector and the community as a whole, and coordinating Hong Kong's attendance and comments on proposals and issues for discussion at FATF and other related forums. The job description of the proposed PAS(FS)7 post is at Enclosure 3. An organisation chart of FSB showing the proposed post is at Enclosure 4.

Encl. 3
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12. It is our plan to have the enhanced AML/CFT regulatory framework ready for operation by January 2011. With the implementation of the enhanced framework, we expect that the volume of work related to AML/CFT duties will be reverted to a normal level and that the reduced workload would be absorbed by FSB through internal redeployment.

13. To commence the policy review and legislative exercise as early as possible after FSB has assumed the coordinating role on AML/CFT policies since October 2008, and to start preparing for the outreaching programme for the business sector to be held in early 2009, a six-month supernumerary AOSGC post was created in FSB in November 2008 under delegated authority. It will lapse upon creation of the supernumerary AOSGC post proposed in this paper.

Alternative Considered

14. At present, there are six Principal Assistant Secretaries (PASs) in FSB³, overseeing different policy portfolios, including securities and futures, banking, insurance, accountancy, mandatory provident funds, and companies-related matters. Their existing job descriptions are set out in Enclosure 5. FSB has critically examined the feasibility of whether any of the existing PASs in the Branch

Encl. 5

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³ These include one supernumerary post created with the approval of the Finance Committee vide EC(2005-06)9 on 13 January 2006 for a period of 48 months, mainly for the rewrite of the Companies Ordinance.

can absorb the new AML/CFT portfolio. In this regard, FSB has reviewed the workload of the existing PASs and the work priorities of the Branch in the coming two years when the proposed post is required for the new AML/CFT tasks. In the next two years, FSB will undertake a number of major policy reviews and legislative exercises pertaining to financial market developments. These include the implementation of the portability proposal of the Mandatory Provident Fund, rewrite of the Companies Ordinance, review of the institutional set-up of the Insurance Authority, review of the Trustee Ordinance, promotion of the development of Islamic finance, and enhancing financial cooperation with the Mainland. FSB will also be playing a central role in dealing with the aftermath of the global financial crisis. The Branch will conduct a series of reviews with a view to promoting the resilience and stability of our financial markets. These include the reviews to improve the regulatory framework and enhance investor protection, review of the supervisory framework for liquidity risk management for authorised institutions, tightening of the regulation of fund managers, and review of the coverage and protection limits of the Deposit Protection Scheme. Recommendations arising from these reviews, if implemented, will require substantial legislative work. Moreover, FSB is a key party to be involved in the work of the LegCo Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products. In the light of the above, all the existing PASs will be fully engaged in their own schedule of work and required to take on additional duties because of their involvement one way or the other in the reviews and follow-up actions arising from the global financial crisis. It is therefore operationally not possible for the existing PASs in FSB to take up the new task without adversely affecting the discharge of their current duties.

15. In addition to the above six D2 officers within the FSB proper, there are another three D2 officers, pitched at the rank of Assistant Commissioner of Insurance, in the Office of the Commissioner of Insurance (OCI), which is organisationally housed under FSB. These three D2 posts cannot be redeployed for the new AML/CFT tasks, as the post-holders belong to the professional grade specialising in the field of insurance. They assist the Commissioner in protecting the interests of policy holders and promoting the stability of the insurance industry through authorisation of insurers as well as regulation of insurers and insurance intermediaries.

FINANCIAL IMPLICATIONS

16. The additional notional annual salary cost of the proposed supernumerary AOSGC post at mid-point is \$1,518,000. The full annual average staff cost, including salaries and staff on-cost, is \$2,144,000. We will absorb the additional expenditure from within the existing provisions in 2008-09 and include the necessary provision in the draft Estimates of subsequent years to meet the cost of this proposal.

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17. The notional annual salary cost of the five non-directorate supporting staff mentioned in paragraph 11 above at mid-point is \$3,060,900, and the full annual average staff cost, including salaries and staff on-cost, is \$4,497,000.

PUBLIC CONSULTATION

18. We briefed the LegCo Panel on Financial Affairs on 21 November 2008 on the proposed creation of the supernumerary AOSGC post. Some Members asked whether the proposed duties and workload justified the creation of a new directorate post for 24 months and whether the proposed duties could be absorbed by other existing directorate staff in FSB instead. The Chairman asked the Administration to consider the Members' views/suggestions before submitting the proposal to the Establishment Subcommittee.

19. We have deliberated on Members' views and considered that it is necessary to create the proposed AOSGC post for 24 months given the complexity and sensitivity of the duties involved as well as the need to complete the necessary tasks against a pressing timetable.

