

SFC consultation paper on proposed anti-money laundering and counter-terrorist financing guidelines

Introduction

On 1 April 2012, the new Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance, Cap. 615 ("**AMLO**") will come into effect, which introduces a new legislative framework on the obligations of financial institutions to take appropriate measures to combat money laundering and terrorist financing activities. The AMLO will be supplemented by guidelines issued by the four relevant regulatory authorities ("**RAs**"), namely the Securities and Futures Commission ("**SFC**"), the Hong Kong Monetary Authority ("**HKMA**"), the Insurance Authority ("**IA**") and the Customs and Excise Department.

The AMLO intends to address the perceived deficiencies in Hong Kong's AML regime and to align Hong Kong's customer due diligence and record-keeping requirements with international standards, namely those of the Financial Action Task Force ("**FATF**").

The measures adopted by the AMLO include: (i) legislating customer due diligence and record-keeping requirements for financial institutions; (ii) enhancing supervisory and enforcement powers of the RAs, including the SFC, the HKMA and the IA; (iii) introducing specific criminal and regulatory sanctions for non-compliance; and (iv) introducing an AML regime for remittance agents and money changers.

The AMLO will be supplemented by guidelines issued by the relevant regulatory authorities for the financial institutions ("**FIs**") they regulate, and the SFC has now launched a consultation on its two proposed guidelines:

- (i) the Guideline on Anti-Money Laundering and Counter-Terrorist Financing ("**Guideline**"); and
- (ii) the Prevention of Money Laundering and Terrorist Financing Guideline for Associated Entities ("**AE Guideline**").

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The Guideline aims to provide guidance to licensed corporations ("**LCs**") and their officers and staff to comply with the AMLO and other applicable anti-money laundering ("**AML**")/ counter-terrorist financing ("**CTF**") legislation and relevant regulatory requirements. On the other hand, the AE Guideline applies to associated entities¹ of LCs which need to implement similar AML/CTF policies.

The Guideline will replace the SFC's existing Prevention of Money Laundering and Terrorist Financing Guidance Note ("**Existing Guidance Note**"), which currently applies to both LCs and associated entities.

The SFC is seeking comments on the Guideline and the AE Guideline by 18 November 2011.

Overview of the Guideline

Chapter 1: Overview

In addition to the AMLO, the main pieces of money laundering and counter-terrorist financing related legislation in Hong Kong are the Drug Trafficking (Recovery of Proceeds) Ordinance (the "**DTROP**"), the Organized and Serious Crime Ordinance (the "**OSCO**") and the United Nations Anti-Terrorism Measures Ordinance (the "**UNATMO**").

The Guideline is issued by the SFC in order to provide guidance to licensed corporations in the application of the AMLO and the other AML/CTF legislation. Since the AMLO provides for a uniform set of requirements applicable to all financial institutions in the banking, securities, insurance and remittance and money changing sectors, the RAs have drafted a set of guidelines that contain generic guidance that is applicable to all FIs. Hence, the guidance in Chapters 1 – 10 of the Guideline is generally the same as that provided by the other Hong Kong regulatory authorities under their respective regulatory regimes relating to the AMLO. Where the SFC considers that sector-specific guidance is required, such guidance is presented in italics.

The Guideline does not have force of law, but a failure to comply with any of the requirements of the Guideline by LCs and their licensed representatives may reflect adversely on their fitness and propriety, and may also constitute an offence under the AMLO.

Chapter 2: AML/CTF Systems and Business Conducted Outside Hong Kong

FIs should have effective controls covering: (i) senior management oversight; (ii) appointment of a compliance officer and a money laundering reporting officer; (iii) compliance and audit function; and (iv) staff screening and training. The compliance officer acts as the responsible person within an FI having oversight of all activities relating to the prevention and detection of money laundering or terrorist financing, and providing support and guidance to the senior management to ensure that such risks are adequately managed. The money laundering reporting officer, on the other hand, is expected to play an active role in the identification and reporting of suspicious transactions.

With respect to business conducted outside Hong Kong, Hong Kong-incorporated FIs which have overseas branches or subsidiary undertakings should have a group AML/CTF policy to ensure that the branches and subsidiary undertakings that carry on the same business as the FI outside Hong Kong have procedures in place to comply with the customer due diligence and record keeping requirements similar to those imposed under Parts 2 and 3 of Schedule 2 of the AMLO, to the extent permitted by the law of that place. This means, effectively, that overseas branches and subsidiaries of a Hong Kong FI must apply similar AML/CTF policies as those prevailing in Hong Kong.

