HK IFA 香港投資基金公會

Hong Kong Investment Funds Association

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CB(1)1926/09-10(10)

September 25, 2009

Officer in charge
Division 7, Financial Services Branch
Financial Services and the Treasury Bureau
18/F Tower I Admiralty Centre
18 Harcourt Road
Hong Kong

Dear Sir/Madam

Re: Conceptual framework of legislative proposal to enhance the anti-money laundering regulatory regime in respect of the financial sectors

On behalf of the Hong Kong Investment Funds Association ("HKIFA"), I would like to express support to the Financial Services and the Treasury Bureau ("FSTB") for undertaking the initiative to further reinforce the anti-money laundering ("AML") regime in Hong Kong.

We agree with the principles as outlined in Paragraph 2.4 of the consultation paper. However, we would exhort FSTB to consider the following when developing the legislative proposals for the financial services industry:

(1) are there any other models that can achieve the same regulatory outcome? It would be helpful if the authorities can conduct cost-benefit analysis of the alternative models;
(2) how to ensure that there is sufficient coordination amongst the relevant authorities in implementation to avoid overlaps and duplication? This is especially pertinent as there are increasingly more overlaps between the different sectors;
(3) how to introduce a framework that can factor in the different business models and unique characteristics of the respective sectors?

With respect to the detailed comments on the questions raised in the consultation paper, please find the attached from members of HKIFA.

If you require any clarifications or wish to discuss this further, please do not hesitate to contact me on 2537 9912.

Yours sincerely,

Sally Wong
Chief Executive Officer

A: \Ltr- FSTB_AML legislative proposal (5)

Hong Kong Investment Funds Association

Comments from members of Hong Kong Investment Funds Association on the Anti-money laundering ("AML") legislative proposal issued by FSTB (September 2009)

Chapter 3 - Obligations of financial institutions

1. In view of the different business nature of financial institutions ("FIs"), we believe that it is not appropriate to adopt a one-size-fits all approach. Instead, the legislative requirements should take into account the specific business characteristics of each segment, (e.g. unlike banks, asset management firms generally do not handle cash transactions), identify the stages of money laundering (placement, layering and integration) which each particular segment is most likely to be exposed to, and map out different requirements accordingly.

   Also, in defining customers, one has to be mindful of the characteristics of each sector, e.g. for fund managers which sell authorized funds, their customers are almost invariably the distributors – be they banks or insurance companies. Fund managers will not interface with the end clients direct as the distributors will bulk the orders through nominee accounts. They do not have access to end clients' information; and they rely on the distributors to perform the client due diligence ("CDD") functions.

2. The CDD requirements as prescribed in the Securities and Futures Commission ("SFC") guidelines have adopted a risk based approach, and the implementation has relied on the judgment of the staff of the licensed corporations e.g. check address of the customer by the best available means (and use common sense approach). Will the new legislation allow similar flexibility?

   We believe that if the new legislation were to be introduced, it should only cover the high level principles, and stop short of prescribing implementation details. The details should be provided for in the guidelines so as to allow flexibility.

3. Concerning proposal 3.4, the current CDD obligations are set out in guidelines but not in law or regulation.

   Financial Services and the Treasury Bureau ("FSTB") intends to set out the CDD and record keeping obligations in the new legislation so as to give the CDD obligations the force of law. However, has FSTB considered whether it is possible to mirror the current guideline requirements as new regulation under the SFO instead of introducing a completely new set of legislation?

4. Proposal 3.4 (b)(ii) suggests that FIs should undertake CDD measures, including identifying and verifying the identity of customers when carrying out occasional transactions above a stated threshold (the threshold set by FATF is EURO/USD 15,000). After doing a quick review of the size of the occasional transactions handled by asset management firms, we believe that a higher threshold, say USD 200,000 would be more practical.

5. Proposal 3.4 (c) suggests that FIs should not perform investors' transactions in case a FI is unable to complete the said CDD measures. However, distributors of SFC authorized funds have a contractual obligation to execute investors' orders on a timely basis. Given the investor has already satisfied the CDD at the point of business relation establishment; for

subsequent transactions, is it more practical to report suspicious cases to relevant authorities rather than refusing to process his/her orders in cases where there are signs that the orders are suspicious?

