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**Paper for the House Committee Meeting
on 12 November 2010**

**Legal Service Division Report on
Anti-Money Laundering and
Counter-Terrorist Financing (Financial Institutions) Bill**

I. SUMMARY

- 1. Objects of the Bill** To provide a legislative framework to implement the requirements of the Financial Action Task Force (FATF), the international anti-money laundering (AML) standard setter.
- 2. Comments**
 - (a) The Bill seeks to address the major deficiencies as identified by FATF by imposing customer due diligence (CDD) requirements and record-keeping requirements on specified financial institutions.
 - (b) It also introduces a licensing regime to regulate the operation of money changing and remittance service.
 - (c) An independent Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal would be set up to review certain decisions of the relevant authorities made under the Bill.
 - (d) The relevant authorities would be provided with a range of supervisory and enforcement powers including the power to impose pecuniary penalty.
- 3. Public Consultation** Two rounds of public consultation on the legislative proposals were carried out by the Administration in July 2009 and December 2009. According to the Administration, the comments received are mainly on the technical and operational aspects of the proposed AML regime and clarifications on the compliance requirements and it has taken into account the comments received and modified some earlier proposals.
- 4. Consultation with LegCo Panel** The Administration briefed the Panel on Financial Affairs on the framework of the proposed legislation on 11 June 2009 and 14 December 2009. The Panel held a meeting on 24 May 2010 to receive public views on the detailed legislative proposals. Members of the Panel raised various concerns.
- 5. Conclusion** In view of the concerns expressed by members at the meetings of the Panel and the possible wide implications on the sector of financial services providers, members may wish to consider setting up a Bills Committee to scrutinize the Bill.

II. REPORT

Objects of the Bill

To provide a legislative framework to implement the requirements of the Financial Action Task Force (FATF) to -

- (a) impose customer due diligence requirements (CDD) 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.

LegCo Brief Reference

- 2. FSB G13/21C issued by the Financial Services Branch of the Financial Services and the Treasury Bureau and dated 27 October 2010.

Date of First Reading

- 3. 10 November 2010.

Comments

A. *Background*

- 4. 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. Hong Kong has joined FATF in 1990 and 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.

5. At present, the CDD and record-keeping requirements for financial institutions (FI) 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 FIs under their regulation. Non-compliance with these requirements is not subject to sanctions. Remittance agents and money changers 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.

6. 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 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).

7. 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 (para. 3 of LegCo Brief).

B. The Bill

8. The Bill seeks to implement the FATF's Recommendations following the Mutual Evaluation conducted on Hong Kong. According to paragraph 4 of the LegCo Brief, the Bill largely reflects the existing CDD and record-keeping requirements in the guidelines issued by MA, SFC and IA, with specific provisions for supervisory and enforcement powers of the regulators and sanctions against non-compliance, having regard to FATF's requirements.

Requirements relating to CDD and record-keeping (Part 2)

9. The proposed requirements relating to CDD and record-keeping are set out in Schedule 2 to the Bill. Clause 2 provides that these requirements have effect with respect to FI. Under Part 2 of Schedule 1 to the Bill, "financial institution" means an authorized institution, a licensed corporation, an appointed insurance agent, an authorized insurance broker, a licensed money service operator or the Postmaster General. Criminal liability is imposed on FI, employees of FI and persons concerned in the management of FI for offences relating to breaches of these requirements.

10. Under Part 2 of Schedule 2, a FI must carry out CDD measures in relation to a customer in certain circumstances, for example, before establishing a business relationship with the customer; before carrying out for the customer an occasional transaction involving an amount equal to or above \$120,000, whether the transaction is carried out in a single transaction or in several operations that appear to the FI to be linked; or when the FI suspects that the customer or the customer's account is involved in money laundering or terrorist financing. Under Part 3 of Schedule 2, a FI must, in relation to each transaction it carries out, keep the original or a copy of the documents and a record of the data and information obtained in connection with the transaction. A FI must also, in relation to each of its customers, keep the original or a copy of the documents, and a record of the data and information, obtained in the course of identifying and verifying the identity of the customer and the original or a copy of the files relating to the customer's account and business correspondence with the customer.

