

立法會
Legislative Council

LC Paper No. CB(1)509/2022(02)

Ref: CB1/BC/5/22

**Bills Committee on Anti-Money Laundering and Counter-Terrorist
Financing (Amendment) Bill 2022**

Background brief

Purpose

This paper provides background information on the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (“AMLO Amendment Bill”), and summarizes the views and concerns expressed by the Panel on Financial Affairs (“FA Panel”) on the relevant legislative proposals and Hong Kong’s anti-money laundering and counter-terrorist financing (“AML/CTF”) regulatory regime in recent years.

Background

2. The Financial Action Task Force (“FATF”) is an inter-governmental body established in 1989 that sets international standards on combating money laundering and terrorist financing (“ML/TF”). Hong Kong has been a member of FATF since 1991. FATF oversees implementation of its standards through mutual evaluations (i.e. a peer review process) conducted by member jurisdictions on their respective AML/CTF regulatory regimes on regular basis.

3. The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) (“AMLO”) was enacted in 2011 and came into full operation in April 2012. Under AMLO, financial institutions (“FIs”)¹ were

¹ According to Part 2 of Schedule 1 to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), a financial institution refers 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 Ordinance (Cap. 41); (d) licensed money service operators (i.e. money changers and remittance agents); (e) the Postmaster General; or (f) an stored value facilities licensee.

required to implement customer due diligence (“CDD”) and record-keeping requirements which are the main strands of AML/CTF regulatory regime championed by FATF. The relevant CDD and record keeping requirements are set out in Schedule 2 to AMLO. Under the CDD measures, FIs are required to identify and verify the identity of customers and keep the relevant customer records for certain periods of time. Non-compliance with the requirements may render FIs liable to supervisory and criminal sanctions.

4. The Administration introduced the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 (“the 2017 AML Bill”) and the Companies (Amendment) Bill 2017 (“the 2017 CO(A) Bill”) into the Legislative Council (“LegCo”) in June 2017 to address two potential deficiencies that might be identified in FATF’s mutual evaluation on Hong Kong’s AML/CTF regulatory regime scheduled for 2018 to 2019, namely the absence of statutory CDD and record-keeping requirements for designated non-financial businesses and professions (“DNFBPs”), and the absence of statutory requirements for companies to keep beneficial ownership information. The 2017 AML Bill sought to, inter alia, prescribe statutory CDD and record-keeping requirements applicable to four DNFBPs (i.e. solicitors, accountants, real estate agents, and trust or company service providers)² when they engage in specified transactions.³ The 2017 CO(A) Bill required companies incorporated in Hong Kong to ascertain the individual and legal persons that have significant control over the companies, and to keep up-to-date information of these parties. The two bills were passed by LegCo in January 2018.

Proposals to enhance Hong Kong’s anti-money laundering and counter-terrorist financing regulatory regime

5. The Mutual Evaluation Report on Hong Kong, published by FATF in September 2019, set out FATF’s recommendations on areas for Hong Kong to improve its AML/CTF regime including putting in place appropriate AML/CTF obligations for dealers in precious metals and stones (“DPMS”).

6. Separately, the rapid development of virtual asset (“VA”) trading activities in recent years have posed ML/TF risks. To address such risks, FATF

² In FATF’s parlance, designated non-financial businesses and professions cover casinos, dealers in precious metals and stones, real estate agents, lawyers, notaries, accountants, and trust or company service providers (“TCSPs”). In view of Hong Kong’s prevailing circumstances, the Administration’s then legislative proposals covered solicitors, accountants, real estate agents and TCSPs only.

³ Specified transactions include real estate transactions; management of client money, securities or other assets; management of bank, savings or securities accounts; company formation and management; and buying and selling of business entities.

required in early 2019 member jurisdictions to regulate virtual asset services providers (“VASPs”) and subject them to the same range of AML/CTF obligations as applicable to FIs and DNFBPs.

7. On 3 November 2020, the Administration launched a three-month public consultation on the legislative proposals on the AMLO Amendment Bill. In relation to regulation of DPMS, the Administration has proposed introducing a two-tier registration regime and subject registrants engaging in cash transactions at or above HK\$120,000 to the AML/CTF obligations stipulated in Schedule 2 to AMLO. As regards regulation of VASPs, the Administration has proposed establishing a regulatory regime requiring any person seeking to engage in the regulated activity of operating a virtual asset exchange in Hong Kong to apply for a licence from the Securities and Futures Commission (“SFC”). Licensed VASPs will be subject to the AML/CTF requirements stipulated under AMLO as well as other regulatory requirements including that they can only offer services to professional investors. The Administration published the consultation conclusions on 21 May 2021. According to the Administration, the respondents generally agreed with the overall direction and principles as well as the broad framework of the legislative proposals.