6. For proposal 3.4(c), it would be helpful if FSTB can provide further guidance on:
   - what constitutes "reliable and independent" sources of information to verify a customer's identity
   - circumstances in which reliance on third party CDD would be allowed
   - what is considered "reasonable steps" to verify the identity of "beneficial owners". How far up the "beneficial owner" chain does a FI need to go before it would have satisfied the identification requirement?

7. For proposal 3.4(e), the requirement to seek "senior management approval" before establishing business relationship with higher-risk clients needs to be clarified: what level of senior management approval is expected? For example, does an RO need to vet all such transactions/clients? If that is the case, it would be unduly onerous and impractical.

8. Proposal 3.6 provides that relevant AML regulatory authorities would be empowered to issue guidelines to facilitate compliance with the new legislation. How will these work out, e.g. is it intended that the legislation will only provide the broad principles and the "additional" guidelines set out the detailed requirements? What will be the liability attached to a breach of the guidelines?

9. On consultation question 3.2, we hope that the Government can provide assistance to the industry in authenticating ID documents, including HK or overseas documents.

   Also, the legislation should not have retrospective effect and the CDD measures should only apply to new accounts. It is impractical and imposes huge administrative burden to update all existing accounts with the new CDD measures.

Chapter 4 - Powers of the regulatory authorities

1. In proposal 4.6, if the FSTB intends to mirror the inspection, supervisory and enforcement powers of the SFC for the purposes of the new legislation, does this not suggest that the current SFC powers under the SFO are already adequate? As stated in the earlier comments on paragraph 3.4, if there are already mechanisms in place, why doesn't the Government consider enacting regulation under the SFO in relation to AML for FIs, and allow SFC to use its powers already granted in the SFO to supervise such regulation?

2. Under consultation question 4.2, the FSTB asks whether an independent appeals tribunal to hear appeals against the regulator's decisions on supervisory sanctions is appropriate.

   It is difficult to answer this question as we do not have a clear picture of the model being envisaged, e.g. how will this tribunal be constituted/its membership? Under what circumstances can a party appeal to the tribunal? Will the tribunal's findings be final and binding? Will appeal to the tribunal preclude the parties from seeking recourse under the court system? Will the tribunal be bound by precedent decisions? The Government should address this before we can pass comments on it.

Chapter 5 – Offences and Sanctions

1. If criminalization is absolutely necessary – which we think the Government needs to provide justifications - the scope of criminality should be more clearly delineated. The draft (pt 5.4) as it stands is too broad-brushed and vague:

2. For proposal 5.4(a), "any financial institution which breaches the CDD requirements without reasonable excuse" would commit an offence. This is a strict liability offence under which the FIs have the burden to prove that it has a "reasonable excuse" to avoid committing the offence. However, there is no definition or guidance as to what constitutes a "reasonable excuse". Furthermore, as this is a criminal offence, we would expect that some form of knowledge or intent requirement is imputed so as to match the severity of a criminal sanction.

3. In proposal 5.4(b), the extension of the criminal liability to individuals whose "consent", "connivance" or "recklessness" leads to a breach of the CDD requirements by a FI is another area that causes concerns. The realm of AML is inherently about a judgment call on the part of the AML officer in assessing whether, in the opinion of AML officer based on the information available to him, a transaction or customer satisfies the CDD requirements. If criminal liability was to be attached to such a judgment call, a fair and legitimate expectation is that there are very clear guidances or trainings from the authorities as to what criteria or standards need to be met by an AML officer in assessing CDD requirements so as to avoid committing an offence. We would also expect guidance as to what constitutes a defense to this offence. For example, if an officer can show that he has complied with all the FI's AML policy and procedures and has taken all reasonable steps to ensure compliance; can this be a defense even if ultimately the officer gave consent to the transaction? Furthermore, it needs to be clarified whether all "officers or managers" who have knowledge of the transaction will be liable or whether the offence is targeted at the final consent giving individual.