11. Under clause 7, a relevant authority may publish in the Gazette any guideline that it considers appropriate for providing guidance in relation to the operation of any provision of Schedule 2. A guideline published under clause 7 is not subsidiary legislation.

Regulation of operation of money service (Part 5)

12. Part 5 provides for an MSO licensing regime which is to be administered by the Commissioner of the Customs and Excise (the Commissioner). Under the regime, any person who wishes to operate money changing and/or remittance services as a business is required to obtain an MSO licence. Failure to comply with this requirement is an offence punishable by a fine at level 6 (\$100,000) and imprisonment for six months.

13. Under the proposed licensing regime, the Commissioner is empowered to grant, renew, suspend or revoke an MSO licence, and impose or vary the conditions of an MSO licence. The Commissioner may make regulations for the better carrying out of the provisions and purposes of Part 5 of the Bill. Clause 42 provides that the Commissioner may take disciplinary actions against a licensee that has contravened a regulation made under clause 50, a licence condition or a specified provision of Part 5. These actions include publicly reprimanding the licensee,

ordering the licensee to take remedial actions and to pay a pecuniary penalty not exceeding \$1,000,000. Before the Commissioner first exercises the power to impose a pecuniary penalty, he is required under clause 44 to publish guidelines to indicate the manner in which he proposes to exercise the power. Clause 44(3) provides that such guidelines are not subsidiary legislation.

14. Under clauses 45 and 46, the Commissioner may appoint persons to be authorized officers and these officers may, under a magistrate's warrant, enter premises and remove things that appear to be evidence of the commission of an offence in relation to restrictions on operating money changing or remittance service. Under clause 47, these officers may also, without a warrant, arrest or detain a person whom they suspect have committed or are committing such an offence for further enquiries.

15. The Commissioner and other specified persons are required to preserve secrecy with regard to matters that come to their knowledge in the performance of functions under the Bill (clause 48).

Supervision and investigations (Part 3)

16. Part 3 of the Bill confers on a relevant authority powers to supervise compliance with this Bill and to carry out investigations in respect of contraventions of the provisions of this Bill. These include the powers to carry out routine inspections, to investigate suspected offences under the Bill and to enter premises and search for records and documents under a magistrate's warrant. A "relevant authority", under Part 2 of Schedule 1 to the Bill, means -

- (a) in relation to an authorized institution, MA;
- (b) in relation to a licensed corporation, SFC;
- (c) in relation to a authorized insurer, appointed insurance agent or authorized insurance broker, IA; and
- (d) in relation to a licensed money service operator or to the Postmaster General, the Commissioner of Customs and Excise (the Commissioner) (as defined in Part 2 of Schedule 1, includes any Deputy Commissioner or Assistant Commissioner of Customs and Excise and a person to whom the Commissioner of Custom or Excise has delegated any of his functions).

17. Part 3 of the Bill creates offences in relation to routine inspections and investigations and provides that applications may be made to the Court of First Instance for an inquiry into a person's failure to comply with the requirements for production of records or documents or answering questions.

Disciplinary actions by relevant authorities (Part 4)

18. Under clause 21, a relevant authority may take disciplinary actions against a FI which has contravened a specified CDD or record-keeping requirement. A relevant authority may publicly reprimand the FI, order the FI to take remedial actions and to pay a pecuniary penalty up to \$10 million or three times the profit gained or costs avoided as a result of the contravention, whichever is greater.

19. Before a relevant authority first exercises the power to impose a pecuniary penalty, it is required under clause 23 to publish guidelines to indicate the manner in which it proposes to exercise the power. Clause 23(3) provides that such guidelines are not subsidiary legislation.