¹ An associated entity of a licensed corporation is a company incorporated or registered in Hong Kong which (a) is in a controlling entity relationship with the licensed corporation; and (b) receives or holds in Hong Kong client assets of the licensed corporation.

Chapter 3: Risk-Based Approach

The Guideline endorses a risk-based approach to customer due diligence and monitoring. Whilst the SFC notes that an effective risk-based approach involves identifying and categorizing money laundering and terrorist financing risks at the customer level and establishing reasonable measures based on the risks identified, it recognizes that there can be no universally accepted methodologies that prescribe the nature and extent of a risk-based approach. The Guideline suggests four factors that FIs should consider when making risk assessments:

- (i) Country risk – e.g. a customer with residence in, or connected with, a jurisdiction that does not or insufficiently applies the FATF recommendations².
- (ii) Customer risk – e.g. a customer with a public profile involving with, or connected to, politically exposed persons ("PEPs").
- (iii) Product/ service risk – e.g. services that inherently have provided more anonymity.
- (iv) Delivery/ distribution channel risk – e.g. customers with non-face-to-face account opening or business sold through agencies or intermediaries.

It is important for the FI to keep relevant records and documents when carrying out its risk assessment to demonstrate, amongst other things, how it assesses the customer's money laundering and terrorist financing risk and the extent of customer due diligence and ongoing monitoring is appropriate based on that customer's risk.

Chapter 4: Customer Due Diligence

The Guideline lists out the customer due diligence measures that are applicable to an FI, with examples of relevant information that should be obtained. Amongst other things, detailed guidance is provided in relation to:

- (i) the identification and verification of the customer's identity, its beneficial owner, and any person purporting to act on behalf of the customer;
- (ii) customer due diligence measures appropriate for different types of customers including natural persons, corporations, partnerships and unincorporated bodies and trusts;
- (iii) the types of customers or situations to which simplified customer due diligence, enhanced due diligence or special requirements can or should be applied under the AMLO;
- (iv) customer due diligence measures for PEPs, customers not physically present for identification purposes, or pre-existing customers;
- (v) jurisdictions that do not or insufficiently apply the FATF recommendations;
- (vi) reliance on customer due diligence performed by intermediaries; and
- (vii) keeping customer information up-to-date.

² FATF recommendations comprise of the 40 Recommendations and the 9 Special Recommendations. The FATF's 40+9 Recommendations, together with their interpretative notes, provide the international standards for combating money laundering and terrorist financing.

Who is the customer?

There is no definition of customer – the Guideline simply states that the meaning of the term should be inferred from its everyday meaning and in the context of industry practice. Given the central importance of this term, the absence of any guidance is surprising. For example, when does an investor or counterparty become a customer? FIs will need to determine very carefully to whom they will need to apply the AML/CTF measures.

Persons purporting to act on behalf of customers

Under section 2(1)(d) of Schedule 2 to the AMLO, FIs are required to identify all persons purporting to act on behalf of customers, and take reasonable measures to verify their identity and verify their authority to act on behalf of the customers. Whilst the Guideline has provided some flexibility as to what measures would be considered reasonable for verifying the identity of a person purporting to act on behalf of a customer, it will be very burdensome for an FI to verify the identity of a person purporting to act for a customer, for example when the customer is a bank or some other large organization. This may be less of an issue for banks who will verify the identity of bank account signatories as a matter of course, but the same cannot necessarily be said for mandates carried out by LCs, such as a corporate finance adviser or broker-dealer.

Chapter 5: Ongoing Monitoring

Ongoing monitoring by the FI involves, amongst other things, reviewing from time to time documents, data and information relating to the customer and transactions of the customer, and identifying transactions that may indicate irregularities. The extent of ongoing monitoring should be linked to the risk profile of the customer, such that an FI's resources are targeted towards business relationships presenting a high or higher risk of money laundering and terrorist financing. When handling unusual or suspicious activities, FIs will need to document in writing the findings, outcomes and the rationale of all decisions made. Whilst examinations may include asking the customers questions, it is important that any enquiries do not constitute tipping off.

Chapter 6: Financial Sanctions and Terrorist Financing

FIs are expected to maintain a system containing names and particulars of terrorist suspects and designated parties by consolidating the various lists that have been made known to it. Alternatively, an FI may engage third party service providers to access such a database. The FIs should have processes in place to identify payment instruction attempts to designated parties.