   The authorities should be mindful that the imposition of criminal liability may breed a culture of "over-compliance" due to individual's fear of attracting criminal liability. The "over-compliance" or inflexibility may have negative implications to Hong Kong as an international finance centre.

   5.4 (b) has also extended the criminal liabilities beyond the company to its officers. This will potentially expose any front and back office executives, compliance officers, risk officers who are involved in the approval (exception approval) of the account opening process to the risks. Normally all of them may be involved in giving consent to an exception. The test for 'connivance' and 'reckless' is also subjective. This provision is wider than the SFO since SFO only put the responsibilities on the licensed corporations and ROs.

   It is overly burdensome to extend the scope of criminal liabilities to procedural and compliance obligations such as CDD and record keeping requirements. Criminalization should only focus on acts of dishonesty, fraud or intentional misbehavior etc. Non-compliance of CDD, record keeping obligations should be dealt with by civil/supervisory sanctions.

4. In proposal 5.4(c), "any person who willfully breaches" the CDD requirements would commit an offence. Although the FSTB has imputed some level of "intent" in the formulation of this offence, it is not clear, how this offence is differentiated from the offence of the proposal 5.4(b) above. Is this offence more serious than 5.4(b) due to the "willful" element? Should there also be an element of fraud or dishonesty?

(End)

HKIFA

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寄件日期: 2010年2月12日星期五 8:12
收件者: 'aml_consultation@fstb.gov.hk'
副本:
主旨: FSTB's consultation on proposed customer due diligence and record-keeping requirements
附件: HKIFA members' feedback on proposed CDD and record-keeping requirements.pdf

Dear Sir/Madam

On behalf of the Hong Kong Investment Funds Association ("HKIFA"), I would like to express support to the Financial Services and the Treasury Bureau for undertaking the initiative to further reinforce the anti-money laundering ("AML") regime in Hong Kong. Attached please find the comments/questions of our members re the captioned consultation paper.

One general comment we wish to make is that as the legislation covers a whole range of industries, it would be difficult, if not impossible, to include detailed provisions that can address the unique characteristics of each industry. What we would like to suggest is for the legislation to prescribe the high level principles, ıd then the relevant authorities can, based on the specific operation models of the respective industries, come up with detailed guidelines/FAQs. For instance, for the fund management industry, guidance can be provided by SFC (e.g. in guidelines or FAQ) to facilitate implementation by the transfer agents, intermediaries (nominee companies) and/or other relevant parties within the value chain, etc. (to illustrate our point re the difficulty in coming up with an all-embracing piece of legislation, we provide in "note 1" below questions/issues that members have raised when they try to apply the proposed legislation to fund distribution.)

If you require any clarifications or wish to discuss this further, please feel free to contact Eric So.

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Note 1

Below are questions/issues that HKIFA members raised when they try to apply the proposed legislation to fund distribution:

- Fund managers may delegate certain parts of the fund management or advisory functions to other sub-managers or advisers. It seems that the definition of "customer" under the consultative proposals does not cover the scope of customer due diligence ("CDD") obligations of the sub-managers or advisers.

  Does an intermediary who, acting as agent, has a nominee account on behalf of its underlying customers be considered a "customer"?

  A carve-out should be provided to ensure that persons who are signatories to an account only by virtue of a power of attorney are not "customers" for the purpose of the legislation.

- Fund managers may rely on administrators to conduct CDD on their direct clients.
  For item 8(e) of Annex A, the exemption of an investment vehicle should not only apply to the fund managers, but to whoever is responsible for performing CDD in relation to the investors of the vehicle, such as administrators.

does not cover the scope of customer due diligence ("CDD") obligations of the sub-managers or advisers.

Does an intermediary who, acting as agent, has a nominee account on behalf of its underlying customers be considered a "customer"?

A carve-out should be provided to ensure that persons who are signatories to an account only by virtue of a power of attorney are not "customers" for the purpose of the legislation.

- Fund managers may rely on administrators to conduct CDD on their direct clients.
For item 8(e) of Annex A, the exemption of an investment vehicle should not only apply to the fund managers, but to whoever is responsible for performing CDD in relation to the investors of the vehicle, such as administrators.

