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

Background brief

Purpose

This paper provides background information on the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill (the Bill), and a summary of members' views and concerns on relevant matters during relevant discussions at meetings of the Panel on Financial Affairs (FA Panel).

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.

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 (CDD) 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 (MSO) (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. According to FATF's procedures, Hong Kong is expected to have addressed the above issues and seek removal from the follow-up process about three to four years after the Mutual Evaluation, that is, by mid-2012 at the latest.

Existing AML regulatory regime

5. At present, the CDD and record-keeping requirements for financial institutions are set out in the guidelines issued by the Monetary Authority (MA), the Securities and Futures Commission (SFC) and the Insurance Authority (IA) to the respective financial institutions under their regulation. Non-compliance with these requirements is not subject to sanctions. Remittance agents and money changers (RAMCs) are subject to the statutory requirements to register with the police and keep transaction records under sections 24B and 24C of the Organized and Serious Crimes Ordinance (Cap. 455). There is no statutory provision on powers to refuse registration and to access the premises or books/records of remittance agents and money changers for routine compliance checks.

The Bill

6. Having regard to FATF's recommendations made upon its evaluation of Hong Kong, the Administration proposed that new legislation should be put in place to enhance the AML regulatory regime of the financial sectors. Following two rounds of public consultation on the legislative proposals in July 2009 and December 2009, the Administration introduced the 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 (the Tribunal) to review certain decisions of the relevant authorities made under the Bill.

7. The main provisions of the Bill include the following-

Commencement

(a) clause 1 provides that the legislation will commence on 1 April 2012. The Secretary for Financial Services and the Treasury may amend the commencement date by notice in the Gazette;

Application to Government

(b) clause 3 provides that the legislation will apply in relation to the remittance service operated by the Postmaster General, except for specific provisions therein on MSO licensing requirements and provisions enabling the Commissioner on Customs and Excise (CCE) to impose a pecuniary penalty for AML breaches;

Requirements relating to CDD and record-keeping

(c) clause 5 stipulates that Schedule 2, which contains the CDD and record-keeping requirements, has effect with respect to financial institutions. That clause also provides that a contravention of a specified requirement of that Schedule constitutes an offence;

(d) Schedule 2 prescribes the detailed CDD and record-keeping requirements;

Supervision and investigations

(e) clause 9 provides for the powers of the relevant authorities to conduct routine inspections. Clause 11 provides that the relevant authorities may initiate investigations if they have reasonable cause to believe that an offence under this legislation may have been committed and when they are considering whether to take disciplinary actions against a regulatee;

Disciplinary actions by relevant authorities

(f) clause 21 empowers the relevant authorities to impose supervisory sanctions on financial institutions for breaches of the CDD and record-keeping requirements specified in Schedule 2. Under that clause, a relevant authority may publicly reprimand financial institutions and order financial institutions to take remedial actions and to pay pecuniary penalties up to a maximum limit of HK$10 million or three times the profit gained or costs avoided;

Regulation of operation of money service

(g) Part 5 of the Bill (viz clauses 24 to 52) provides for an MSO licensing regime to be administered by CCE. CCE is empowered to grant, renew, refuse, suspend or revoke an MSO licence, and impose or vary the conditions of an MSO licence. The matters to be considered by CCE in determining whether an applicant is a "fit and proper" person before granting or renewing an MSO licence are stipulated in clause 30. That clause also provides that MSO licences are generally valid for two years;

(h) clause 50 empowers CCE to make regulations to provide for matters for the better carrying out of Part 5. Under clause 42, a contravention of these regulations may lead to disciplinary actions by CCE (viz. public reprimand, order for remedial actions and order to pay a pecuniary penalty not exceeding HK$1 million). CCE's disciplinary powers can also be exercised in relation to breaches of licence conditions and specified provisions concerning certain licensing matters;

(i) clause 81 stipulates the transitional arrangements for RAMCs currently on the Police register maintained under OSCO. A RAMC is deemed to be licensed as an MSO until the expiry of a

period of 60 days from the commencement of the legislation. However, if an RAMC applies for an MSO licence within that period, the RAMC is deemed to be licensed until the application is granted, refused or withdrawn, whichever is the earliest ;

(j) Schedule 3 specifies the fees payable in connection with MSO licensing matters;

The Tribunal

(k) clause 54 provides for the establishment of the Tribunal to review the relevant authorities' decisions under the legislation concerning the imposition of supervisory sanctions and MSO licensing matters; and

(l) Schedule 4 provides for the appointment and procedures of the Tribunal.

Major views and concerns of FA Panel members

Discussion on broad legislative framework

8. The Administration briefed the FA Panel on the broad framework of the proposed legislation on 11 June 2009. During the Panel discussion, members generally supported the policy objective and direction of the proposed legislative framework. Individual members expressed the following concerns:

(a) in view of the relatively small scale of business operation of RAMCs, the licensing requirements for RAMC should not create excessive burden on RAMCs and reduce their room for survival;

(b) a transitional period should be allowed for RAMCs to implement the various new regulatory measures;

(c) the legislation should provide necessary checks and balances on the enforcement powers of the regulatory authorities;

(d) there should be a clearly defined mental threshold for the criminal liabilities that might be incurred by financial institutions for non-compliance;

(e) apart from criminal sanctions, the Administration should consider different regulatory sanctions such as fines or suspension of licence for non-compliance of financial institutions. Reference should be made to the international best practice in this regard; and

(f) the Administration should impose on the financial institutions the minimum necessary AML regulatory requirements to achieve a proper balance between regulatory oversight and compliance burden on the institutions concerned.