Major provisions in the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022

8. The Government published in the Gazette the AMLO Amendment Bill on 24 June 2022. The Bill received its First Reading at the LegCo meeting of 6 July 2022.

9. The AMLO Amendment Bill seeks to:

- (a) amend AMLO to establish a licensing regime for VASPs (new Part 5B and new Schedules 3B to 3G) and a registration regime for DPMS (new Part 5C and new Schedules 3H to 3J);
- (b) apply the CDD and record-keeping requirements under Schedule 2 to Cap. 615 (i.e. AML/CTF requirements) to VASPs and DPMS when they conduct certain transactions (proposed new section 5A(5A)); and
- (c) make related and miscellaneous amendments (clauses 24, 26, 29 and 34).

10. The main provisions of the AMLO Amendment Bill are explained in paragraph 40 of the LegCo Brief (File Ref.: B&M/4/1/41C issued on 22 June 2022) and paragraphs 5 to 16 of the Legal Service Division Report on the Bill (LC Paper No. LS54/2022). The AMLO Amendment Bill, if passed, will come into operation on 1 January 2023, except the proposed sections 53ZRD to 53ZRG relating to the restrictions on carrying on a business of providing VA service, and proposed section 53ZTX and Schedule 3G on the transitional arrangements for the licensing requirements of VASPs, which will come into operation on 1 March 2023.

Members' views and concerns

11. The Administration briefed FA Panel on its proposal to regulate VASPs and consulted the Panel on the legislative proposals under the Bill at the meetings on 7 June 2021 and 7 February 2022 respectively. Panel members also discussed measures to protect investors of VAs during briefings on the latest development of financial technologies (“Fintech”) in Hong Kong at meetings on 3 April 2018, 1 April 2019, 1 June 2020 and 6 June 2022. The views and concerns expressed by members are summarized in the ensuing paragraphs.

Measures to protect investors of virtual assets

12. During the briefings on the latest development of Fintech in Hong Kong in 2018, 2019, 2020 and 2022, members raised concerns about regulation of VA trading platforms and measures to protect investors, and called on the Administration and regulators to formulate prudent regulations over Initial Coin Offerings (“ICOs”) through introducing a licensing regime for ICOs and restrict the participation of ICO trading to professional investors. Members further urged the Administration to step up its work on investor education regarding investment risks of VAs. Members enquired how the AMLO Amendment Bill could protect investors from fraud involving VAs, and whether the Bill would impose requirements (e.g. ring-fencing arrangement) on a licensed VASP to protect the assets of its customers. There were also suggestions that the Administration should draw reference from the practices of other local and overseas financial regulators to enhance protection for investors of VAs.

13. Regarding the regulation of ICOs, SFC advised that digital tokens were generally regarded as virtual commodities; and depending on terms and conditions, certain digital tokens might be regarded as “securities” under the Securities and Futures Ordinance (Cap. 571). SFC had issued a statement in September 2017 to clarify when digital tokens would be subject to the securities laws of Hong Kong. If issuers of ICOs applied to SFC for licences in launching

ICO exercises, SFC could consider imposing conditions on such licences to ensure proper protection for investors including setting eligibility criteria for investors.

14. As regards the regulation of VA trading platforms, SFC advised that it had issued licensing and supervisory frameworks for virtual asset funds and trading platforms in November 2018 and November 2019 respectively. As at end May 2020, SFC had granted a licence to a company managing VA funds and was processing licensing applications from a number of interested trading platforms. The Administration and SFC advised that under the proposed VASP licensing regime, any person seeking to operate a VA exchange would be required to obtain a VASP licence from SFC. Unlicensed parties would be prohibited from actively marketing their services to the public.

15. On the protection for client assets, SFC responded that a licensed VASP would be required to purchase insurance for its customers' assets and make proper arrangements in relation to client assets. All relevant investor protection measures currently applicable to SFC-regulated intermediaries (like proper segregation of client assets and financial resources requirements) would also be adopted in the proposed VASP licensing regime.

Proposed regulation of virtual asset services providers

16. At FA Panel discussions in 2021 and 2022, members expressed concern on whether the Administration's proposal to regulate VASPs could offer sufficient protection for investors and effectively combat money laundering through VA activities, in particular how the proposed regime could cover new kinds of VAs emerging in the market. Concerns were also raised about possible regulatory loopholes given that the proposed regime would only regulate VA exchanges. These members urged the Administration to closely monitor the development of VASP regulatory regimes of other jurisdictions in working out Hong Kong's own regime. Members further enquired about the scope of the proposed VASP licensing regime, including whether VAs issued by large information technology companies (e.g. Facebook) and VAs backed by real assets (e.g. real estate) would be covered.

