

**For Discussion
on 11 June 2009**

LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

Broad Framework of Legislative Proposal to Enhance the Anti-Money Laundering Regulatory Regime in respect of the Financial Sectors

Purpose

This paper sets out the broad framework of a legislative proposal to enhance the anti-money laundering (AML)¹ regulatory regime in respect of the financial sectors, on the basis of which the industry will be consulted.

Background

2. As foreshadowed at the Special Meeting of the Finance Committee held on 23 March this year, we have formulated a proposal to provide statutory backing and appropriate sanctions for customer due diligence (CDD) and record keeping requirements for financial institutions² and put in place an AML regulatory framework for the remittance agents and money changers (RAMCs). This proposal is to address relevant deficiencies identified in the Mutual Evaluation (ME) conducted by the Financial Action Task Force (FATF)³ on Hong Kong which was published in July 2008.

Issues to be Addressed

3. Through the findings of the ME, FATF recognized the strengths of Hong Kong's AML regime, but also highlighted inter alia that the lack of statutory backing and appropriate sanctions for CDD and record keeping

¹ For the purpose of this paper, references to "AML" include the meaning of both anti-money laundering (AML) and counter financing of terrorism (CFT).

² For the purpose of this proposal, financial institutions are those institutions referred to in paragraph 8(A)(a) of this Paper.

³ FATF is an inter-governmental body which sets international AML/CFT standards. Members of FATF, including Hong Kong, are subject to the ME conducted by FATF on their compliance with the international standards.

requirements for financial institutions and the absence of an AML regulatory regime for RAMCs are major deficiencies that should be addressed.

4. At present, the basic requirements on CDD and record-keeping by financial institutions are implemented through guidelines issued by the financial regulators, viz. the Monetary Authority (MA), Securities and Futures Commission (SFC) and the Insurance Authority (IA) pursuant to their statutory powers respectively under the Banking Ordinance (Cap. 155) (BO), the Securities and Futures Ordinance (Cap. 571) (SFO) and the Insurance Companies Ordinance (Cap.41) (ICO). Whilst currently there is no specific provision for sanctions against non-compliance, failure to comply with these guidelines will be taken into account in financial regulators' consideration of the "fitness and properness" of the regulatees.

5. RAMCs are currently subject to the statutory requirements under sections 24B and 24C of the Organized and Serious Crimes Ordinance (Cap. 455) (OSCO) to be registered with the Joint Financial Intelligence Unit of the Police, to verify customers' identity for transactions or wire transfers of HK\$8,000 or above and to keep records of such transactions for a specified period. There is however no statutory provision for the power to refuse registration and the power to access to RAMC's premises or books/records for routine compliance checks. FATF recommended enhancement of the AML regulation over this sector.

6. Hong Kong is required to report to FATF on actions taken or planned to address the deficiencies identified in the ME on a regular basis, and the first progress report is due in Q2, 2010. According to FATF's procedure, jurisdictions required to submit post-ME follow-up reports to FATF are expected to have made substantial progress in their first report, and they are expected to seek removal from the follow-up process about three years after the ME, which means 2011 in the case of Hong Kong. Failure to achieve removal from the follow-up process within a reasonable period due to absence of significant improvements may entail more enhanced scrutiny and monitoring by FATF.

Broad Framework of the Proposed Legislation

7. After detailed discussions with the relevant regulators and authorities, we propose that legislation should be put in place to enhance the AML

regulatory regime of the financial sectors by-

- (a) prescribing the CDD and record-keeping requirements for financial institutions; and
- (b) introducing a licensing system for RAMCs for AML regulatory purpose.

To ensure effective supervision of the financial institutions' compliance with the requirements, the legislation would provide for requisite powers for the regulators and appropriate sanctions against breaches.

8. The proposed broad framework is set out below-

(A) Coverage

- (a) The following financial institutions would be covered and subject to the requirements under the legislation:
 - (i) authorized institutions within the meaning of the BO;
 - (ii) licensed corporations within the meaning of the SFO;
 - (iii) insurance institutions carrying on or advising on long term business (as defined in the ICO) in or from Hong Kong, and as required by FATF, these would include the relevant insurance companies, insurance agents and insurance brokers within the meaning of the ICO; and
 - (iv) RAMCs currently covered by the registration scheme under OSCO.
- (b) MA, SFC and IA would be designated as the authorities to supervise the compliance of the banking, securities and insurance sectors respectively, and the Customs and Excise Department (C&ED) will be designated as the new licensing and supervisory authority for RAMCs to supervise their compliance.

