

The New FATF 40 Recommendations and the Impact on Hong Kong and China: A Framework for the Future

Since 1991 Hong Kong (**HK**) has been an independent member of the Financial Action Task Force (**FATF**), an inter-governmental organisation established by the G-7 Summit in 1989, based in the OECD, Paris, France, with responsibility for promoting national and international policies to combat money laundering and terrorism financing. The People's Republic of China (**China**) is also one of the 36 members of FATF, having become a full member in June 2007. Anti-money laundering measures (**AML**) and combating financing of terrorism (**CFT**) have been an increased focus of national regulators around the world. Member countries and numerous observer organisations of the FATF participate in the formulation and implementation of the FATF's 40 Recommendations. The members of FATF represent most major financial centres in all parts of the world. The continued need to further strengthen agreed international standards and the evolution of money laundering techniques has led the FATF to revise its International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation (**the Recommendations**) following its recent plenary in February 2012.

Separately, Hong Kong is also required to implement the United Nations Security Council Resolution 1373 (**UNSCR 1373**) to prevent and suppress terrorist financing, criminalize funds for terrorist acts and freeze terrorist assets. The obligations of UNSCR 1373 and FATF's Special Recommendations on Terrorist Financing have been implemented in Hong Kong through the United

Key issues

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Nations (Anti-Terrorism) Measures Ordinance (**UNATMO**). Recent steps are being taken in HK to further strengthen HK's commitment to combat terrorist financing.

In this briefing we cover these key issues:-

- **Key Changes to the FATF Recommendations**
- **Legislative Steps Taken by Hong Kong since the FATF's Mutual Evaluation Report of Hong Kong in 2008**
- **Timetable for Implementation in HK of the Recommendations**
- **FATF Follow-Up Report on China**
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The changes include an increased focus on a risk-based approach to anti-money laundering (**AML**) and counter terrorist financing (**CFT**) measures designed to allow countries, within the framework of the FATF requirements, to adopt a more flexible set of measures commensurate to the nature of risks identified. This includes the strengthening of requirements in areas now identified as high risk, such as the identification of politically exposed persons (**PEPs**), and the expansion of the Recommendations to deal with new threats, such as the financing of the proliferation of weapons of mass destruction.

In addition to extending the scope of the Recommendations, FATF has also sought to encourage the efficient and effective use of resources by embedding a risk-based approach and clarifying obligations in some specific areas where countries have experienced practical difficulties with implementation.

Key changes to the FATF Recommendations

The key changes to the new single set of 40 Recommendations (incorporating FATF's 40 Recommendations and 9 formerly named Special Recommendations) are: -

- The inclusion of tax crimes as predicate offences for money laundering;
- The extension of obligations on financial institutions (**FIs**) to conduct enhanced due diligence on a risk basis to domestic PEPs;
- The introduction of more rigorous requirements in relation to the information which must accompany wire transfers;

- The requirement for countries to establish mechanisms to record basic company information and to enable FIs, competent authorities and others to determine beneficial ownership and conduct appropriate Customer Due Diligence (**CDD**);
- The introduction of a new step-by-step process for the identification of beneficial ownership and control of companies as part of CDD measures.

Many of the measures in the Recommendations are directed at national governments and jurisdictions (for example, those requiring increased international co-operation and information sharing), whereas others are directed at those in the private sector required to comply with AML and CFT obligations (financial institutions and other non-financial businesses and professions).

Although Hong Kong was not one of the countries originally subject to the Third European Union (**EU**) Anti-Money Laundering Directive on the Prevention of the Use of the Financial System for the Purpose of Money Laundering, (**the AML Directive**) passed by the EU in 2005 (Hong Kong not being a member of the EU), in May 2008, member States of the EU agreed a list of equivalent third countries or jurisdictions that would be included under the Directive. Hong Kong was included in that list for the purposes of the relevant parts of the AML Directive. Whilst the AML Directive is a voluntary non-binding measure, it nevertheless represents a common understanding of member states and jurisdictions listed thereunder for the purposes of achieving compliance with global AML standards. Since 2008, Hong Kong has made significant efforts to improve its AML/CFT legislative regime. The steps it has taken are set out below.

