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8 December 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 28 November 2017

I refer to your letter dated 29 November. The Administration's responses are set out in **Annex** for your information.

Yours sincerely,

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

c.c.
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)

Annex

Hong Kong's situation in implementing the requirements of the Financial Action Task Force ("FATF")

1. Customer due diligence ("CDD") and record-keeping requirements are the main strands of an effective anti-money laundering and counter-terrorist financing ("AML/CTF") regime to deter and disrupt money laundering activities and ensure the integrity of a financial system. The FATF recommends that financial institutions ("FIs") should implement CDD measures to identify and verify customers, and maintain records on customer identification and transactions for at least five years. Meanwhile, CDD and record-keeping requirements should be codified into the statute. The FATF considers that, in addition to FIs, designated non-financial businesses and professions ("DNFBPs") that engage in specified transactions should also be subject to similar statutory CDD and record-keeping requirements. The FATF also requires competent authorities or self-regulatory bodies with adequate powers to be designated to monitor and ensure compliance with AML/CTF requirements by the relevant DNFBP sectors. Meanwhile, effective, proportionate and dissuasive sanctions should be applied to deal with non-compliances.

   The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 ("AML Bill") was drafted with the FATF standards in mind, and is intended to be an overarching, enabling piece of legislation for prescribing the general CDD and record-keeping requirements applicable to DNFBPs. Applying a risk-based approach and having regard to the different risk levels faced by FIs and DNFBPs, there is a range of sanctions available under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO") and the AML Bill to deal with any non-compliance of Schedule 2 requirements by FIs and DNFBPs respectively. Briefly speaking, FIs are subject to criminal sanctions under the AMLO, whereas DNFBPs are not under the AML Bill.

   At present, the maximum criminal sanctions for non-compliances by an FI of the Schedule 2 requirements are a fine of $1 million and imprisonment of seven years under the AMLO. Alternative to the criminal route, the AMLO empowers relevant authorities of FIs to take a range of disciplinary actions, including public reprimand, remedial orders, a civil penalty not exceeding $10 million or three times the amount of profit gained or costs avoided as a result of the contravention (whichever is higher).

   For DNFBPs (viz. legal and accounting professionals, estate agents and trust or company service providers ("TCSPs")) proposed to be regulated under the AML Bill, we do not propose criminal sanctions on non-compliances of Schedule 2 requirements having regard to the lesser risks concerning these sectors vis-à-vis FIs. The Legal Practitioners Ordinance, the Professional Accountants

Ordinance and the Estate Agents Ordinance have already stipulated a set of sanctions ranging from reprimands, orders for remedial actions, to civil fine, and suspension from practice or revocation of licence (as the case may be) for handling professional misconduct. With due respect to the principle of professional self-regulation, we have proposed, from the outset, leveraging on the existing regulatory regimes applicable to legal and accounting professionals and estate agents to enforce Schedule 2 requirements under the AML Bill. The Law Society of Hong Kong ("LSHK"), the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the Estate Agents Authority ("EAA") will continue to rely on the applicable disciplinary and sanction measures to process any non-compliance under the AMLO. The exact level of sanction will be considered with reference to the merits of individual cases by these regulatory bodies, taking into account the nature and severity of non-compliances, desirable level of deterrents and other relevant circumstances. We believe that this should provide sufficient and proportionate deterrent effect in the legal and accounting professionals and estate agents sectors. For TCSPs, the Registrar of Companies will be empowered to investigate any non-compliance of Schedule 2 requirements in relation to the licensees and impose disciplinary sanctions (including public reprimand, remedial order, a pecuniary fine not exceeding $500,000, and suspension or revocation of the licence), in line with the maximum level of civil sanction for legal and accounting professionals.

2. The CDD and record-keeping requirements now applicable to FIs under the AMLO have been drawn up having regard to the FATF requirements and views received during public consultations. In proposing to extend the AMLO requirements to DNFBPs, we are mindful of the need to reduce the regulatory burden for the DNFBP sectors which carry lesser risks than FIs. This explains our decision to subject FIs, but not DNFBPs, to criminal sanctions under the AMLO in case of non-compliance of the CDD and record-keeping requirements. The AML/CTF requirements currently proposed in the AML Bill are on a par with the FATF standards.

3. A comparison between the Practice Direction P ("PDP") issued by the LSHK and Schedule 2 requirements has already been provided vide our reply dated 13 November 2017 [Ref: LC Paper No. CB(1)205/17-18(02)]. While the PDP differs from Schedule 2 in terms of specificity and depth, a common principle underlying the two sets is that legal professionals should be subject to CDD and record-keeping requirements. The same principle that DNFBPs should observe CDD and record-keeping requirements is also acknowledged by the HKICPA and the EAA, which we understand are in the process of preparing AML/CTF guidelines to provide guidance in relation to the operation of the AMLO Schedule 2 requirements. A comparison is therefore not appropriate at this stage.

