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

Background Brief

Purpose

This paper provides background information on the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Amendment of Schedule 2) Notice 2015 ("the Notice") and summarizes the views and concerns expressed by Members when related matters were discussed by the relevant committees of the Legislative Council ("LegCo") from 2008 to 2011.

Background

Customer due diligence requirements under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615)

2. The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO"), which came into operation on 1 April 2012, stipulated a set of customer due diligence ("CDD") requirements and record-keeping requirements on financial institutions ("FI")¹, in line with the recommendations of the Financial Action Task Force ("FATF")², the

¹ In the context of AMLO, "financial institutions" refer to (a) authorized institutions under the Banking Ordinance (Cap. 155); (b) licensed corporations under the Securities and Futures Ordinance (Cap. 571); (c) authorized insurers, appointed insurance agents, and authorized insurance brokers under the Insurance Companies Ordinance (Cap. 41); (d) licensed money service operators (i.e. money changers and remittance agents); or (e) the Postmaster General.

² The FATF was established in 1989 and its recommendations are recognized by the International Monetary Fund and the World Bank as the international AML/CFT standards. Hong Kong joined FATF as a member jurisdiction since 1990.

standard-setting body for the global efforts in anti-money laundering and counter-terrorist financing ("AML/CFT"). Such requirements are set out in Schedule 2 to AMLO³. According to the Administration, the CDD and record-keeping measures are intended to make it more difficult for criminals to make use of the financial system for money laundering and terrorist financing activities; and preserve an audit trail and relevant transaction records and documents to facilitate subsequent law enforcement agencies' investigation into money laundering or other criminal activities if necessary.

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 –

- (a) the intermediary consents in writing to be the FI's intermediary; and
- (b) the FI 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 an FI may rely on to complete the statutory CDD measures. The intermediary specified in section 18(3)(a) 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 –

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

5. Section 18(3) will expire after 31 March 2015 (i.e. at the end of three years beginning on the date of commencement of AMLO), by virtue of section 18(5). According to the Administration, section 18(5) was intended to provide for the transition of the four sectors mentioned in paragraph 4 above to a statutory AML/CFT regime on par with the same applying to FIs in accordance

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. Section 6 of AMLO provides that the Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend Schedule 2.

with AMLO⁴. The provisions in section 18 of Schedule 2 are set out in **Appendix I**.

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

6. The Notice was published in the Gazette on 23 January 2015, and tabled before LegCo at its sitting of 28 January 2015 for negative vetting. The Notice seeks to provide for the extension of the expiry date of section 18(3)(a) of Schedule 2 to AMLO for three more years up to 31 March 2018, so that relevant FIs may continue to carry out relevant CDD measures by means of a relevant intermediary specified in section 18(3)(a). The Administration has advised that, as the implementation of the FATF recommendations regarding the regulation of CDD and record-keeping requirements for designated non-financial businesses and professions ("DNFBPs") is evolving in various financial centres, it will be necessary to study and assess the developments in comparable markets to consider when and how to bring DNFBP sectors into the statutory CDD and record-keeping regime as per the latest FATF recommendations. The relevant provisions under the Notice will come into operation on 1 April 2015.

Concerns and views expressed by Members

7. When the Panel on Financial Affairs considered the legislative and related staffing proposals on enhancement of the AML regulatory regime in respect of the financial sectors at the meetings on 21 November 2008, 11 June 2009, 14 December 2009 and 24 May 2010, and the relevant bills committee scrutinized the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill⁵, Members expressed views and concerns on issues relating to third-party reliance by FIs for conducting CDD measures. The major views and concerns are summarized in the ensuing paragraphs.

Third-party reliance by FIs for conducting CDD

8. Members noted that during the public consultation launched in July 2009 on the conceptual framework of the legislative proposal to enhance the AML/CFT regime in respect of the financial sectors, respondents raised the need for allowing FIs to rely on third-party intermediaries to conduct CDD and asked for clear criteria on eligible third parties permitted to be relied on.

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 Financial Services and the Treasury Bureau on 21 January 2015.

