

**Bills Committee on  
Anti-money Laundering and Counter-Terrorist Financing  
(Financial Institutions) Bill**

**Response to Hong Kong Association of Banks' Submission**

This paper reports on the Administration's response to the written submission of the Hong Kong Association of Banks ("HKAB") on the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill ("the Bill") provided to the Bills Committee on 21 January 2011 (paper no. CB(1)1196/10-11(01)) and amendments proposed to be made to the Bill as agreed after discussion with HKAB.

**Major Amendments Proposed to be Made to the Bill**

2. Following the Bills Committee meeting on 17 February 2011 which went through HKAB's submission, the Administration and the Hong Kong Monetary Authority ("HKMA") met with representatives from HKAB on a number of occasions to discuss the latter's submission in detail. At these meetings, we explained the rationale behind the provisions related to the various issues raised in HKAB's submission, the prevailing requirements of the Financial Action Task Force ("FATF") and the proposed obligations under the Bill in the light of the current regulatory regime being put in place through the administrative guidelines issued by HKMA. HKAB representatives also provided useful comments on the operation of the proposed statutory regime from the perspectives of their practical experience on customer interface, internal risk controls and compliance management.

3. We are pleased to report that these discussions have resulted in consensus amongst the concerned parties on many of the key issues covered in HKAB's submission. We have shared the draft committee-stage amendments to the Bill with HKAB and they were agreeable to the draft. The Administration's response to the major issues raised in HKAB's submission are summarized at **Annex**. The following highlights the key issues agreed and the proposed committee-stage amendments that the Administration intends to take forward:

#### *Risk-based Approach (“RBA”)*

4. HKAB proposed that the Bill should be suitably modified to better reflect the principle of RBA. We explained that RBA has always been an important underlying principle for the FATF requirements in respect of customer due diligence and the various sections in the Bill stipulating the specific requirements in relation to business relationships or customers of different risk profiles seek to reflect the important RBA principle. On this premise and taking into account HKAB’s views, we agree to propose amendments to sections 12(9) and (10) and 15 of Schedule 2 to provide for greater flexibility for financial institutions to determine the additional measures required under the special requirements in accordance with the money laundering/ terrorist financing risk of the customer.

#### *Definition of Beneficial Owner (“BO”)*

5. HKAB requested that the threshold in the definition of BO (currently defined in the Bill as owning or controlling 10% or more shareholding or voting rights of a customer or exercising ultimate control over the customer) should be relaxed to 25%, in line with that adopted in EU and Australia. They considered that the 10% threshold will commercially disadvantage financial institutions in Hong Kong and create substantial practical difficulties. We explained to HKAB that the BO threshold of 10% for identification and verification is currently provided under HKMA’s guidelines and we note that banks has had no major difficulty in complying with this requirement. As the 10% BO threshold has been in operation for a long time with no specific compliance problem, the Administration does not see a strong ground for substantial relaxation. On the other hand, having regard to the overseas examples quoted by HKAB and their concerns with operational difficulty, we agreed with HKAB’s suggestion that, in order to mitigate the difficulty in the verification process, financial institutions should be allowed to conduct verification on BO according to the 25% threshold if the business relationships and customers are assessed not to be of high risk.

#### *Criminal Liability of Employees of Financial Institutions*

6. In response to HKAB’s concern that front-line staff acting in accordance with the advice from the compliance officer or other

responsible officer who has made a wrong judgment leading to a breach of the relevant statutory requirements should not be subject to criminal liability, we proposed to add a statutory defence for employees who have acted in accordance with the policy and procedure established by his employer for complying with the statutory requirements under the Bill.

7. We have also agreed to a number of HKAB's drafting comments to the Bill. The changes that the Administration will make are highlighted in items 4, 6 and 11-17 of the **Annex**.

### **Other Issues Discussed**

8. HKAB also suggested aligning or merging the requirements in relation to "wire transfers" under section 12 of Schedule 2 and those in relation to "remittance transactions" under section 13 of Schedule 2, noting that wire transfers are usually conducted by banks while remittance transactions are usually conducted by money service operators. HKAB expressed concern that the different requirements applicable to wire transfers and remittances might put banks at a competitive disadvantage. We have explained that the requirement on wire transfers covered under section 12 of Schedule 2 seeks to fulfill specific FATF requirements on wire transfers which are explicitly defined to cover transfers carried out by electronic means. Noting that the many remittance transactions are not conducted through electronic means, we have put in place specific obligations for such transactions under section 13 of Schedule 2 which are modeled on the current requirements under the Organized and Serious Crimes Ordinance (Cap 455). In fact, certain obligations for wire transfers set out under section 12 of Schedule 2, such as including specified originator's information in the message or payment form accompanying the wire transfer, are not applicable to remittance transactions which are not carried out through electronic means. Aligning sections 12 and 13 of Schedule 2 will create undue compliance hardship for financial institutions conducting such transactions.

