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Paper for the House Committee meeting on 27 February 2015

**Report of the Subcommittee on Anti-Money Laundering and
Counter-Terrorist Financing (Financial Institutions) Ordinance
(Amendment of Schedule 2) Notice 2015**

Purpose

This paper reports on the deliberations of the Subcommittee on Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Amendment of Schedule 2) Notice 2015 (L.N. 16 of 2015) ("the Subcommittee").

Background

2. The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO") came into operation on 1 April 2012. It stipulates a set of customer due diligence ("CDD") requirements and record-keeping measures to be undertaken by financial institutions ("FI")¹, in line with the recommendations of the Financial Action Task Force² ("FATF"). Such requirements are detailed in Schedule 2 to AMLO³. Section 6 of AMLO provides that the Secretary for Financial Services and the Treasury ("SFST") may, by notice published in the Gazette, amend Schedule 2.

3. Section 18 of Schedule 2 to AMLO permits an FI to carry out any CDD measure by means of an intermediary specified in subsection (3) if –

¹ According to Part 2 of Schedule 1 to AMLO, "financial institutions" refer to (a) authorized institutions under the Banking Ordinance; (b) licensed corporations under the Securities and Futures Ordinance; (c) authorized insurers, appointed insurance agents, and authorized insurance brokers under the Insurance Companies Ordinance; (d) licensed money service operators (i.e. money changers and remittance agents); or (e) the Postmaster General.

² Established in 1989, the FATF was the standard-setting body for the global efforts in anti-money laundering and counter-terrorist financing. Its recommendations are recognized by the International Monetary Fund and the World Bank as the international AML/CFT standards. Hong Kong has been a member jurisdiction of FATF since 1990.

³ Under the CDD measures, FIs are required to identify and verify the identity of customers and beneficial owners of legal persons and arrangements, understand the control and ownership structure, and obtain information on the intended nature of the business, etc.

- (a) the intermediary consents in writing to be the financial institution's intermediary; and
- (b) the financial institution is satisfied that the intermediary will on request provide a copy of any document, or a record of any data or information, obtained by the intermediary in the course of carrying out the CDD measure without delay.

4. Section 18(3) of the same Schedule specifies the relevant "intermediary" whom a financial institution may rely on to complete the statutory CDD measures. The intermediary specified in section 18(3)(a) ("specified intermediary") is any of the following persons who are able to satisfy the FI that they have adequate procedures in place to prevent money laundering and terrorist financing –

- (i) a solicitor practising in Hong Kong;
- (ii) a certified public accountant practising in Hong Kong;
- (iii) a current member of The Hong Kong Institute of Chartered Secretaries practising in Hong Kong; and
- (iv) a trust company registered under Part 8 of the Trustee Ordinance (Cap. 29) carrying on trust business in Hong Kong.

5. Section 18(5) provides that section 18(3)(a) will expire at the end of three years beginning on the date of commencement of AMLO (i.e. after 31 March 2015). According to the Administration, the interim provision is intended to provide for the transition of the four sectors mentioned in paragraph 4 above to a statutory anti-money laundering and counter-terrorist financing ("AML/CFT") regime on par with the same applying to FIs in accordance with AMLO⁴.

The Notice

6. In the light of the expiration of section 18(3)(a) of Schedule 2 to AMLO after 31 March 2015, SFST has made Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Amendment of Schedule 2) Notice 2015 ("the Notice") under section 6 of AMLO to amend section 18(5) of Schedule 2 to AMLO. The Notice seeks to provide for the extension of the expiry date of section 18(3)(a) for three more years up to 31 March 2018 to enable FIs to continue relying

⁴ Paragraph 5 of the Legislative Council Brief on "Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Amendment of Schedule 2) Notice 2015" issued by the Administration on 21 January 2015.

on relevant specified intermediaries to carry out CDD measures under AMLO. The Notice was gazetted on 23 January 2015 and tabled at the Legislative Council ("LegCo") of 28 January 2015. Subject to negative vetting by the LegCo, the relevant provisions will come into operation on 1 April 2015.

The Subcommittee

7. At the House Committee meeting held on 30 January 2015, Members agreed to form a subcommittee to study the Notice. The membership list of the Subcommittee is in **Appendix**.

8. Under the chairmanship of Hon CHAN Kam-lam, the Subcommittee held one meeting on 10 February 2015 with the Administration to examine the Notice.