17. The Administration advised that it would closely monitor the market development, and would strive to strike a proper balance between regulation and market development in formulating the proposed VASP regulatory regime. The proposed regulatory regime was developed based on the prevailing international standards for addressing ML/TF risks of VA activities and ensuring proper protection of market integrity and investor interests. Licensed VASPs would be subject to AML/TF requirements under AMLO and other regulatory requirements

for investor protection purposes as appropriate. There would also be requirements on licence applicants including the fit and proper test.

18. On the scope of VAs subject to regulation, SFC responded that under the existing regime, only securities-type VAs (e.g. security tokens or crypto funds) were subject to regulation by SFC. Under the proposed regulatory regime, both securities-type or non-securities type VAs would be regulated. A VA would be defined as “a digital representation of value that is expressed as a unit of account or a store of economic value; an asset functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services or for the discharge of a debt, or for investment purposes; and can be transferred, stored or traded electronically”. This definition was consistent with that promulgated by FATF.

19. Regarding the rationale for regulating VA exchanges, the Administration pointed out that the proposed licensing regime was tailored for VA exchanges as they were by far the most prevalent and developed embodiment seen in Hong Kong. Besides, VA activities conducted outside VA exchanges either had scanty local presence (e.g. VA payment systems) or could involve financial institutions which were already subject to the regulation of AMLO. As VAs were evolving rapidly, the AMLO Amendment Bill would adopt a functional approach in defining VAs so that new tokens emerging in future could be captured if they perform the same functions that the Bill sought to regulate. In a similar vein, the scope of the proposed regulatory regime would be on centralized VA exchanges. To cater for future development in VAs, the Secretary for Financial Services and the Treasury would be empowered under the Bill to designate further VA activities to be subject to the VASP licensing regime as necessary.

20. Noting that under the proposed VASP licensing regime all executive directors of a licensed VASP must be made responsible officers upon approval by SFC, members asked if such directors would be required to possess relevant knowledge of Fintech, as well as to participate in relevant training programmes so as to ensure that such executive directors were fit and proper persons.

21. The Administration advised that under the legislative proposals, the executive directors of a licensed VASP, who must also obtain the approval of SFC to become as responsible officers of the licensed VASP, were required to satisfy the fit-and-proper test, which took into account, amongst others, the experience and relevant qualifications of the person, and whether the person was competent to carry on the regulated VASP activity. In this connection, given the nascent nature of the VASP business model, SFC would expect the executive directors to have both financial and technical expertise to ensure the proper and smooth running of the VASP business. Responsible officers were also required to update

their knowledge and skills through continuous professional training as part of the regulatory requirements. These detailed regulatory requirements would be provided in codes and guidelines to be published by SFC, subject to consultation before the commencement of the proposed regime. The above requirements were currently applicable to the executive directors, who were also the responsible officers, of licensed VA exchanges under SFC 's existing opt-in regime.

22. Some members, while expressing support for the proposed regulatory framework to regulate VA trading platforms and licensing system for VASP, stressed the importance for the Administration to strike a balance between regulation and development of the market and called for relaxation of the proposed restriction on VASPs that they could only provide services to professional investors.

23. The Administration responded that to provide certainty to the market, the Administration would specify in the AMLO Amendment Bill that licensed VASPs could only offer services to professional investors at the initial stage. The Administration and SFC would keep in view the evolving landscape and make suitable adjustments in due course in light of experience in operating the new regulatory regime.

Exemptions for virtual asset service providers

24. As VA exchanges that were already regulated as a licensed corporation under SFC's existing opt-in regime would be exempt from the licensing requirements of the proposed VASP licensing regime, some members expressed concern about possible regulatory inconsistencies of VA exchanges under the two regimes. Enquiries were also raised about whether intermediaries/practitioners engaging in VA trading activities would be subject to regulation.

25. SFC confirmed that regulation of VA exchanges under its opt-in regime and the proposed VASP licensing regime would be consistent. SFC and the Hong Kong Monetary Authority had issued a joint circular for intermediaries engaging in VA-related activities, including restricting the sale of VAs to professional investors and imposing risk disclosure requirements.

Two-tier registration regime for dealers in precious metals and stones

26. During discussions at FA Panel meetings in 2022, members enquired whether a group company could make one exemption application for all its eligible subsidiaries under the two-tier registration regime for DPMS instead of submitting separate application for each subsidiary.