9. HKAB also suggested that a longer transitional period should be allowed for financial institutions to make necessary preparations before the commencement of the legislation. We explained to HKAB that the commencement date of 1 April 2012 was determined with a view to ensuring that the substantial improvement to our AML regime resulting

from the Bill will be in place before Hong Kong seeks removal from the FATF follow-up process in mid-2102, in accordance with FATF's timetable. HKMA has assured HKAB that in the run-up to the commencement of the legislation, they will closely liaise with HKAB in preparing the guidelines to be issued under clause 7(1) of the Bill to facilitate banks' compliance with the statutory requirements under Schedule 2 of the Bill and will consult the industry on the guidelines as soon as possible after the passage of the Bill. Noting that the statutory obligations in the Bill are essentially similar to those provided in the current guidelines applicable to banks, HKMA envisage that banks should not encounter major difficulties in future compliance.

**Financial Services and the Treasury Bureau**  
**25 May 2011**

**Major issues raised by HKAB and the Administration's Response**

<b>Issues raised by HKAB</b>	<b>Administration's response</b>	<b>Amendments Proposed</b>
<b>1. Risk-based approach</b>		
HKAB proposed that amendments should be made to the Bill to better reflect the principle of a risk-based approach (RBA).	We agree to amend sections 12 and 15 of Schedule 2 to allow more flexibility to financial institutions ("FIs") to determine the additional measures required having regard to the risk involved.	Changes will be made to section 15 of Schedule 2 to give FIs flexibility to either take reasonable measures to establish the relevant customer's or beneficial owner's source of wealth and source of funds; or take additional measures to mitigate the risk of money laundering and terrorist financing ("ML/TF") involved.  See item 6 below for amendments to section 12 of Schedule 2.
<b>2. Implementation of the Legislation</b>		
HKAB remarked that (i) the consultation process for the guidelines to be issued under clause 7 of the Bill should commence as soon as possible; (ii) the operation of the legislation should commence at least 12 months after the passage of the Bill and all necessary supporting guidelines are in final form; (iii) the Bill and supporting guidelines	The proposed commencement date of 1 April 2012 was set to ensure that substantial improvement to the anti-money laundering /counter financing of terrorism regime resulting from the Bill will be in place before Hong Kong seeks removal from the FATF follow-up process in mid-2012, in accordance with FATF's timetable.	No amendment will be made.

<p>should commence on the same date; and (iv) FSTB and relevant authorities undertake a coordinated approach to educate the public before commencement of the Bill.</p>	<p>It should be noted that the obligations for financial institutions under the Bill are essentially similar to those provided in the current guidelines issued by HKMA. Preparation of the guidelines to be issued under clause 7 of the Bill is underway. Industry consultation on the draft guidelines will be conducted as soon as possible after the passage of the Bill. Reasonable time will be allowed for the industry to comment on the draft guidelines. Suitable publicity will be launched to enhance the public awareness of the new requirements before the commencement of the legislation.</p>	
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**3. Beneficial Ownership ('BO') Threshold**