9. To allow sufficient time for the Subcommittee to compile a report to the House Committee, a resolution was passed at the Council meeting of 25 February 2015 to extend the period for LegCo's scrutiny of the Notice to 18 March 2015.

Deliberations of the Subcommittee

10. The Subcommittee supports the extension of the expiry date of section 18(3)(a) of Schedule 2 to AMLO so that relevant FIs may continue to carry out CDD measures by means of a relevant intermediary for three more years up to 31 March 2018. During the scrutiny of the Notice, the Subcommittee has discussed issues regarding the regulation of specified intermediaries, the respective legal liabilities of FIs and specified intermediaries and various related matters.

Regulation of CDD and record-keeping requirements for specified intermediaries

11. Members note that the interim arrangement set out in section 18(3)(a) of Schedule 2 to AMLO to permit an FI to carry out any CDD measure by means of an intermediary under specified conditions is meant to allow time for the relevant four sectors (i.e. the designated non-financial businesses and professions ("DNFBPs") in FATF's parlance) to be regulated by a statutory AML/CFT regime as required by FATF. Members consider that an effective statutory AML/CFT regulatory regime for the relevant professional sectors that aligns with the international AML/CFT standards set by FATF would be conducive to maintaining Hong Kong's status as an international financial centre. The Subcommittee has enquired about the time-frame for the transition of DNFBPs to a statutory AML/CFT regulatory regime and asked the Administration to formulate implementation plan in the light of development in other jurisdictions.

12. The Administration has explained that the CDD requirements under AMLO apply to the financial sector only and does not cover AML/CFT regulation for DNFBPs. As the implementation of the FATF recommendations regarding the regulation of CDD and record-keeping requirements for DNFBPs is evolving in various financial centres, the Administration considers it prudent to extend the interim arrangement for further three years until 31 March 2018 to continue to allow FIs to conduct CDD measures by means of intermediaries under specified conditions where necessary. The extension will allow the Administration more time to study and assess the developments in comparable markets and to consider when and how to bring DNFBP sectors into a statutory CDD and record-keeping regime as per the latest FATF recommendations. The Administration would consider the way forward in consultation with the relevant sectors having regard to the fourth round of mutual evaluation on Hong Kong by FATF which is expected to take place around late 2017/early 2018. In the meantime, the Administration will closely monitor compliance in other jurisdictions and continue to work with the relevant professional sectors to enhance and strengthen their AML/CFT compliance through, among other measures, the promulgation and implementation of relevant guidance documents by the professional bodies, and other forms of professional development and education work.

Legal liability for non-compliance with CDD requirements under AMLO

13. Members note that, under section 18(2) of Schedule 2 to AMLO, an FI that carries out a CDD measure by means of an intermediary remains liable for a failure to carry out the CDD requirements under AMLO. Mr James TO considers it unfair that FIs should continue to be held liable for the failure of their intermediaries in carrying out the CDD requirements upon the transition of the DNFBPs to the AML/CFT regulatory regime in the future. Mr CHUNG Kwok-pan shares Mr TO's view that the intermediaries specified in section 18(3)(a) should be liable for their own non-compliance after their transition to the AML/CFT regime. Mr TO suggests that the Administration should consider relieving FIs from the legal liability for their intermediaries' failure to carry out CDD measures so long the FI concerned has exercised due diligence in the selection and appointment of qualified intermediaries in accordance with AMLO.

14. The Administration has explained that the existing provision for FIs to retain the legal responsibility for undertaking CDD obligations and any failure to comply with the CDD requirements is in line with FATF's requirements. This is to ensure due diligence on the part of FIs in the appointment, supervision and control of their intermediaries. The Administration will take into account Members' views about the respective legal liabilities of FIs and the specified intermediaries when reviewing the relevant provisions in future.

Compliance burden on FIs

15. Members have highlighted the importance of striking a proper balance between regulatory oversight and compliance burden on the FIs concerned so as to ensure that the implementation of the CDD and record-keeping requirements would not hamper the operation and efficiency of FIs. In this regard, Mr NG Leung-sing has enquired how the continuation of the interim arrangement allowing FIs to rely on specified intermediaries to carry out CDD measures is likely to impact on the competitiveness and compliance costs of local FIs.