BACKGROUND

20. The FATF is an inter-governmental body which sets international AML and CFT standards generally known as the FATF Recommendations. Member jurisdictions of FATF, including Hong Kong, are obliged to implement the FATF Recommendations and subject to the ME conducted by FATF on their compliance with the FATF Recommendations.

21. As an international financial centre, Hong Kong should put in place an effective AML/CFT regime to deter criminals from making use of our systems to launder criminal proceeds, and to sustain the healthy growth of legitimate business and investments in Hong Kong. The Chief Executive highlighted in his Policy Address on 15 October 2008 the need for improving our systems to combat money laundering and terrorist financing.

ESTABLISHMENT CHANGES

22. The establishment changes under Head 148 – Government Secretariat: Financial Services and the Treasury Bureau (Financial Services Branch) (including the OCI) for the last two years are as follows –

/Establishment

Establishment (Note)	Number of posts		
	Existing (as at 1 December 2008)	As at 1 April 2008	As at 1 April 2007
A	12 + (2)#	12 + (2)	12 + (2)
B	51	51	51
C	88	88	88
Total	151 +(2)	151 +(2)	151 +(2)

Note:

- A – ranks in the directorate pay scale or equivalent
- B – non-directorate ranks, the maximum pay point of which is above MPS Point 33 or equivalent
- C – non-directorate ranks, the maximum pay point of which is at or below MPS Point 33 or equivalent
- () – number of supernumerary directorate posts
- # – The supernumerary post created under delegated authority mentioned in paragraph 13 above is not included. As at 1 December 2008, there is no unfilled directorate post in FSB.

CIVIL SERVICE BUREAU COMMENTS

23. The Civil Service Bureau supports the proposed creation of the supernumerary AOSGC post for two years. The proposed ranking of the post is considered appropriate having regard to the level and scope of the responsibilities concerned.

ADVICE OF THE STANDING COMMITTEE ON DIRECTORATE SALARIES AND CONDITIONS OF SERVICE

24. As the post is proposed on a supernumerary basis, its creation, if approved, will be reported to the Standing Committee on Directorate Salaries and Conditions of Service in accordance with the agreed procedure.

**Summary of the Key Findings of
the Mutual Evaluation (ME) Report of Hong Kong
Published by the Financial Action Task Force (FATF) in July 2008**

- In overall terms, the Report recognised the strengths of Hong Kong's anti-money laundering (AML) and counter financing of terrorism (CFT) regime. The assessment team welcomed the setting up of the Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism chaired by the Financial Secretary and said it was a development in the right direction.
- The report commended Hong Kong for its good legal structure with a satisfactory conviction rate for money laundering offences, clear and broad obligations for reporting suspicious transactions, and strong law enforcement efforts.
- The report found the supervisory regime over the banking, securities and insurance sectors effective with comprehensive obligations and a fairly broad range of sanctions.
- The report acknowledged the prompt provision of a wide range of international cooperation, and proactive and effective outreach to the private sector in raising its awareness. The report also commended Hong Kong's Joint Financial Intelligence Unit as proactive and effective.
- Under FATF's regular follow-up process, Hong Kong is required to submit the first progress report on rectification of the deficiencies identified in the ME Report to the FATF in June 2010, and thereafter at regular intervals as determined by the FATF.
- The major recommendations on addressing the deficiencies identified in the ME Report are –
 - (a) incorporate the key elements of the customer due diligence process into law or regulations for the financial sector;
 - (b) extend all the requirements related to financial institutions to remittance agents and money changers;

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- (c) assess the risk which the non-core financial institutions (viz. money lenders, credit unions, Post Office and financial leasing companies) are exposed to and extend the AML/CFT requirements to these sectors if exemption is not justified;
- (d) consider how to implement the FATF Recommendations among the designated non-financial businesses and professions, especially when only a few of their statutory or professional bodies embrace all practitioners in the respective sectors;
- (e) expedite enactment of Court rules to enable implementation of key provisions in United Nations (Anti-Terrorism Measures) Ordinance, and broaden the provisions of anti-terrorism legislation to enable full implementation of the FATF Recommendations;
- (f) prioritise work to conclude formal arrangements for rendition and mutual legal assistance with the Mainland and Macao;
- (g) set up a disclosure or declaration system for cross-border physical transportation of cash or bearer negotiable instruments as soon as possible; and
- (h) place more emphasis on the tracing, seizure and confiscation of the proceeds of crime to improve the regime's effectiveness.