Legislative Steps Taken by Hong Kong since FATF's Report on Hong Kong in 2008

In 2008, the FATF completed its Mutual Evaluation Report (**the Report**) on HK's compliance with the then existing FATF Recommendations in countering money laundering and terrorist financing. Although the Report recognized the strengths of HK's AML and CFT regime, the Report made a number of recommendations to improve HK's compliance of FATF's Recommendations.

Specifically, the Report concluded that HK needed to effectively implement legislative measures to address certain key deficiencies in the AML/CFT regime, including improvement to compliance with **two major recommendations** which respectively required:-

- the criminalization of the financing of terrorism, terrorist acts and terrorist organizations, and
- the full implementation of the requirements of the United Nations on CFT including Security Council Resolution on CFT (UNSCR 1373) (for a copy of the FATF's full 2008 report on Hong Kong please refer to www.oecd.org/dataoecd/19/38/41032809.pdf).

Hong Kong's major trading partners, including the United Kingdom, the USA, Singapore, Canada and Australia have already complied with these two major recommendations referred to above. On the basis of the Report and in accordance with FATF procedures, HK is expected to have addressed the major deficiencies identified above and seek FATF's agreement to remove HK from the follow-up process not later than four years after the Report. i.e. by June 2012. If HK fails to seek removal from the follow-up process within a reasonable period due to absence of substantial improvements, the FATF could tighten its scrutiny and monitoring of HK which could have an adverse effect on HK as a major financial centre.

To address the perceived deficiencies, the new Anti-Money Laundering and Counter-Terrorism Financing (Financial Institutions) Ordinance (**AMLO**) will come into effect in HK on 1 April 2012 and the United Nations (Anti-Terrorism Measures) (Amendment) Bill 2012 (**the UNATMO Bill**) has recently been introduced into HK's Legislative Council (**LegCo**). (see below).

Timetable for implementation in HK of Recommendations

On 1 April 2012, Hong Kong will introduce the Anti-Money Laundering and Counter-Terrorism Financing (Financial Institutions) Ordinance (**AMLO**) which legislation is a strong indicator of HK's ongoing efforts to comply with the FATF's Recommendations. The Securities and Futures Commission in Hong Kong (**SFC**) has also recently proposed guidelines for FIs regarding AML and CFT to implement the new AMLO (please refer to our previous briefing on [SFC Consultation Conclusions, February 2012](#)).

On 22 February 2012, the HK Government introduced the **UNATMO Bill** into LegCo for its first reading. Specifically, the UNATMO Bill aims to amend HK's existing United Nations (Anti-Terrorism) Ordinance Chapter 575 (**UNATMO**) by :-

- repealing the definition of "funds" and replacing it with the broader term "property" so as to criminalize all assets and not simply funds;
- expanding the definition of "terrorist act" to cover the intended coercion of international organizations;
- criminalizing the collection (in addition to the provision or making available) of funds for terrorists and terrorist organizations to cover the collection of property or the solicitation of financial (or related) services for such persons and organizations; and
- making consequential amendments to the AMLO and Rules of the High Court

Many of the changes under the revised FATF Recommendations will form part of HK's AML and CFT regime once the two pieces of legislation, identified above, become part of HK's laws.

All FATF members, including HK, are expected to implement the new Recommendations. **In 2013**, FATF will commence its evaluation process to assess how effectively countries and jurisdictions, including Hong Kong and China, have implemented the Recommendations (including the latest changes) (please refer below for a summary of FATF's recent **Follow-Up Report on China**).