16. The Administration has advised that the prescribed CDD measures and record-keeping requirements under AMLO are in line with FATF's recommendations and align with the prevailing international best practices. Compliance with these measures therefore will not render the local financial sectors less competitive than their counterparts in other jurisdictions nor undermine local FIs' competitiveness in the international arena. The continuation of the interim arrangement will cause the least disruptions to the operation of the financial and professional sectors involved, and will facilitate FIs and relevant intermediaries to continue to work together where necessary to comply with the CDD requirements applying to FIs under AMLO. The Administration has consulted the relevant financial sectors, including the Hong Kong Association of Banks, as well as the relevant professional bodies of the specified intermediaries. They do not have any objection to the extension of the interim provision.

Effectiveness of the AML/CFT regulatory regime

17. Mr CHUNG Kwok-pan has enquired about the effectiveness of the current AML/CFT regulatory regime and the compliance performance of FIs and intermediaries. He has raised concern as to whether an intermediary, such as a solicitor who may not have knowledge of a customer's sources and flow of funds, can effectively detect any suspicious transactions involving AML/CFT activities.

18. According to the Administration, the full operation of AMLO since April 2012 has significantly strengthened the AML/CFT regulatory regime for the financial services industry in Hong Kong. Apart from making it more difficult for criminals to use the financial system for money laundering and terrorist financing activities, the CDD and record-keeping measures are instrumental to the detection of suspicious activities by FIs, which leads to reports being made to the relevant authorities for further investigation. The audit trail and relevant transaction records kept by FIs can also facilitate follow-up by law enforcement agencies and be used as evidence in legal proceedings. The relevant financial regulators⁵ and the relevant professional

⁵ Regulatory bodies including the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority.

bodies⁶ have updated their supervisory guidelines from time to time to assist FIs and the specified intermediaries to enhance their internal control system and procedures for compliance. Moreover, under the Organized and Serious Crimes Ordinance (Cap. 455), all persons should report suspected money laundering cases to the Joint Financial Intelligence Unit ("the Unit"). The Unit formed by officers from the Hong Kong Police Force and the Customs and Excise Department is dedicated to analysing suspicious transaction reports in relation to money laundering and terrorist financing activities and making dissemination of the intelligence to investigation units as appropriate. The Administration will closely liaise with the regulatory authorities, professional bodies and the industry to enhance the regulatory regime and review the compliance capability of FIs and specified intermediaries. In response to Mr CHUNG's enquiry, the Administration has advised that it has no official data on the number of FIs currently engaging intermediaries to conduct CDD measures on their behalf.

Consent in writing to be an FI's intermediary

19. Referring to the requirement for an intermediary to consent in writing to be an FI's intermediary under section 18(1)(a) of Schedule 2 to AMLO, Mr NG Leung-sing has enquired whether the Administration would consider specifying a standardized format and provisions in relation to the written consent, such as the respective obligations and liabilities of the FIs and their intermediaries, under AMLO.

20. The Administration has explained that the purpose of the written consent is to establish in writing the agreement and business relationship between the FI and the intermediary concerned. To allow flexibilities for the contractual parties concerned, the Administration does not consider it necessary to regulate the format and the provisions in relation to the written consent by statute. If necessary, guidelines in this respect can be issued by the relevant financial regulators and professional bodies for reference.

Recommendation

21. The Subcommittee has no objection to the Notice. The Subcommittee does not propose any amendment to the Notice.

⁶ Professional bodies including the Hong Kong Association of Banks, the Law Society of Hong Kong, the Hong Kong Institute of Certified Public Accountants, Hong Kong Institute of Chartered Secretaries etc.

Advice sought

22. Members are invited to note the deliberations of the Subcommittee as set out above.

Council Business Division 1
Legislative Council Secretariat
26 February 2015

**Subcommittee on Anti-Money Laundering and Counter-Terrorist
Financing (Financial Institutions) Ordinance
(Amendment of Schedule 2) Notice 2015**

Membership List

Chairman	Hon CHAN Kam-lam, SBS, JP
Members	Hon James TO Kun-sun
	Hon Andrew LEUNG Kwan-yuen, GBS, JP
	Hon NG Leung-sing, SBS, JP
	Hon Dennis KWOK
	Hon Christopher CHEUNG Wah-fung, SBS, JP
	Hon SIN Chung-kai, SBS, JP
	Hon CHUNG Kwok-pan
	 (Total : 8 members)
Clerk	Ms Annette LAM
Legal Adviser	Miss Evelyn LEE