According to item 10(e) of Annex A, FIs may rely on certain categories of third parties to conduct CDD. However, it appears that administrators do not fall within the definition of third parties.

- Under the categories of item 8 of Annex A, an FI may apply simplified due diligence and may not be required to conduct CDD on the beneficial owners of the customer. However, based on the proposal, it seems that where distributors apply for subscriptions and redemptions, and hold the funds on behalf of their clients in the name of their nominee companies, the nominee companies are not covered by the categories of customers subject to simplified due diligence.

It is a common practice for a FI, i.e., intermediary, to open a nominee account with a fund house under a nominee company name. Nonetheless, it is also almost the case that the nominee company is a wholly owned subsidiary of the intermediary or an affiliate of the intermediary. Maybe a viable approach is to allow an intermediary (a licensed corporation (bank or securities firm for example) in Hong Kong or overseas) to provide a letter of undertaking to confirm all such required CDD would have been performed by the respective intermediary even though the nominee company is the account holder.

Even if intermediaries nominee companies are covered, some of the provisions in item 10 for third party may not be appropriate for the nominees, especially for those regulated in other countries. A better approach maybe to use the provisions in the existing AML guidelines re financial or professional intermediaries as they are more tailored for intermediaries and also cover overseas intermediaries.

- Pursuant to item 8, an FI can conduct simplified due diligence on certain categories of regulated entities which have directly opened accounts with the FI (presumably including omnibus accounts?) without bearing the CDD liabilities of such regulated entities. Pursuant to item 10, an FI is liable for CDD liabilities of certain categories of regulated entities, which include those stated in item 8, even after it has obtained their consent of being relied on.

It seems that the difference between item 8 and item 10, to an investment fund distributor, is that the former applies to regulated entities which are direct account holders whereas the latter applies to nominees. At present, nominees having the status as associated entities under the SFO are governed by the AML guidance note issued by the SFC. Please clarify whether associated entities will be covered in item 8, i.e. simplified due diligence can be applied to them?

For risk management reason, an FI may include clauses of CDD responsibilities in its distribution agreement with certain SFC licensed corporations as holders of omnibus accounts. Please clarify whether such clauses would render the FI liable for CDD failure?

(End)

HKIFA members' feedback on the FSTB's consultation to gauge views on the detailed legislative proposals for the New Legislation on the Customer Due Diligence and Record-keeping Requirements for Financial Institutions and the Regulation of Remittance Agents and Money Changers

Consultation Paper Ref	Proposed Requirements or Rules	HKIFA members' feedback
Overall comments		As the legislation covers all industries, it would be difficult, if not impossible, to include detailed provisions that can address the unique characteristics of each industry. A better approach is that the legislation prescribes the high level principles, and then the relevant authorities can, based on the specific operation models of the respective industries, come up with detailed guidelines. For instance, for the fund management industry, guidance can be provided by SFC (e.g. in guidelines or FAQ) to facilitate implementation by the transfer agents, intermediaries (nominee companies) and/or other relevant parties within the value chain, etc.
Item 4(a) of Annex A	Verifying the identity of a customer	It should be made clear that assessment of whether there is a risk of money laundering or terrorist financing is done by the FI acting reasonably. As such, the words "(in the reasonable opinion of the FI)" should be added after the words "... there is little risk".
Item 5 of Annex A	• The CDD measure includes "identifying the beneficial owner, where relevant, and take reasonable measures to verify his identity..."	The industry needs more guidance in respect of what level of assurance is required and what satisfies the requirement of identifying the 'beneficial owner'. This should not be an absolute measurement as evidence may be difficult to obtain, e.g. BVI companies where a search cannot be done and the FI may need to rely on confirmation from the company. The regulator should adopt a pragmatic approach and let the industry understand clearly how far up the beneficiary chain are FIs expected to request due diligence information. The proposals allow an FI to determine the extent of CDD measures to be applied based