**Central Coordinating Committee on
Anti-Money Laundering and Counter Financing of Terrorism**

Terms of Reference

1. To steer and coordinate the strategic development of Hong Kong's anti-money laundering and counter financing of terrorism (AML/CFT) regime in line with internationally recognised standards.
2. To ensure that appropriate legal, regulatory and supervisory systems are in place to fulfill Hong Kong's policies and commitment to fight money laundering and counter terrorist financing.
3. To monitor the progress of the implementation of AML/CFT policies, and where necessary to direct and guide further action by relevant agencies.
4. To keep under review the effectiveness of Hong Kong's AML/CFT regime and ensure an effective systemic response to changing threats.

**Job Description of Principal Assistant Secretary
for Financial Services and the Treasury (Financial Services) (PAS(FS)7)**

Rank : Administrative Officer Staff Grade C (D2)

Post Title : Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)(7)

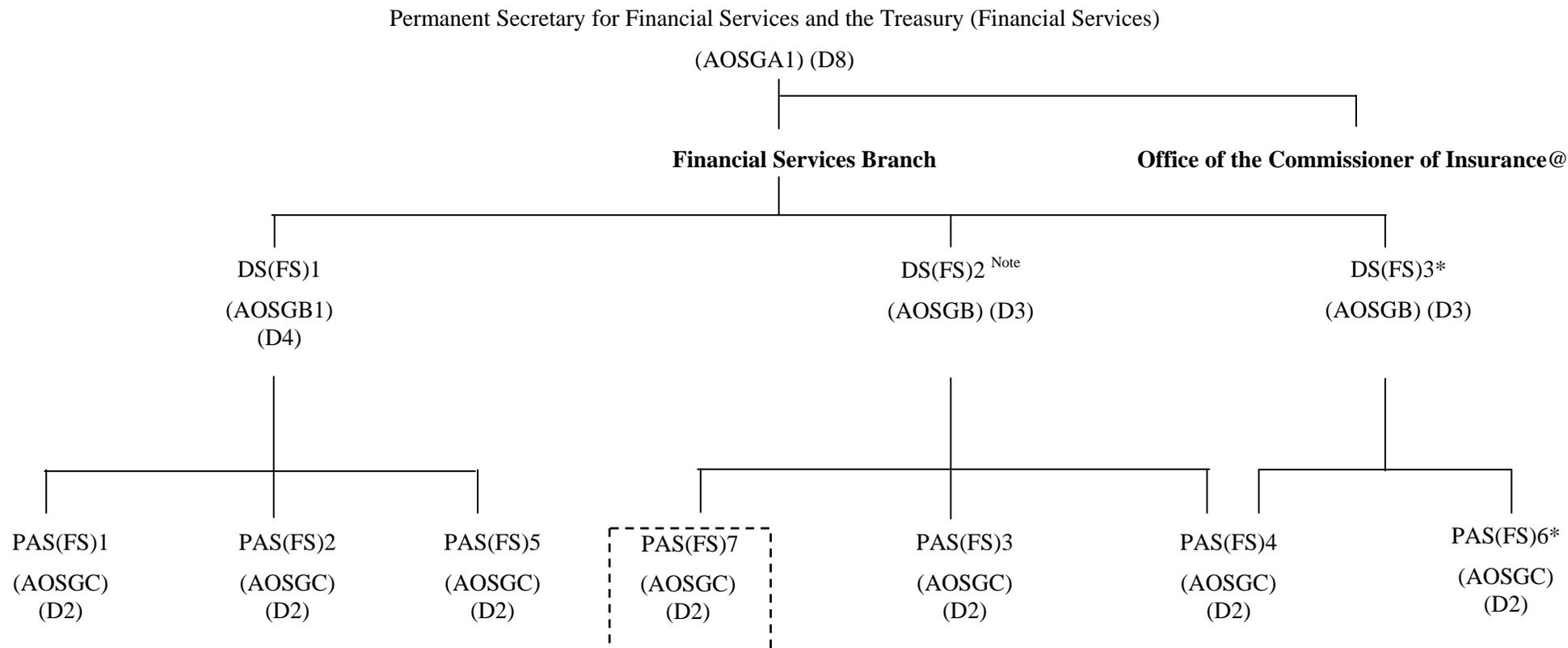
Major Duties and Responsibilities –

Responsible to the Deputy Secretary for Financial Services and the Treasury (Financial Services)2 (DS(FS)2)^{Note} for the following duties –

1. To serve as Secretary to the Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism (CCC) chaired by the Financial Secretary;
2. To coordinate the draft legislation for addressing the deficiencies identified in the Financial Action Task Force (FATF) mutual evaluation conducted in 2007 and the formulation of the statutory regulatory framework for remittance agents and money changers;
3. To coordinate the first progress report to FATF;
4. To coordinate and provide policy support to the CCC and senior officials in putting in place the appropriate legal and regulatory systems to fight money laundering and terrorist financing, having regard to the prevailing international standards;
5. To assist in overseeing the implementation of Anti-Money Laundering (AML)/Counter Financing of Terrorism (CFT) policies in Hong Kong;
6. To act as the coordinator and contact point for Hong Kong's participation in and input to the discussions of the FATF and other international forums on AML/CFT; and
7. To oversee the conduct of AML/CFT threat assessment and organisation of the regular outreaching and educational programmes for financial services sectors in Hong Kong.