⁵ The bill was passed by LegCo at the Council meeting of 29 June 2011 and enacted as AMLO.

Taking into account the then permission for third party reliance under the guidelines issued by financial regulators⁶, the Administration proposed to retain such permission in the AML/CFT regime in order not to cause undue inconvenience and business disruptions to FIs. The Administration stressed that while FIs might rely on a third party to conduct CDD, they retained the ultimate responsibility for undertaking the CDD obligations and any failure to comply with the CDD requirements.

9. In Hong Kong, lawyers, accountants, and trust and company service providers are common third parties that FIs rely on for conducting CDD, but they are not regulated for AML purpose to the extent as required by FATF. As FATF requires that FIs may only rely on third parties that are regulated for AML purpose to conduct CDD on customers in introduction of business, the Administration proposed under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill in 2010 an interim arrangement to be 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. According to the Administration, this arrangement was meant to allow time for the DNFBPs to be regulated as required by FATF if reliance on third parties was to be permitted, and facilitate FIs and relevant intermediaries to continue to work together to comply with CDD requirements applying to FIs under AMLO. The Administration advised then that this special arrangement was time-limited and would lapse within a qualified period, i.e. three years, from the implementation of AMLO.

Regulation of CDD and record-keeping requirements for non-financial businesses and professions

10. Members noted that the mutual evaluation conducted by FATF on Hong Kong in 2007 revealed, among other deficiencies, the absence of a proper regulatory system for CDD in the prevailing AML/CFT regime of Hong Kong. Some Members enquired about the obligations for DNFBPs to conduct CDD on their own clients, and expressed concern about the introduction of regulatory guidelines for DNFBPs, which might involve new requirements for client identification and information gathering.

11. The Administration advised that the initial phase of work for enhancing the AML/CFT regime focused on the AML/CFT regulation for the financial sector and would not cover AML/CFT regulation for DNFBPs. Whilst the Financial Services and the Treasury Bureau was the overall coordinator in relation to AML/CFT policies, the Security Bureau ("SB") was responsible for implementing FATF's recommendations in relation to the AML/CFT

⁶ Before AMLO came into operation on 1 April 2012, the CDD and record-keeping requirements for FIs are set out in the guidelines issued by the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority respectively to the relevant trades.

requirements concerning CDD and record keeping among DNFBNs. The work would involve establishment, by statute, of relevant regulations in order to better align Hong Kong's regime with FATF requirements. SB would consider the way forward pending the next round of mutual evaluation on Hong Kong by FATF in or after late 2017. In the meantime, the Administration would continue to work with the relevant professional sectors to enhance their AML/CFT compliance through, among others, the promulgation and implementation of relevant guidance documents by the professional bodies, and other forms of professional development and education work.

Compliance costs

12. Some Members stressed the importance to ensure that implementation of the CDD and record-keeping requirements should not hamper the operation and efficiency of FIs, and lead to undue additional costs on them. They urged the Administration to consult the trades on formulation of relevant regulatory guidelines and provide assistance to the trades as far as possible in the transitional period to facilitate smooth implementation of AMLO. The Administration assured Members that it would be mindful of the need to avoid causing undue disruption to the operation of FIs in complying with the CDD and record-keeping requirements.

Latest development

13. At the House Committee meeting on 30 January 2015, Members agreed to form a subcommittee to study the Notice.

Relevant papers

14. A list of relevant papers is in **Appendix II**.

**Section 18 of Schedule 2 to Anti-Money Laundering and
Counter-Terrorist Financing (Financial Institutions) Ordinance**

Carrying out customer due diligence measures by means of intermediaries

- (1) Subject to subsection (2), a financial institution may carry out any customer due diligence measure by means of an intermediary specified in subsection (3) if—
 - (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 customer due diligence measure without delay.
- (2) A financial institution that carries out a customer due diligence measure by means of an intermediary remains liable under this Ordinance for a failure to carry out that customer due diligence measure.
- (3) The specified intermediary is—
 - (a) any of the following persons who is able to satisfy the financial institution 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;
 - (iv) a trust company registered under Part 8 of the Trustee Ordinance (Cap 29) carrying on trust business in Hong Kong;
 - (b) a financial institution that is an authorized institution, a licensed corporation, an authorized insurer, an appointed insurance agent or an authorized insurance broker; or
 - (c) a lawyer, a notary public, an auditor, a professional accountant, a trust or company service provider or a tax advisor practising in an equivalent jurisdiction, or a trust company carrying on trust business in an equivalent jurisdiction, or an institution that carries on in an equivalent jurisdiction a business similar to that carried on by a financial institution mentioned in paragraph (b), that—