<p>HKAB requested that the BO threshold should be relaxed to 25%, in line with that adopted in EU and Australia.</p>	<p>The requirement to identify and verify BO according to the 10% threshold is an existing requirement in HKMA's guidelines. So far, there has not been specific compliance problem. Noting the overseas examples quoted by HKAB and operational concerns raised by HKAB, we agree to allow FIs to</p>	<p>Add a new provision under section 2 of Schedule 2 to allow FIs to only verify BOs with a shareholding (or other form of control) of 25% or more, except when there is a high risk of ML/TF.</p>
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	verify the identities of BO with a shareholding (or other form of control) of 25% or more under section 2(b) of Schedule 2, except when there is a high risk of ML/TF.	
<b>4. Beneficial ownership in relation to a trust</b>		
HKAB suggested that as the FIs' customer would technically be the trustee acting on behalf of a trust, paragraph (c) of the definition of BO as contained in Schedule 2 of the Bill should be amended.	We accept HKAB's suggestion. Arising from the suggested change, we also note that the use of the word 'customer' in the definition of BO may restrict its application where intermediary layers in the control structure contain a corporation, partnership or trust, for example, a corporation owned by a trust or partnership that are not themselves <i>customers</i> of the FI. As such, we will make necessary changes to tidy up the drafting, drawing reference to the approach adopted in some overseas jurisdictions.	We will amend paragraphs (a), (b), (c) and (d) of the definition of BO under section 1(1) of Schedule 2 to delete the references to "customer".
<b>5. Wire transfers &amp; Remittance Transactions</b>		
HKAB considered that the requirements in relation to "wire transfers" and "remittance transactions" should be aligned and merged.	The statutory obligation in relation to "wire transfers" was crafted in accordance with the FATF requirements, which only covers transfers carried out by electronic means. It	No amendment will be made.

	<p>does not cover remittance transactions. Special requirements for remittance transactions are separately covered under section 13 of Schedule 2, which are modeled on the current requirements under the Organized and Serious Crimes Ordinance (Cap 455). In fact, key obligations set out under section 12 of Schedule 2, which includes including specified originator's information in the message or payment form accompanying the wire transfer do not apply to remittance transactions.</p>	
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**6. Post Transaction Monitoring and Risk Based Approach**

<p>HKAB remarked that banks may not be able to screen all incoming wire transfers with incomplete or meaningless information and take the required measures under section 12 of Schedule 2 as such transfers are usually conducted in real time.</p>	<p>We note the practical difficulties arising from section 12 of Schedule 2 in view of the nature of wire transfers. We will make suitable amendments.</p>	<p>We will amend section 12(9) and 12(10) of Schedule 2 to replace the requirement to decide whether to decline the transfer with an obligation to consider restricting or terminating its business relationship with the ordering institution or taking reasonable measures to mitigate any ML/TF risks involved as soon as reasonably practicable.</p> <p>We will add a new</p>
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		<p>paragraph in section 12(9) &amp; 12(10) of Schedule 2 requiring FIs to take reasonable measures to mitigate any ML/TF risks involved as soon as reasonably practicable after becoming aware of that information accompanying a wire transfer is incomplete or meaningless.</p>
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**7. Ongoing Due Diligence**

<p>The Bill requires on-going due diligence on customers and makes separate provision for pre-existing customers (i.e. where the relationship pre-dates the bill). In practical terms, CDD for pre-existing customers has to be brought up to the standard required in the Bill upon triggering events. HKAB submitted that these should be merged.</p>	<p>HKAB noted our explanation that these requirements, though linked, are different requirements stipulated by FATF. On-going monitoring applies to all customers and includes transaction monitoring. On the other hand, since CDD in respect of pre-existing customers may not have been undertaken up to the standards required under the Bill when the business relationship was established, it is necessary to put in place a requirement to remediate the position upon triggering events. The two sets of requirements cannot be merged.</p>	<p>No amendment will be made.</p>
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<b>8. Correspondent Banking</b>		
<p>HKAB considered the correspondent banking-related remediation requirements in section 7 of Schedule 2 unnecessary as stringent due diligence requirements has already been imposed by the HKMA guidelines.</p>	<p>Since existing corresponding banking relationships are already subject to the requirements under HKMA’s guidelines. HKMA does not foresee any major compliance issue in respect of section 7 of Schedule 2. Assurance has been provided to HKAB that if a bank has conducted all necessary due diligence on a correspondent bank, this would be sufficient to meet the requirements under section 7 of Schedule 2. HKMA will provide guidance on how to comply with the obligation to document each parties’ responsibilities in the guidelines to be issued under the Bill.</p>	<p>No amendment will be made.</p>
<b>9. Extraterritorial Application</b>		
<p>HKAB requested that the requirements related to overseas branches and subsidiaries should be confined to “<u>majority owned</u> subsidiary undertakings” of the FI.</p>	<p>We explained that the definition of “subsidiary undertakings” as provided under section 22(3) of Schedule 2 which refers to the Companies Ordinance already includes the element of majority ownership. As the subsidiaries in question are owned by the FI, we do not foresee that the</p>	<p>No amendment will be made.</p>