The Tribunal (Part 6)

20. Part 6 provides for the establishment of the Tribunal to review decisions made by the relevant authorities under the Bill including their decisions to impose supervisory sanctions and the Commissioner's decisions relating to MSO licensing. The Tribunal may confirm, vary or set aside the decision or remit the matter to the authority concerned.

21. The Tribunal consists of a chairperson and two other persons appointed by the Secretary for Financial Services and the Treasury. The chairperson of the Tribunal must be a person who is eligible to be appointed as a judge of the High Court and is not a public officer.

22. A party to a review who is dissatisfied with the determination of the review may, with the leave of the Court of Appeal, appeal to the Court of Appeal against that determination on a question of law or a question of fact or a question of mixed law and fact.

Application of the Bill

23. Under clause 2, Schedule 1 to the Bill contains interpretation provisions that apply to the Bill in accordance with their terms. The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend Part 2 of Schedule 1 which provides for the interpretation of the entities or bodies referred to in the Bill.

24. The Bill applies to the Government in respect of the remittance service operated by the Postmaster General (clause 3).

Miscellaneous provisions and transitional provisions (Part 7)

25. Part 7 contains miscellaneous provisions including the power of Chief Executive in Council to make regulations for the better carrying out of the provisions and purposes of the Bill, the standard of proof to be adopted by a relevant authority for the purpose of the Bill (i.e. other than provisions relating to criminal proceedings, the standard of proof applicable to civil proceedings), prosecution of offences by a relevant authority and giving of notices. Clause 80 provides that the Bill does not affect any claims, rights or entitlements that would, apart from the Bill, arise on the ground of legal professional privilege but the provision does not affect any requirement under the Bill to disclose the name and address of a client of a legal practitioner.

26. Clause 81 provides that money changers and remittance agents carrying on business immediately before the commencement date of the Bill are deemed to have been granted a licence to operate a money service. The deemed licence is valid for 60 days but if an application for a licence under the Bill is made during that period, the deemed licence will be valid until the application is granted, refused or withdrawn, whichever first happens.

Commencement

27. Subject to the power of the Secretary for Financial Services and the Treasury to amend the date, the Bill (if enacted) would come into operation on 1 April 2012.

Public Consultation

28. The Financial Services and the Treasury Bureau, in conjunction with MA, SFC IA and the Customs and Excise Department, has conducted two rounds of public consultation on the legislative proposals in July 2009 and December 2009. According paragraph 21 of LegCo Brief, the comments received are mainly on the technical and operational aspects of the proposed AML regime and clarifications on the compliance requirements. Members may refer to the Administration's response to the major views received are summarized in the Consultation Conclusion at Annex C to the LegCo Brief.

29. According to the Administration, it has take into account the comments received in the public consultations and modified some earlier proposals. Key changes that have been made include doing away with the across-the-board requirement to conduct CDD on all pre-existing accounts, removing the personal civil liability of officers of FI and clarifying the CDD requirements for beneficiaries of life insurance policies.

Consultation with LegCo Panel

30. The Administration briefed the Panel on Financial Affairs on the broad framework of the proposed legislation on 11 June 2009 and on the detailed legislative proposals on 14 December 2009. The Panel held a meeting on 24 May 2010 to receive public views on the detailed legislative proposals. The major views and concerns expressed by members during the discussions include the following -

- (a) a proper balance should be struck between regulatory oversight and compliance burden on the institutions concerned;
- (b) whether the legislative proposals were more or less vigorous than the international standards;
- (c) the legislation should provide a clearly defined mental threshold for criminal liabilities and necessary checks and balances on the enforcement powers of the regulatory authorities;
- (d) apart from criminal sanctions, different regulatory sanctions for non-compliance should be provided for in the legislation; and
- (e) the requirement to apply CDD checks to all existing accounts within two years upon the commencement of the legislation might cause undue compliance burden to financial institutions.

Conclusion

31. In view of the concerns expressed by members at the meetings of Panel on Financial Affairs and the possible wide implications on providers of financial services, members may wish to set up a Bills Committee to scrutinize the Bill.

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