If an FI freezes funds under Hong Kong's financial sanctions legislation or where it has suspicions of terrorist financing or sanction violations then it must make a report to the Joint Financial Intelligence Unit ("**JFIU**").

Chapter 7: Suspicious Transaction Reports

FI should provide sufficient guidance to its staff to enable them to recognize money laundering and terrorist financing activities. Where there is knowledge or suspicion of money laundering and terrorist financing, FI has an obligation to report its knowledge or suspicion to the JFIU as soon as practicable. Under the OSCO, DTROP and UNATMO, FIs and their staff are prohibited from disclosing to their customer the fact that a suspicious transaction report is reported to the JFIU, so as to mitigate the risk that customers could be unintentionally tipped off when the FI performs its customer due diligence obligations during the establishment or in the course of the business relationship or when conducting occasional transactions.

Chapter 8: Record Keeping

The records prepared and maintained by FIs on customers and transactions should meet the record keeping requirements established under the AMLO, the Guideline and other regulatory requirements that are appropriate to the scale, nature and complexity of the FIs' business. Such records must also be made available on a timely basis to the relevant Hong Kong regulatory authorities, other authorities and auditors upon appropriate authorization.

Documents relating to customer identity should be kept throughout the business relationship with the customer and for a period of six years after the business relationship ends. Certain information in connection with a transaction carried out for a customer, including the nature and date of the transaction and the type and amount of currency involved should be kept for a period of six years after the completion of a transaction regardless of whether the business relationship ends during the period.

It is possible for an RA by notice to request an FI to keep records for a longer period of time where the records are relevant to an on-going criminal or other investigation, or for other purposes as specified in the notice.

It is important to note that whilst FIs can rely on an intermediary to carry out customer due diligence measures on its behalf, the FI concerned remains responsible for compliance with all record keeping requirements. FIs should ensure that the intermediaries being relied on have systems in place to comply with all the record keeping requirements under the AMLO and the Guideline.

Chapter 9: Staff training

Staff training is an important element of an effective system to prevent and detect money laundering and terrorist financing activities. FIs can tailor their training program, such as the timing and contents of the training package for different groups of staff provided they take into account the size and the complexity of their business and the type and level of money laundering and terrorist financing risk. To ensure that relevant staff receive adequate AML/CTF training, the policy implemented by the FIs should be clear and well articulated. FIs are also required to monitor the effectiveness of their AML/CTF training, for example by testing staff of their understanding of the AML/CTF policies and procedures and monitoring the compliance of staff with the FIs AML/CTF systems.

Chapter 10: Wire Transfers

Chapter 10 provides guidance relating to the wire transfer provisions in the AMLO. The AMLO imposes special requirements on FIs when carrying out wire transfers, such as the need to verify and record various identification information of the originator of the wire transfer, including the information in the message or payment form accompanying the wire transfer.

Paragraph 10.1 states that the wire transfer provisions and the corresponding guidance in Chapter 10 primarily apply to authorized institutions and money service operators. Other FIs should also comply with section 12 of Schedule 2 and the guidelines provided in Chapter 10 if they act as an ordering institution or beneficiary institution as defined under the AMLO. Where an FI is the originator or recipient/beneficiary of a wire transfer, it is not acting as an ordering institution or beneficiary institution and thus is not required to comply with the requirements under section 12 of Schedule 2 or Chapter 10 in respect of that transaction.

The SFC notes that there had been discussions during the soft consultation as to whether LCs would ordinarily be considered to carry out wire transfers, and is seeking comments on whether Chapter 10, and in particular paragraph 10.1, is sufficiently clear as to when the wire transfer provisions do not apply to an LC.

Summary

Whilst the Guideline implements and provides guidance on the interpretation of the AMLO and does not cover new ground, the level of detail provided in the Guideline has put the spotlight on a number of areas where FIs may find practical implementation challenging. Depending on the business carried out by the relevant FI, problematic areas may include (i) determining who constitutes a customer; (ii) verifying the identity of a person acting on behalf of a customer; (iii) delegation of customer due diligence to an overseas service provider; and (iv) when relying on customer due diligence carried out by a third party intermediary, assessing whether such intermediary has "measures in place to ensure compliance with requirements similar to those imposed" under the AMLO. As there is little time before the AMLO is enacted, it is important that FIs review in detail the requirements imposed under the AMLO and fleshed out in the Guideline, and provide comments to the SFC where the requirements cannot be appropriately met in practice.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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