27. The Administration responded that whether separate exemption applications for individual subsidiaries of a group company would be required would depend on the company's structure. In general, an entity already regulated under a relevant legislation (e.g. the Securities and Futures Ordinance (Cap. 571)) would be exempt from the registration regime for DPMS where it conducted DPMS activities as an ancillary to its principal business.

28. Given that the majority of DPMS were already familiar with the international standards on anti-money laundering, some members considered that the Administration should implement measures and provide exemptions to DPMS so as to mitigate the impact on the industry.

29. The Administration advised that the Customs and Excise Department would be the enforcement authority for the proposed regulatory regime for DPMS, and had been maintaining close liaison with the industry on the related issues. In fact, the two-tier registration regime for DPMS was proposed having regard to the views of the industry and the relevant international standards.

Regulation of online crowdfunding activities

30. In response to members' enquiry about whether local and overseas online crowdfunding activities targeting Hong Kong public were currently regulated under AMLO, the Administration responded that the AMLO Amendment Bill did not cover the regulation of online crowdfunding activities. That said, the Administration was reviewing measures to enhance the regulation of such activities.

Council questions

31. LegCo Members raised a number of questions relating to the trading of VAs and its regulation during the Sixth and Seventh LegCo. The questions and the Administration's responses are provided in hyperlinks in the **Appendix**.

Latest development

32. At its meeting on 8 July 2022, the House Committee agreed to form a Bills Committee to study the AMLO Amendment Bill.

Relevant papers

33. A list of relevant papers is in the **Appendix**.

Council Business Division 1 and Public Complaints Office
Legislative Council Secretariat
26 July 2022

List of relevant papers

Date	Event	Papers/Minutes of meeting
29 June 2011	The Legislative Council (“LegCo”) passed the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill	The Bill passed Legislative Council Brief Report of the Bills Committee (LC Paper No. CB(1)2586/10-11)
8 November 2017	Hon CHAN Chun-ying raised a written question on “Regulation of the offering and trading of digital tokens”	Hansard (pages 1473- 1476)
6 December 2017	Hon Charles Peter MOK raised an oral question on “Regulating and facilitating financial technology development”	Hansard (pages 3537- 3546)
24 January 2018	LegCo passed the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 and the Companies (Amendment) Bill 2017	The Bills passed 1 and 2 Legislative Council Briefs 1 and 2 Report of the Bills Committee (LC Paper No. CB(1) 496/17-18)
3 April 2018	The Panel on Financial Affairs (“FA Panel”) was briefed by the Administration on the development of financial technologies (“Fintech”) in Hong Kong	Administration’s paper (LC Paper No. CB(1)724/17-18(03)) Minutes (LC Paper No. CB(1)1178/17-18)

Date	Event	Papers/Minutes of meeting
1 April 2019	FA Panel was briefed by the Administration on the development of Fintech in Hong Kong	Administration's paper (LC Paper No. CB(1)760/18-19(04)) Minutes (LC Paper No. CB(1)1212/18-19)
3 April 2019	Hon Dennis KWOK raised a written question on "Regulation of financial technology applications"	Hansard (pages 8401- 8405)
4 September 2019	The Financial Action Task Force ("FATF") published the Mutual Evaluation Report on Hong Kong	FATF's report (English version only) Administration's paper (LC Paper No. CB(1)1347/18-19(01))
1 June 2020	FA Panel was briefed by the Administration on the development of Fintech in Hong Kong	Administration's paper (LC Paper No. CB(1)674/19-20(04)) Minutes (LC Paper No. CB(1)953/19-20)
3 November 2020	The Administration launched a consultation on legislative proposals to enhance anti-money laundering and counter-terrorist financing regulation	Press release Consultation paper
17 March 2021	Hon LEUNG Che-cheung raised a written question on "Virtual asset trading platforms"	Hansard (pages 4069- 4071)

Date	Event	Papers/Minutes of meeting
21 May 2021	The Administration released the consultation conclusions on the consultation launched on 3 November 2020	Press release Consultation conclusions
7 June 2021	FA Panel was briefed by the Administration on its proposal to regulate virtual asset trading platforms	The Administration's paper (LC Paper No. CB(1)963/20-21(04)) Minutes (LC Paper No. CB(1)1323/20-21)
7 February 2022	The Panel on Financial Affairs was briefed by the Administration on the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022	Administration's paper (LC Paper No. CB(1)32/2022(02)) Minutes (LC Paper No. CB(1)226/2022)
16 February 2022	Written question raised by Hon CHAN Kin-por on "Trading of Digital Assets"	Hansard (pages 18 & 248-250)
6 June 2022	FA Panel was briefed by the Administration on the development of Fintech in Hong Kong and measures in tackling financial fraud	Administration's paper (LC Paper No. CB(1)311/2022(03))