Other jurisdictions' situations in implementing the requirements of the FATF

4. At the time of undergoing mutual evaluation in 2015/16, lawyers in Singapore were subject to statutory CDD and record-keeping requirements, whereas estate agents and accountants were only subject to administrative guidelines issued by the respective self-regulatory bodies ("SRBs"). Singapore received unfavourable ratings in the mutual evaluation for their DNFBP regime. The assessors specifically pointed out that, for estate agents and accountants, the CDD requirements were only set out in circular or code of ethics but not in law as required by the FATF recommendations. After the mutual evaluation, we understand that Singapore is taking remedies to improve its regulatory regime. The United Kingdom, another comparable jurisdiction which will undergo the FATF mutual evaluation in 2018, already sets out statutory CDD requirements under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 for independent legal professionals (among other DNFBPs and FIs) to observe when they engage in specified transactions.

5. Relevant extract of FATF's mutual evaluation on Singapore is as follows (English version only) –

"Criterion 22.1 [CDD]

…

(b) ***Real estate agents****: CDD obligations are promulgated through the CEA (Council for Estate Agencies)'s Practice Circular. The CEA is the self-regulatory body for real estate agents with a role of regulating and supervising its members, and the Practice Circular meets the FATF requirements for other enforceable means (OEM).* ***However, the principle to conduct CDD is only set out in the Circular but not in law, as required by the FATF Recommendations.*** *CEA has, on 17 September 2015, updated the revised Practice Circular to require CDD to be performed where (i) a customer in a property purchase transaction is a foreigner; and (ii) the estate agent is aware that physical cash is used for the purchase or sale of the property. However, the CEA's Practice Circular only contains a general description of CDD measures and does not specify the detailed requirements such as verification of any person purporting to act on behalf of a customer (c.10.4), understanding of intended nature of the business relationship (c.10.6) and of ownership/control structure (c. 10.8).*

…

(d) ***Lawyers and accountants****: For lawyers, the principle to conduct CDD is set out in s.70C of Part VA of the Legal Profession Act, while other CDD requirements are contained in the Legal Profession (Prevention of Money Laundering and Financing of Terrorism) Rules 2015. The beneficial ownership requirements contain the same exemptions as identified above in relation to c.10.10. As explained in relation to c.10.10, these exemptions are wider than the example in footnote 31 to c.10.10.* ***For accountants, CDD measures are set***

out in the ethics standards (ISCA EP-200) issued by the Institute of Singapore Chartered Accountants (ISCA), the SRB for accountants, but the ISCA EP-200 does not qualify as law or other enforceable means.
…"

Issues relating to the implementation of requirements under the AML Bill

6. As addressed at the meeting held on 28 November 2017, we believe that it should not be common for DNFBPs to rely on other DNFBPs as intermediaries to conduct CDD measures on their behalf. We will keep in view the transition of the DNFBP sectors to the AMLO regime and review the need to allow DNFBPs to rely on intermediaries in future.

7. The FATF requires that the principle for FIs and DNFBPs to conduct CDD and maintain records on transactions and information obtained through the CDD measures must be set out in law, although specific requirements may be set out in enforceable means. In the FATF parlance, "enforceable means" refers to regulations, guidelines, instructions or other documents or mechanisms that set out enforceable AML/CTF requirements in mandatory language with sanctions for non-compliance, and which are issued or approved by a competent authority. By competent authority, the FATF refers to all public authorities with designated responsibilities for combating money laundering and/or terrorist financing. SRB that represents a profession and which is made up of members from the profession, has a role in regulating the persons that are qualified to enter and who practise in the profession, and also performs certain supervisory or monitoring type functions, is not to be regarded as a competent authority according to the FATF.

   Much as we appreciate the PDP that the LSHK has put in place for subjecting solicitors and foreign lawyers to CDD and record-keeping requirements, we note that "these guidelines do not have the force of law and should not be interpreted as such" as also noted in paragraph 11 of the PDP. The CDD and record-keeping requirements set out in 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. Having regard to the FATF requirements as explained above and overseas experience, we are concerned that the absence from the law of the CDD and record-keeping requirements for legal professionals will very likely result in our failing the FATF test.

8. "Trust or company service" as defined in clause 25(3) of the AML Bill includes the provision in Hong Kong by a person, by way of business, of the service of acting as a trustee of an express trust or a similar legal arrangement. A trust can be contained in a will. Under the proposed new section 53F(1) of the AML Bill, only those who carry on a trust or company service business in Hong Kong need to obtain a licence. Whether a person carries on a business of providing trust services will depend on the facts and circumstances of each case, taking into

account factors such as scale of operation, regularity of transactions and profit-making motive. A licence is unlikely to be required in purely family arrangements which are one-off and do not involve commercial gain. In any event, as a trust will only be formed when the testator dies, the trustee will only need to obtain a licence when he commences to provide trust services.

Financial Services and the Treasury Bureau
8 December 2017