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24 November 2017

Legal Service Division
Legislative Council Secretariat
1 Legislative Council Road
Central, Hong Kong
(Attn: Mr Hugo Chiu)

Dear Hugo,

**Bills Committee on Anti-Money Laundering and Counter-Terrorist Financing
(Financial Institutions) (Amendment) Bill 2017 and
Companies (Amendment) Bill 2017**

Follow-up to meeting on 14 November 2017

I refer to your letter dated 15 November. The Administration's responses are set out in **Annex** for your information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Eureka Cheung', written over a large, faint circular stamp or watermark.

(Ms Eureka Cheung)
for Secretary for Financial Services and the Treasury

c.c.

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| Bills Committee Chairman | (Attn: Hon. Wong Ting-kwong, GBS, JP) |
| Registrar of Companies | (Attn: Ms Ada Chung) |
| Secretary for Justice | (Attn: Ms Nilmini Dissanayake Ms Rayne Chai Ms Frances Hui Mr Vincent Wai Mr Danny Yuen Dr Stefan Lo) |

Approach in applying statutory customer due diligence (“CDD”) and record-keeping requirements to the legal professionals

As explained at the previous Bills Committee meetings, we follow closely the recommendations of the Financial Action Task Force (“FATF”) in proposing to prescribe statutory CDD and record-keeping requirements. These requirements are set out as appropriate in Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) (“AMLO”) for designated non-financial businesses and professions (“DNFBPs”). Much as we appreciate that the Practice Direction P (“PDP”) issued by the Law Society of Hong Kong (“LSHK”) has put in place certain CDD and record-keeping requirements for solicitors and foreign lawyers in Hong Kong to follow, we note that it does not have the force of law. The CDD and record-keeping requirements under the PDP do not amount to statutory requirements. The promulgation of and amendment to the PDP are not subject to the scrutiny of the Legislative Council. Even if amendments were to be made to the PDP to align it with the requirements stipulated in Schedule 2 to the AMLO or requirements promulgated by the FATF, the PDP’s status would be the same (that is, it will not have the force of law).

2. Overseas experience shows that the absence from the statute of the core FATF principles that legal professionals should observe CDD and record-keeping requirements when they engage in specified transactions will very likely result in our failing the relevant FATF assessment. The extension of the statutory anti-money laundering and counter-terrorist financing (“AML/CTF”) requirements as set out in the AMLO to cover DNFBPs, including legal professionals, is therefore essential to ensure that Hong Kong can stand up to the FATF scrutiny in the upcoming mutual evaluation scheduled for 2018/19.

3. Having regard to the principle of professional self-regulation, from the outset we have proposed leveraging on the existing regulatory regimes applicable to the DNFBPs to enforce the statutory CDD and record-keeping requirements. In the case of legal professionals, the LSHK will take on statutory oversight for monitoring and ensuring their compliance with the AMLO requirements. Non-compliance with the requirements will be handled in accordance with the prevailing investigation and disciplinary mechanism under the Legal Practitioners Ordinance (Cap. 159) governing professional misconduct. To facilitate the LSHK in their discharge of regulatory functions in relation to statutory CDD and record-keeping requirements that are applicable to legal professionals, enabling provisions have been built in the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 (“AML Bill”) to the effect that the LSHK, as the sole authority for enforcing AMLO requirements for legal professionals, has the discretion to promulgate guidelines as they consider appropriate in relation to the operation of the AMLO Schedule 2 requirements. Moreover, the LSHK may have regard to or take into account any practice direction that it issues in providing guidance on the statutory CDD requirements. The above approach has struck a balance between the need to observe FATF requirements and the equally important need to keep compliance burden to the absolute minimum.

Implementation of statutory CDD and record-keeping requirements for DNFBBs

4. The AMLO is intended to be an overarching, enabling piece of legislation prescribing the general CDD and record-keeping requirements applicable to financial institutions and DNFBBs in accordance with the FATF standards. Following a risk-based approach, Schedule 2 to the AMLO sets out the CDD requirements applicable in different risk situations. Taking into account the higher risks of financial institutions as compared to DNFBBs, we do not propose to extend to DNFBBs the more stringent enforcement and sanction mechanism (with enforcement by government bodies or statutory agencies, and both civil and criminal sanctions available for non-compliance of CDD requirements) now applicable to financial institutions under the AMLO. Instead, accounting professionals, legal professionals and estate agents will only be subject to the regulatory oversight of their respective regulatory bodies. In the event of non-compliance with the CDD requirements, they will be subject to the prevailing investigation and disciplinary mechanisms under the respective Ordinances for the professional bodies, without attracting criminal sanctions under the AMLO in the case of non-compliance with the CDD requirements.

5. We have adopted the same risk-based approach in respect of trust or company service providers (“TCSPs”). The Registrar of Companies will have regulatory oversight of TCSPs under the AML Bill. But any non-compliance with CDD requirements will not attract criminal sanctions under the AMLO. Instead, they will be dealt with by way of the proposed disciplinary mechanism in the AML Bill.

6. To facilitate regulatory bodies in the discharge of their regulatory functions under the AMLO, section 7 of the AMLO will be amended to enable them to publish sector-specific guidelines to provide guidance in relation to the operation of AMLO Schedule 2 requirements. This will enable the DNFBB sectors to take into account industry-specific considerations when implementing the AMLO requirements, and ensure the conduct of CDD measures in a risk-sensitive manner.

7. As noted above, we follow closely the FATF recommendations in formulating the CDD and record-keeping requirements for financial institutions and DNFBBs. These include the circumstances when CDD measures tailored for different risk situations should trigger, when third parties can be relied on to perform CDD measures and, in the case of incorporated DNFBBs, when CDD requirements should extend to branches and subsidiary undertakings of regulatees. The AML Bill as it is now drafted has incorporated consensual views received during the consultation, which saw a majority of respondents expressing support for the Government’s proposal to enhance AML/CFT regulation in Hong Kong.

8. The CDD measures applicable to a DNFBB, where there is a beneficial owner in relation to the customer, are to identify and take reasonable steps to verify the beneficial owner’s identity so that the DNFBB is satisfied that it knows who the beneficial owner is and keeps a record of the information of the beneficial owner.

Scope of law enforcement officer in the Companies (Amendment) Bill 2017

9. The proposed section 653B of the Companies Ordinance sets out a list of law enforcement officers that are permitted to inspect the register of significant controllers kept by an applicable company. The current list has been carefully crafted to include only officers of the Companies Registry and those officers who perform functions under the law of Hong Kong that are related to the prevention, detection or investigation of money laundering, or terrorist financing. To cater for future needs, we have reserved a regulation making power for the Financial Secretary under the proposed section 653ZG. Under section 653ZG(1)(b), the Financial Secretary may, by regulation, specify any other department or agency of the Government, or any other statutory body for the purposes of section 653B(1)(j). If the power under new section 653ZG(1)(b) is exercised by the Financial Secretary in future, the effect would be that an officer of the department, agency or body so specified by the Financial Secretary would also be a law enforcement officer under proposed section 653B(1)(j). We will keep in view the implementation of the significant controllers register regime and review the specified list under section 653(B) whenever necessary to ensure that it is in keeping with law enforcement needs.

Financial Services and the Treasury Bureau
24 November 2017