		on a risk-based approach. This approach will involve judgment and may vary from firm to firm. It is important that the regulator explains its expectations and details of supporting documents required.
	• FI should put in place a system to determine whether a person is PEP	The proposals do not mention the risk based element in the procedures. Suggest to add 'risk-based' before 'system'. The current SFC guidelines only require identification of PEPs if clients are from higher risk countries. Furthermore, the term "system" can mean computer system or manual monitoring system etc. Please clarify the definition. What are the measurements to ensure the effectiveness of the system? Please confirm and if possible, please define. Realistically, how can an FI get the information about all PEP in all countries in the world?
	• To decide "whether a person is a known close associate of a person, an FI needs only have regard to information which is in his possession or is publicly known"	If an FI does not possess the information about the close associate of a person AND the FI cannot find any information about the close associate of that person, will the FI be caught by the new legislation? How to define "publicly known"? Can an FI rely on the internet search? If a person is a known close associate of a person and it is so called "publicly known" and the FI cannot search such information from internet, will the FI be caught by the new legislation?

Paragraph 3.11 / Item 6 of Annex A	Reviewing existing customer identification records	It is important if the relevant detailed provisions elaborate on the extent to which FIs are required to review existing customer identification records. For instance, are FIs required to obtain from a customer replacement documents as and when any identity documents expire? If FIs have already verified the identity of the customer at the account opening stage and there is no change in the customer profile, it is questionable whether FIs should be required to obtain the new identity documents from the existing customer and replace the expired identity documents. It is onerous to expect FIs to ensure all identification documents are kept up-to-date as FIs have to rely on clients' volition to provide the updated information to the FIs. For example, passport copies expire every few years and FIs may not be able to obtain the new copy if client does not provide. Would the frequency of reviews be specified? The onus to update information should lie with the customer, requiring them to offer updated due diligence information if their circumstances have changed. Clarification should be provided as to who determines which customers fall within the "higher risk categories". Will the authorities provide guidance or will this simply be a judgment call on the part of the FI? In addition, it seems appropriate to consider whether a simplified on-going due diligence process could be adopted for low-risk existing customers such that FIs would not be required to collect up-to-date identity documents from such customers. A low-risk existing customer can be defined to mean a customer who has established a business relationship with a FI to buy and sell investment products using a settlement account in his/her own name (i.e. with no third-party payments) maintained with a regulated bank subject to the same CDD requirements.

Paragraph 3.11 / Item 7 of Annex A	On-going due diligence	Members do not believe that the 2-year approach as proposed (i.e. requiring FIs to apply CDD requirements to all existing accounts within 2 years upon the commencement of the legislation notwithstanding the non-occurrence of any of the relevant triggering events) should be adopted as there have been no triggering events suggesting any additional AML risk. In addition, the detailed provisions should provide guidance on the actions that are required to be taken by FIs for an existing customer who is un-contactable and/or refuses to provide identity documents as requested. Fund companies cannot mandatorily redeem a client's holdings and close the account if there is a contravention of the anti-money laundering provisions or refusal to provide due diligence information, although they have the contractual right to suspend redemptions. Will the new legislation make this a statutory right to empower fund managers to so doing? Furthermore, members believe it is important to provide more guidance on triggering events, namely "transactions of significance" and "substantial changes to customer documentation standards" as the requirement to conduct due diligence becomes mandatory when these events occur. Also, some query whether it is necessary to review the customer identification records within 2 years after the commencement of the legislation if FIs are comfortable that their existing CDD standards are in line with the requirements under the new legislation.
Item 8(b) of Annex A	Simplified due diligence	Please clarify what does "regulatory disclosure requirements" mean? Does it mean the Disclosure of Interest/Substantial Shareholdings Disclosure regime in various jurisdictions?