^{Note} Due to internal reshuffling of duties, DS(FS)2 will take over from DS(FS)1 the AML/CFT portfolio with effect from February 2009.

Organisation Chart of the Financial Services and the Treasury Bureau (Financial Services Branch)



Legend:

- Supernumerary directorate post to be created
- DS(FS) Deputy Secretary for Financial Services and the Treasury (Financial Services)
- PAS(FS) Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)
- * Supernumerary posts created with Finance Committee's approval vide EC(2005-06)9 on 13 January 2006, for a period of 60 months for the DS(FS)3 post and 48 months for the PAS(FS)6 post
- Note Due to internal reshuffling of duties, DS(FS)2 will take over from DS(FS)1 the AML/CFT portfolio with effect from February 2009.
- @ The Office of the Commissioner of Insurance has a total of four directorate officers, namely, the Commissioner of Insurance (D4) and three Assistant Commissioners of Insurance (D2).

**Duties and Responsibilities of
the Existing Principal Assistant Secretaries
(Financial Services) (PAS(FS)s)**

PAS(FS)1 is responsible for the regulation of listing and market development issues in relation to debt market, financial products, fund management industry and offers of investment. He/She is responsible for policy matters relating to the housekeeping of the Insider Dealing Tribunal, Market Misconduct Tribunal and Securities and Futures Appeals Tribunal, and provides secretariat support to the Process Review Panel of the Securities and Futures Commission (SFC). He/She also deals with matters relating to the Hong Kong Exchanges and Clearing Limited and promotion of Hong Kong as an international financial centre overseas and in the Mainland.

2. PAS(FS)2 oversees matters relating to the development of market infrastructure, investor protection, and supervision of intermediaries in the securities and futures markets. He/She co-ordinates the work of the regulators on risk management matters including market contingency planning and other cross-market issues. He/She is responsible for the maintenance and regular update of the Securities and Futures Ordinance in the light of market development. He/She is in charge of housekeeping matters relating to the SFC.

3. PAS(FS)3 oversees insurance policy matters. The major projects coming on stream include the review of the institutional set-up of the Insurance Authority; feasibility study of establishing policyholders' protection funds; and consultancy study on the supervisory framework of the assets of long-term insurers. Moreover, he/she deals with retirement scheme policy matters and the on-going review of the relevant legislation. In addition, he/she is responsible for providing support to the Council of Financial Regulators and the internal administration of the Financial Services Branch. He/She is also the subject officer responsible for matters relating to human resources development in the financial services sector and the coordination of the Mainland and Hong Kong Closer Economic Partnership Arrangement related matters in the financial services sector.

4. PAS(FS)4 deals with policies in respect of companies, from their incorporation to dissolution. One of the major initiatives is the implementation of recommendations made by the Standing Committee on Company Law Reform to modernise the Companies Ordinance and improve corporate governance. He/She is also in charge of policy responsibility for bankruptcy matters and the

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self-regulatory regime of accountants. He/She oversees the work of the Official Receiver's Office, and co-ordinates trade matters in respect of financial services under the World Trade Organization. He/She is also responsible for taking forward the proposals to enhance the oversight of the public interest activities of auditors and for liaising with the Financial Reporting Council.

5. PAS(FS)5 is responsible for the review and maintenance of Banking Ordinance, and liaises with the Hong Kong Monetary Authority on banking and monetary issues. He/She oversees the development and monitoring of the Deposit Protection Scheme. In addition, he/she co-ordinates input from financial services perspective on Hong Kong's participation in international forums such as the International Monetary Fund, Asia-Pacific Economic Cooperation, and the Organization for Economic Co-operation and Development.

6. PAS(FS)6 deals with policies and legislation relating to companies and trust companies. He/She co-ordinates the work relating to rewrite of the Companies Ordinance as well as review of the Trustee Ordinance. He/She is also in charge of housekeeping matters of the Companies Registry. We need a dedicated D2 post to deal with the rewrite of the Companies Ordinance because of the scope and complexity of the legislative exercise, the need to conduct thorough policy research and analyses on highly technical and complex issues which have not been subject to review before, the need to engage various stakeholders in the review process, as well as the need to ensure that the new Companies Bill is a piece of quality work within a reasonable timeframe.