(B) Obligations

The legislation would set out essentially those basic CDD and record-keeping requirements prescribed by FATF. In essence, financial institutions:

- (a) should not open or maintain anonymous accounts or accounts in fictitious names;
- (b) should conduct CDD when establishing business relations or carrying out occasional transactions above a stated threshold or when there are suspicions of money laundering/terrorist financing or doubts on veracity or adequacy on previously obtained customer identification data;
- (c) should implement CDD measures to:
 - (i) identify the customer or any persons purporting to act on behalf of the customer;
 - (ii) verify customer's identity using reliable, independent source documents;
 - (iii) identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner; and
 - (iv) understand the ownership and control structure of those customers who are legal persons and arrangements;
- (d) should conduct ongoing due diligence measures e.g. scrutinize transactions to ensure transactions are in line with the institutions' knowledge of the customers, their business and risk profile, ensure identification documents or data are up-to-date;
- (e) should conduct enhanced CDD measures for higher-risk customers, business relationship and transactions;

- (f) should maintain all relevant records on transactions, both domestic and international, for a specified period, regardless of whether the account or business relationship is ongoing or has been terminated;
- (g) should keep records including identification data, account files and business correspondence, for a specified period following the termination of accounts or business relationships; and
- (h) should ensure that all customer and transaction records and information are made available on a timely basis to the local regulatory authority upon request.

All the above requirements are already covered in the current guidelines issued by MA, SFC and IA respectively. As for RAMCs, they are currently subject to certain CDD and record keeping requirements under section 24C of the OSCO. Under the legislation, regulatory authorities are empowered to issue guidelines to facilitate regulatees' compliance with the requirements.

(C) Powers

The regulatory authorities would be empowered to supervise compliance with the requirements. Other than the RAMCs whose regulator is yet to be designated (see paragraph 8(G) below), these powers are generally in line with those which the regulators (i.e. MA, SFC and IA) already possess. The legislation would, inter alia, empower the authorities to access to the financial institutions' business premises and books/records and other relevant information for routine inspections, to investigate into non-compliance cases by requiring information from the financial institutions, their staff and counterparties involved in the transactions in question, to enter into and search a premises and seize documents/records and other items upon production of warrant. The authorities would also be empowered to share information obtained in their regulatory actions with overseas regulators to facilitate international cooperation on AML front, as

required by the FATF. The legislation would include suitable checks and balances.

(D) Liability and Offence

Financial institutions which breach the CDD or record-keeping requirements without reasonable excuse would commit an offence under the legislation and be liable to a fine and/or imprisonment. If an offence has been committed with the consent or connivance of, or is attributable to any recklessness on the part of the directors, chief executive officers or managers of the institutions, the individuals concerned would also be liable. Any person who willfully breaches the statutory CDD and record-keeping requirements under this legislation would be liable to criminal offence. Authorities designated under the legislation may prosecute offences summarily. Again suitable safeguards would be featured to avoid abuses.

(E) Sanctions

- (a) We will draw reference from sanctions for offences of similar nature in other statutes⁴ to determine the appropriate level for the criminal sanctions to be imposed on offences under the new legislation.
- (b) To enhance effectiveness of the AML regulatory regime as recommended by FATF, we propose that regulatory authorities should be empowered to impose regulatory sanctions, including public reprimand and fines, or issue directions to financial institutions to implement remedial actions or other specified actions for breaches of the statutory obligations. We shall draw reference from the existing provisions on disciplinary powers of the SFC as prescribed in the SFO as they are most recently examined by the legislature and enacted.

