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Panel on Financial Affairs

Meeting on 29 November 2010

**Background brief on
proposal to extend a supernumerary directorate post to
coordinate anti-money laundering matters**

Purpose

This paper provides background information on the Administration's proposal to extend a supernumerary directorate post in the Financial Services Branch (FSB) of the Financial Services and the Treasury Bureau (FSTB) to coordinate anti-money laundering (AML¹) and counter financing of terrorism matters. The paper also summarizes the concerns/views expressed by Members when the proposal to create the supernumerary directorate post was discussed by the Panel on Financial Affairs (FA Panel) and the Establishment Subcommittee.

Background

Mutual evaluation conducted by the Financial Action Task Force

2. The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 with 36 member jurisdictions. The FATF Recommendations are recognized by the International Monetary Fund and the World Bank as the international anti-money laundering (AML) standards. Having joined FATF in 1990, Hong Kong is obliged to implement FATF's requirements and is subject to a process of Mutual Evaluation by FATF to monitor progress made by jurisdictions in implementing FATF's requirements.

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

3. FATF conducted a Mutual Evaluation on Hong Kong in 2007-08 to assess the compliance of Hong Kong's AML regime with FATF's Recommendations which are the prevailing international AML standards. Whilst FATF recognized the strengths of Hong Kong's AML regime, they also identified, inter alia, the following issues -

- (a) the lack of a statutory backing for customer due diligence and record-keeping requirements;
- (b) the lack of appropriate sanctions for breach of the above requirements;
- (c) the limited range of regulators' supervisory and enforcement powers; and
- (d) the absence of an AML regulatory regime for money service operators (viz. remittance agents and money changers).

4. Based on the results of the Mutual Evaluation, FATF resolved that Hong Kong should be put on a regular follow-up process and be required to report to FATF on a regular basis on improvement actions taken or planned. Hong Kong was expected to submit the first progress report in June 2010 and to have addressed the above issues and seek removal from the follow-up process about three to four years after the Mutual Evaluation.

Organizational arrangements within the Administration for the AML work

5. The Administration set up the Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism (CCC) in April 2008 to provide steer on the strategic directions for the enhancement of the AML regime in Hong Kong and coordinate internal efforts in following up the FATF recommendations. The CCC is chaired by the Financial Secretary 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.

6. Before October 2008, the Narcotics Division (ND) of the Security Bureau (SB) was in charge of the overall coordination for AML policies within the Administration as an ancillary to its anti-drug efforts. As the trends and typologies of money laundering and terrorist financing activities had been fast changing, and the modern financial systems were facing increasing threats of

being abused by criminals for money laundering and other illicit purposes, the CCC decided that FSB should take over from ND the overall coordinating role for AML policies, while ND would continue to deal with the AML matters relating to non-financial sectors under FSB's coordination.

Creation of one supernumerary D2 post in FSB for the AML work

7. Upon taking up the overall coordination role over AML policies in October 2008, FSB immediately commenced preparation for the new AML legislation. The then schedule of the Administration was to complete the legislative exercise substantially by around June 2010 and to have the enhanced regulatory framework ready for operation by January 2011. In order that the policy formulation and legislative work could commence as soon as possible, the Administration created a supernumerary Administrative Officer Staff Grade C (AOSGC) (D2) post in FSB in November 2008 under delegated authority.

8. On 21 November 2008, the Administration briefed the FA Panel on the proposal to create a supernumerary AOSGC (D2) post in FSB for two years to undertake follow-up actions in response to FATF's recommendations. The proposal was endorsed by the Establishment Subcommittee on 14 January 2009 and approved by the Finance Committee on 13 February 2009.

Major views and concerns of Members

9. During the discussions of the staffing proposal at the FA Panel and the Establishment Subcommittee, some Members considered that the workload relating to AML did not justify the creation of a supernumerary AOSGC post for two years. The Members pointed out that when ND was in charge of the overall coordination for AML coordination and policies, the Principal Assistant Secretary (a AOSGC post) concerned had to undertake other duties in addition to the AML duties. They also queried why the existing directorate officers in FSB could not absorb the AML work.

10. Some other Members were supportive of the staffing proposal. They considered it necessary to provide adequate staffing support to enable timely follow-up on FATF's recommendations, since enhancing the AML regime of Hong Kong was part of Hong Kong's international obligations and was crucial to maintaining Hong Kong's international financial centre. They also considered it appropriate for FSB to take over the overall coordination of AML policies from ND, in view of the trends and typologies of money laundering and terrorist financing activities in recent years.

Recent developments

11. Following two rounds of public consultation in July 2009 and December 2009 on the legislative proposals to enhance Hong Kong's AML regulatory regime, the Administration introduced the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill into the Legislative Council on 10 November 2010. The object of the Bill is to provide a legislative framework to implement the requirements of the FATF to -

- (a) impose customer due diligence requirements and record-keeping requirements on specified financial institutions and to provide for the powers of the relevant authorities to supervise compliance with those requirements;
- (b) regulate the operation of money changing and remittance service and licensing of money service operators and to provide for the licensing of operators of these services; and
- (c) establish the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal to review certain decisions of the relevant authorities made under the Bill.