Discussions on detailed legislative proposals

9. When the detailed legislative proposals for the AML regulatory regime was discussed by the FA Panel on 14 December 2009, members expressed support for the legislative proposals in principle. Pointing out that under the current regime where a number of banks had refused to provide account services to RAMCs, a member considered that the proposed licensing system for RAMCs would help improve the operational environment of RAMCs by alleviating the concerns of the banking sector about possible money-laundering activities involved in the remittance and money changing business of RAMCs. Another member commended the Administration for taking on board the views of the financial sectors by raising the threshold for CDD requirements for money changing transactions from $8,000 to $120,000 and introducing a single category of personal criminal liability with a clearly-defined mental threshold. Members urged the Administration to actively engage the stakeholders in its consultation on the detailed legislative proposals.

10. The Panel held a meeting on 24 May 2010 to receive public views on the detailed legislative proposals. A total of 12 deputations from various financial services sectors attended the meeting. The main concerns raised by these deputations include the following -

(a) the legislation should be extended to include real estate agents and companies registered with the Estates Agents Authority, so that CDD would be carried out on buyers who made cash payments in buying properties;

(b) certain terms in the legislation, such as "customer" and "reasonable suspicion", should be clearly defined;

(c) the legislative proposals failed to set out the required standard of or steps to be taken for Simplified Due Diligence and Enhanced Due Diligence;

(d) the proposed requirement for remediation of existing accounts within two years after commencement of the legislation was impractical and burdensome;

(e) financial institutions might have difficulties to comply with the requirement to conduct ongoing CDD on customers;

(f) there might be difficulty in tracking information of customers relating to inward remittances, and the legislation should allow some flexibility for financial institutions in this regard;

(g) RAMCs would have difficulty in complying with the requirement of CDD on the recipients of remittance transactions, as the recipients were not customers of the RAMCs, and had no obligation to provide their particulars to RAMCs;

(h) since the CDD and record-keeping requirements in different jurisdictions might vary, it might be difficult for an overseas branch offices of a local financial institution to comply with the proposed legislation;

(i) it should be the financial institution, rather than a member of the institution, which should be subject to criminal or supervisory liability for breaches of the CDD and record-keeping requirements; and

(j) despite the Administration's claim that the right of silence might create a barrier for investigation of breaches of AML requirements, regulatory infractions were not criminal offences, and the right of silence should not be removed from the legislation on CDD and record-keeping for financial institutions.

11. The Administration's response to deputations' concerns/views at the Panel meeting was summarized in the **Appendix**. Taking note of deputations' concerns and the Administration's response, individual Panel members raised the following points -

(a) the implementation of the legislation should not hamper the operation and efficiency of financial institutions, and cause undue additional costs to them;

(b) the requirement to apply CDD to all existing accounts within two years upon the commencement of the legislation was questionable;

(c) whether the legislative proposals were more or less vigorous than the international standards, particularly whether the adoption of the threshold of 10% or more of the shares or the voting rights of a company in the definition of beneficial owner of corporate customers were in line with international standards; and

(d) whether CDD was required for the customer's customers in cases where the customer acted on the instruction of his customers, and whether in the case of wire transfer, both the RAMC and the bank concerned had to conduct CDD on the same customers.

12. In response to members' concerns/views, the Administration explained that while the requirement for conducting CDD on all existing customers within two years was not part of the international standards, it was drawn up in response to some specific suggestions received during the first round of public consultation. The Administration would review this specific requirement in light of comments raised at the meeting.[1] The international standards required financial institutions to conduct due diligence on beneficial owners when establishing business relationship. The international standards did not prescribe a numeric threshold on how "beneficial owner" should be defined. The proposed 10% threshold under the definition of "beneficial owner" was in line with the relevant requirement under the existing guidelines issued by the HKMA, SFC and IA for their respective financial institutions. A financial institution would nevertheless be allowed to apply Simplified Due Diligence (SDD) when it had reasonable ground to believe that the customer or the product fell under one of the specified categories.

[1] Upon review, the Administration has subsequently agreed that the statutory requirement to update customers' information of existing accounts should be triggered only upon occurrence of specified events, which are prescribed in section 6 of Schedule 2 to the Bill.

References

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

Administration's paper for the Panel meeting on 11 June 2009
http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa0611cb1-1829-2-e.pdf

Minutes of Panel meeting on 11 June 2009 (paragraphs 15 to 26)
http://www.legco.gov.hk/yr08-09/english/panels/fa/minutes/fa20090611.pdf

Administration's consultation paper on the conceptual framework of the legislative proposal (July 2009)
http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/facb1-2247-e.pdf

Administration's consultation paper on the detailed legislative proposal (December 2009)
http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa1214cb1-587-1-e.pdf

Administration's paper for the Panel meeting on 14 December 2009
http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa1214cb1-601-11-e.pdf

Minutes of Panel meeting on 14 December 2009 (paragraphs 32 to 35)
http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20091214.pdf

Administration's paper for the Panel meeting on 24 May 2010
http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0524cb1-1926-12-e.pdf

Minutes of Panel meeting on 24 May 2010
http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20100524.pdf

Papers relevant to the Bill
http://www.legco.gov.hk/yr10-11/english/bc/bc01/general/bc01.htm

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Appendix

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.