	requirement will cause any compliance concerns.	
<b>10. Regulation of Money Service Operators (“MSOs”)</b>		
HKAB welcomes the new regulation of MSOs under the Bill while advocating for a more robust approach to the regulation.	The licensing regime for MSOs under the Bill is a marked improvement to the current regime provided for the sector under the Organized and Serious Crimes Ordinance. We consider that the strength of the proposed regulatory regime is appropriate having regard to the circumstances of the industry and the FATF’s requirements.	No amendment will be made.
<b>11. Pre-existing customers</b>		
HKAB submitted that section 6(1)(b) of Schedule 2 represented a requirement to remediate pre-existing accounts when the Bill comes into effect as banks might be seen as having been aware of the fact that they lacked sufficient information about the customer having regard to the current documentation standards once the legislation commences operation.	It is the FATF’s requirement and our intention that FIs are required to apply CDD on existing customers only upon the occurrence of a triggering event. We will revise section 6 of Schedule 2 to ensure that our intent is properly reflected.	We will delete section 6(1)(b) of Schedule 2.
<b>12. Simplified Due Diligence (‘SDD’)</b>		
HKAB suggested	We agreed with HKAB’s	We will delete section 4(5)

<p>clarifying the requirement that where a person falling under section 4(2) of Schedule 2 forms part of the ownership chain of a customer, the FI does not need to go beyond that person in identifying the BO. This is consistent with the current HKMA guidelines</p>	<p>suggestion.</p>	<p>of Schedule 2 and add a new paragraph in section 4 to provide that FIs are not required to carry out the measures set out in section 2(b) of Schedule 2 in respect of a customer not falling within sub-section 4(2) that has in its beneficial ownership chain an entity that falls within that subsection.</p>
<p><b>13. Definition of Pension Scheme</b></p>		
<p>HKAB sought clarification on whether the reference to “pension scheme” under section 4(4)(b) of Schedule 2 extends to “provident, retirement or superannuation scheme” as provided under section 4(4)(a) of Schedule 2.</p>	<p>We agree to clarify that section 4(4)(b) also covers provident, retirement or superannuation scheme.</p>	<p>We will amend section 4(4)(b) of Schedule 2 to also cover provident, retirement or superannuation scheme.</p>
<p><b>14. Record-keeping</b></p>		
<p>HKAB’s suggested that the requirement under section 20(6) of Schedule 2 in relation to intermediaries should be moved to section 18 of Schedule 2(carrying out CDD measures by means of intermediaries) so that an FI’s obligations relating to intermediaries are grouped thematically and easy to locate.</p>	<p>We agreed with HKAB’s suggestion.</p>	<p>The requirement under section 20(6) of Schedule 2 in relation to intermediaries will be moved to section 18 of Schedule 2.</p>

<b>15. Customer not physically present for identification purpose</b>		
HKAB submitted that the requirement of “obtaining from appropriate persons or authorities certificates certifying that the documents provided by the customer are true copies of the original” may not be practical in all cases. Section 9 of Schedule 2 as currently drafted does not provide the flexibility currently provided under the HKMA’s guidelines.	We agreed with HKAB’s suggestion.	We will delete the later part of section 9(b) of Schedule 2 such that section 9(b) reads “taking supplementary measures to verify all the information provided by the customer”.
<b>16. Verification of Source of Wealth/ Funds - Politically Exposed Persons (‘PEPs’)</b>		
HKAB indicated that section 10(1)(b) and (2)(b) should only require FIs to take “reasonable” measures instead of “adequate” measures to establish the source of wealth and source of funds of PEPs, which is the term used in the FATF methodology.	We agreed with HKAB’s suggestion.	Replace “adequate” with “reasonable” in section 10(1)(b) and 10(2)(b).
<b>17. Criminal Offence under Clause 5(7)</b>		
HKAB expressed concern that front-line staff acting in accordance with the advice or instructions from the Compliance Officer or other responsible officer	To provide reassurance, a statutory defence for employees of an FI or persons employed to work for an FI has been added under clause 5.	Add a statutory defence under clause 5 for an employee of an FI or a person employed to work for an FI who has acted in accordance with the FI’s

<p>who has made a wrong judgment leading to a breach of the relevant statutory requirements should not be subject to the criminal offence under clause 5(7).</p>		<p>established policies and procedures for the purpose of ensuring compliance with the relevant specified provision.</p>
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