⁴ For reference, under s24C of the OSCO, the maximum penalty for a RAMC who failed to verify the identity of the customer and keep proper records for transactions over \$8000 is a fine at level 6 and imprisonment for 3 months; under s151(5) of the SFO, the penalty for failure to keep records is, on indictment, a fine of \$200,000 and imprisonment for 2 years or on summary conviction, a fine of level 6 and imprisonment for 6 months; under s151(4) and (6) of the SFO, the penalty for failure to keep records with intent to defraud is, on indictment, a fine \$1,000,000 and imprisonment for 7 years or on summary conviction, a fine of \$500,000 and imprisonment for 1 year.

- (c) The imposition of regulatory and criminal sanctions for non-compliance will be taken into account by the authorities in their consideration of whether the regulatees are fit and proper, as required under their respective existing Ordinances.

(F) Appeal Mechanism

To ensure that there are proper checks and balances in the system, an independent statutory appeals tribunal would be established to allow aggrieved financial institutions to appeal against the authorities' decisions made pursuant to the new legislation, including the appropriateness of the regulatory sanctions imposed.

(G) AML Regulatory Regime for RAMCs

- (a) As at a designated date in future, all persons carrying out remittance and money exchange services as a business would be required to possess a valid licence issued by C&ED. Any persons carrying out such services as a business without a valid licence would commit a criminal offence and be liable to a fine and/or imprisonment. With reference to the existing powers of the Police in administering the registration scheme for RAMCs, Trade Control Officers of C&ED will be empowered to arrest persons who are found operating unlicensed RAMCs and seize documents, record and items in premises where the unlicensed RAMCs operate⁵.
- (b) Granting of RAMC licences or licence renewal would be subject to a specified fee.
- (c) C&ED would be empowered to grant, refuse, suspend or revoke a

⁵ Currently a C&E officer as listed in Schedule 1 to Customs and Excise Service Ordinance (Cap. 342) and as a “member” of C &E under Cap. 342 has the power to arrest any person whom he may reasonably suspect of having committed an offence under the OSCO and as an “authorized officer” under the OSCO to seize any records relating to any remittance transaction or exchange transaction carried out by the RAMC that he reasonably believes to be related to an offence under his reasonable suspicion having been committed under Part IVA of the OSCO. However, the Trade Control Officer Grade of C&ED are not a “member” listed in Schedule 1 to Cap. 342 and it is proposed that similar powers will be given to the Trade Control Officer Grade who will be the regulatory authority for RAMCs under the new licensing regime.

licence or impose or vary the conditions on a licence. The new legislation would set out the factors to be considered by C&ED in considering the above. The proposed factors include:

- (i) “fit and proper” test (by considering the criminal and bankruptcy records of the applicant (for natural persons) or partners/directors/shareholders (in cases of partnerships/legal persons), failures to comply with the requirements under the legislation and the guidelines issued by the regulatory authority;
- (ii) possession of a certificate of business registration;
- (iii) payment of a licence/renewal fee; and
- (iv) other relevant factors related to the risk of money laundering or terrorist financing of the RAMCs.

C&ED may make regulations prescribing the manner in which the application for licence should be made.

- (d) Similar to the case of other financial regulators, C&ED will be empowered to issue guidelines for providing guidance for the furtherance of its regulatory objectives. Breach of the guidelines would be taken into account in the regulatory authority’s determination of the fitness and properness of the RAMCs.
- (e) Licensees will be required to notify C&ED of any change in business ownership and/or the identity of their partners/directors/shareholders in a timely manner.
- (f) The above licensing regime would replace the current registration scheme administered by the Joint Financial Intelligence Unit of the Police under the OSCO.

Next Steps

9. We shall conduct an industry consultation exercise and proactively

engage the relevant market participants to gauge their views on the proposal. We plan to write to the trade associations and members of the relevant sectors in early July to invite their views on the proposed broad framework of the legislation by 30 September. The proposed broad framework will also be uploaded to the website of the Financial Services Branch in early July. Also, in conjunction with the relevant authorities, we shall arrange consultative sessions with members of individual financial sectors.

10. Taking into account the views and comments from Members at the Panel meeting and received from the financial sectors, we will draw up detailed legislative proposals for a second-round industry consultation, tentatively scheduled for late 2009/Q1, 2010. We aim to introduce the bill into the Legislative Council by Q2, 2010.

**Financial Services Branch
Financial Services and the Treasury Bureau
June 2009**