Item 8(c) of Annex A	Simplified due diligence	Please define "government related organization" and "public function". It is quite common that an organization incorporated in the mainland is a "government related organization" and part of its business may be so called "public functions". If part of a government related organization's functions is public function, can simplified CDD be used? How to draw the line: does the government must be at national level? Will the local government be accepted?
Item 9 of Annex A	Enhanced due diligence	It is important to provide guidance as to what constitutes "additional documents, data or information" and "supplementary measures" to verify the identity of customers not physically present. This would have the largest impact on E-Commerce business in which companies do not see the customer in person throughout the account opening or transaction process.
Paragraph 3.13 / Item 10 of Annex A	Third-party reliance	Under the proposal, FIs that rely on a third party to conduct CDD have the ultimate responsibility for undertaking the CDD obligations and any failure to comply with the CDD requirements. A defence should be introduced so that a FI would not be liable if it could be proved that the FI has taken reasonable steps to comply with the CDD requirements when relying on a third party to conduct CDD. Please clarify whether intermediaries who have nominee accounts with them are intended to be captured by this provision in cases where the intermediary acts as agent of the underlying customer. This is especially the case since fund managers do not have any contractual relationship or contact with the underlying customers of the intermediaries who deal through the nominee account. As a practical step going forward, if members are to rely on this 3rd party due diligence provision, they would probably need their

		intermediaries to sign a consent letter, in accordance with Item 10(a).
Paragraph 3.13 / Item 10(b) and (c) of Annex A	Third-party reliance	Under the proposal, FI needs to immediately obtain from the third party the CDD information and be satisfied that copies of identification data etc will be made available upon request without delay. In situations where Banking Secrecy laws (e.g. in Taiwan, Korea) prevent the third party from providing this information: ● Can FIs not rely on the provision provided under the current SFC guidelines where the third party falls under the permitted categories specified (as in 10(e)) and the FI is satisfied with the CDD measures undertaken by the third party, i.e. there is no need to drill down to the underlying customers? ● Please clarify and provide guidance as to what flexibility will be allowed or is it expected that FIs have to freeze accounts and/or cease to open accounts?
Item 10(e)(ii) of Annex A	(C): "subject to requirements equivalent to ..." and (D): "supervised for compliance with those requirements"	Please clarify who these provisions are directed at.
Item 10(e)(iii) of Annex A	(C): "subject to requirements equivalent ..." and (D): "supervised for compliance with ..."	Please clarify who these provisions are directed at.
Item 15(b) of Annex A	Record retention	The record retention requirement in this section increases from 5 to 6 years. Is this retrospective or only count from the effective date?

Item 17 of Annex A	Responsibilities of "officer"	The current definition of "officer" is very broad, especially with the usage of the generic term "manager". As the definition of "officer" has a direct impact on who in the organization will attract liability for a contravention of the anti-money laundering provisions, it is important to clearly define the scope of the definition. Preferably, it should be tightened up to be more akin to the "responsible officer" definition under the SFO.
Item 22 of Annex A	3 tiers of criminal offences	Please explain the purpose of the "3 tiers of criminal offences". It is not clear whether the 3 tiers are designed to attract different levels of criminal liability.
Item 22(a) of Annex A	Enforcing the inspection and investigation powers of the relevant authority	Members do not agree to the inclusion of a "failure to comply with the requirements imposed by the relevant authority without reasonable excuse" as an act that attracts criminal liability. This provision does not encompass any mental element on the part of the perpetrator to willfully contravene or to be recklessly indifferent. Because there is considerable subjective risk assessment on the part of FI in respect of assessing whether a transaction, in the opinion of the FI, constitutes a contravention of the anti-money laundering provisions, it is inappropriate for such FI to attract criminal liability if subsequently, such a transaction is found to be a contravention. If Item 22(a) must be included in the criminal liability provisions, guidance should be provided as to what would constitute "reasonable excuse". Is it sufficient that the FI has set up a compliance system designed to comply with the legislation and prevent money laundering? Also, if the FI, in implementing such a compliance system, had reviewed the transaction and on a risk-based analysis genuinely considered the transaction not to be suspicious, would this be enough to constitute a "reasonable excuse"?

Item 22(c) of Annex A	Enforcing the inspection and investigation powers of the relevant authority	"failure to comply with a requirement" should not be an offence on its own. It should contain elements of false and misleading information or intent to defraud in order to become a criminal offence. Therefore (c) should only be an offence if Item 22(b) also exists.
Item 60 of Annex A	Appealing to the Court of Appeal	Members would like to confirm that a party that is dissatisfied with a decision of the tribunal will be able to appeal to the Court of Appeal based on the merits of the case (as opposed to only being able to appeal on errors of law or procedure).

(End)