12. The House Committee decided on 12 November 2010 that a Bills Committee be formed to scrutinize the Bill.

13. The Administration will brief the FA Panel on the proposal to extend the supernumerary AOSGC post in FSB to complete the legislative exercise to enhance the AML regulatory regime for financial institutions. The Administration plans to submit the staffing proposal to the Establishment Subcommittee and the Finance Committee on 5 and 28 January 2011 respectively.

References

14. The relevant papers are available at the following links:

The Administration's paper for the FA Panel meeting on 21 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa1121cb1-179-4-e.pdf>

Minutes of FA Panel meeting on 21 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/fa/minutes/fa20081121.pdf>

Administration's paper for the Establishment Subcommittee meeting on 14 January 2009

<http://www.legco.gov.hk/yr08-09/english/fc/esc/papers/e08-13e.pdf>

Minutes of Establishment Subcommittee meeting on 14 January 2009

<http://www.legco.gov.hk/yr08-09/english/fc/esc/minutes/esc20090114.pdf>

Papers relevant to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill

<http://www.legco.gov.hk/yr10-11/english/bc/bc01/general/bc01.htm>

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Summary of the Administration's response to deputations' concerns/views at the meeting of the Panel on Financial Affairs on 24 May 2010

- (a) While the existing CDD and record-keeping requirements for financial institutions were now provided for in guidelines issued by the financial regulators, i.e. HKMA, SFC and the Insurance Authority (IA), the lack of statutory backing and appropriate sanctions for such requirements and the absence of an AML regulatory regime for RAMCs in Hong Kong were highlighted in the mutual evaluation report published by the Financial Action Task Force (FATF), the international AML standard setter, as major areas that require improvement. Hong Kong was required to take follow-up actions to substantially improve these areas by 2011. The proposed legislation sought to enhance our AML regime to better align with the international standards which helped to maintain Hong Kong's status as an international financial centre.
- (b) Two consultation exercises on the legislative proposals were conducted in July and December 2009 respectively. The detailed legislative proposals set out in the consultation document for the second-round consultation were drawn up after taking into account the views of the industry.
- (c) It was proposed that the CDD measures under the new legislation would only apply to financial institutions. Separately, the Security Bureau, in consultation with the relevant stakeholders, was considering means to enhance the AML regulation for non-financial sectors, including the real estate agents. At present, banks and lawyers involved in property transactions had to comply with CDD and record-keeping requirements set out in the guidelines issued by the HKMA and Law Society.
- (d) On-going CDD and remediation of existing accounts were two different requirements. For ongoing CDD, financial institutions were required to monitor the transactions of their existing customers for risk management purpose and ensure documents obtained for identification purpose were up to date. Since the legislative proposals would not have retrospective effect, the Administration proposed that financial institutions should conduct fresh CDD according to the new legislation for business relationships entered into prior to the commencement of the legislation upon the occurrence of triggering events to be specified in the legislation such as an unusual or suspicious transaction. The Administration noted the concerns raised by the industry on the proposed requirement on

remediation of existing accounts, particularly on the administrative burden arising from the requirement for updating sizeable number of dormant accounts. The Administration would critically review the concerned proposal.

- (e) After enactment of the relevant AML legislation, the regulatory authorities concerned would issue draft guidelines to facilitate compliance by the financial institutions for industry consultation. The guidelines would need to be ready before the implementation for the new legislation.
- (f) As regards the concern raised by the securities sector on the requirements on wire transfers, it should be noted that the requirement was meant to apply to financial institutions which carried out wire transfers on behalf of their customers. Securities companies transferring funds from their own accounts for settlement with their customers would not be covered.
- (g) There would be a reasonable lead time between the enactment and commencement of the legislation to allow financial institutions to enhance their internal control system and procedures for compliance with the new legislation. The relevant regulatory authorities would also organize workshops and seminars to facilitate financial institutions to familiarize with the new legislation.
- (h) The requirement to conduct CDD on beneficial owners, including the major shareholders of a company, i.e. those holding 10% or more of the shares or voting rights of a company was an important preventive measure and could not be removed for compliance with the international standards. Under the legislative proposal, a financial institution would be allowed to conduct SDD on its customers if the latter were also financial institutions covered under the new legislation. In future, since licensed RAMCs would be regulated for AML purpose, the AML risks arising from business relationships with these businesses would be properly managed. It was believed that banks would be more forthcoming in establishing/maintaining business relationship with licensed RAMCs. The same situation also applied to business relationship between licensed RAMCs.
- (i) In relation to the concern about the requirement for financial institutions to provide information to the regulatory authorities in an investigation under the legislation, it should be noted that the relevant arrangement were modeled on the SFO and the exercise of such investigation powers by the relevant authorities would generally be confined to their

respective regulated entities, i.e. financial institutions, except in certain circumstances as specified in the future legislation. Different from other law enforcement agencies, the relevant authorities did not have the wide range of criminal investigation powers to probe into regulatory breaches under AML contexts which usually involved concealment of the identity of the customers or sources or flow of funds. The power to compel information by relevant authorities was essential to ensure effective enforcement. There would be statutory safeguards for the use of self-incriminating information under the legislation which would specifically prohibit the use of such evidence for criminal prosecution against the party concerned.