- (i) is required under the law of that jurisdiction to be registered or licensed or is regulated under the law of that jurisdiction;
 - (ii) has measures in place to ensure compliance with requirements similar to those imposed under this Schedule; and
 - (iii) is supervised for compliance with those requirements by an authority in that jurisdiction that performs functions similar to those of any of the relevant authorities.
- (4) A financial institution that carries out a customer due diligence measure by means of an intermediary must—
 - (a) immediately after the intermediary has carried out that measure, obtain from the intermediary the data or information that the intermediary has obtained in the course of carrying out that measure, but nothing in this paragraph requires the financial institution to obtain at the same time from the intermediary a copy of any document, or a record of any data or information, that is obtained by the intermediary in the course of carrying out that measure; and
 - (b) ensure that the intermediary will, if requested by the financial institution within the period referred to in section 20(2) or (3) of this Schedule, as the case requires, provide to the financial institution a copy of any document, or a record of any data or information, obtained by the intermediary in the course of carrying out that measure as soon as reasonably practicable after receiving the request.
- (5) Subsection (3)(a) expires at the end of 3 years beginning on the date of commencement of this Ordinance.
- (6) Nothing in this section prevents a financial institution from carrying out a customer due diligence measure by its agent but such a financial institution remains liable under this Ordinance for a failure to carry out that customer due diligence measure.
- (7) In this section—
certified public accountant (會計師) has the meaning given by section 2(1) of the Professional Accountants Ordinance (Cap 50).

List of relevant papers

Date	Event	Papers/Minutes of meeting
21 November 2008	The Panel on Financial Affairs ("FA") considered the proposal to create a supernumerary post to undertake the enhancement of the anti-money laundering ("AML") and counter financing of terrorism regime in Hong Kong	Minutes (paragraphs 36 to 44) (LC Paper No. CB(1)497/08-09)
11 June 2009	FA Panel considered the broad framework of legislative proposal to enhance the AML regulatory regime in respect of the financial sectors	Background brief (LC Paper No. CB(1)1828/08-09) Minutes (paragraphs 15 to 26) (LC Paper No. CB(1)2740/08-09)
14 December 2009	FA Panel considered the detailed legislative proposals on the new AML legislation for financial institutions ("FIs")	Administration's paper (paragraph 7(e)) (LC Paper No. CB(1)601/09-10(11)) Administration's consultation document on proposed new legislation on the customer due diligence and record-keeping requirements for FIs and the regulation of remittance agents and money changers – detailed proposals (paragraphs 3.12 to 3.15) (LC Paper No. CB(1)587/09-10(01))
24 May 2010	FA Panel considered the proposed new AML legislation for FIs	Administration's paper (paragraph 4(e)) and paragraph 10 of Annex A) (LC Paper No. CB(1)1926/09-10(12))

Date	Event	Papers/Minutes of meeting
		Minutes (paragraphs 16 to 18) (LC Paper No. CB(1)2850/09-10))
November 2010 to June 2011	The relevant bills committee scrutinized the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill	Legislative Council Brief (File Ref: FSB G13/21C)
29 June 2011	The Legislative Council ("LegCo") passed the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill	Hansard (pages 138 to 178) The Bill passed Report of the relevant bills committee (LC Paper No. CB(1)2586/10-11)
28 January 2015	The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Amendment of Schedule 2) Notice 2015 was tabled before LegCo	Legislative Council Brief (File Ref: G13/21C) Legal Service Division Report (LC Paper No. LS34/14-15)