Since the 2008 Report on HK, HK has submitted two progress reports to the FATF on improvement actions taken or planned by HK to implement FATF's earlier Recommendations. According to a recent press release issued by the HK Government, HK intends to seek a firm commitment from the FATF for HK to be removed from the more rigorous follow-up process of the FATF in June 2012, because of the recent legislative efforts made by HK to address the major deficiencies identified by the FATF in its 2008 Report on HK. If HK is removed from the follow-up process, it will serve as a show of confidence by the FATF in HK's continuing progress in the AML/CFT sphere.

The FATF'S Recent Follow-Up Report on China

As noted above, China joined the FATF as a full member on 29 June 2007. The First Mutual Evaluation Report on China by the FATF (**the first Report**) was completed and published on the same date (for a copy of the FATF's first report on China please refer to www.oecd.org/dataoecd/33/11/39148196.pdf).

According to the first Report, China had, in a very short time, made significant progress in the implementing AML and CFT provisions and had a legal framework in place that applied a uniform set of AML/CFT measures to the entire financial system (rather than providing for a risk-based approach of preventive measures for FIs). The legal framework is based on various articles under the Penal Code (including Articles 349, 191, 312), rules issued by the People's Bank of China (**PBOC**) and various Rules and Administrative Regulations resulting in the Anti-Money Laundering Law (**AML Law**) of January 2007. The PBOC, supported by the State Council AML Bureau, the China AML Monitoring and Analysis Centre and Regulatory Commissions of the banking, securities and insurance sectors, has the overarching responsibility for driving forward and supervising China's AML policies. After the introduction of the AML Law, the PBOC issued the Financial Institutions Anti-Money Laundering Regulations and the Financial Institutions Reporting and Monitoring Schemes for Large and Suspicious Transactions in 2007. Financial Institutions, their directors and responsible officers are liable for penalties, both monetary and non monetary, if they do not fulfil their legal obligations under the AML Law. Foreign bank subsidiaries are expected to have adequate AML policies in place that comply with local requirements.

However, the first Report identified that China had opted for a "one-sided criminal procedure approach" using traditional and existing means. The FATF reported that this approach needed to be revisited as a whole, with special attention to be given to improving reporting obligations in all relevant financial and banking sectors, to implementing effective compliance of supervisory bodies, and to

better legislative coverage of the CFT offence. China was urged to introduce more specific customer due diligence (**CDD**) rules, particularly enhanced due diligence with regard to the identification and verification of bank customers, high risk categories of customers (such as PEPs), business relationships and transactions, taking more robust action with regard to filing suspicious transaction reports (**STRs**) and implementing specific AML requirements in relation to foreign PEPs.

China has reported back to the FATF at each FATF Plenary and, according to the FATF, China has been taking the necessary steps to tackle deficiencies identified in the first Report. China's new AML strategy will include the improvement of AML supervision and the establishment of a non-financial industry AML system. At the FATF's recent plenary held on 15-17 February 2012, **the FATF approved its follow-up Report on China**. (A copy of the recent report on China which is not yet available will be published shortly on the FATF's website at www.fatf-gafi.org/). The FATF has recently stated that because China has now taken additional action to address the deficiencies in its AML/CFT regime China has been taken off the regular follow-up process. Henceforth, China will report back to the FATF Plenary on China's further AML/CFT improvements on a biennial basis.

Impact of the changes for HK firms

Where the changes to the revised FATF Recommendations that affect FIs and other non-financial businesses and professions are not already covered by HK legislation, in many cases they may nevertheless already be incorporated into the practice currently employed by FIs. For example, many institutions currently, when conducting due diligence, do not typically differentiate between domestic and foreign PEPs.

Whilst the changes to the Recommendations introduce some new obligations and place additional emphasis on some areas, their immediate impact on HK firms is not likely to be substantial. However, AML and CFT legislation and practice vary significantly across jurisdictions, and the changes are likely to require more significant legislative and structural changes in many other jurisdictions where HK and Mainland Chinese firms operate.

Most HK firms will already be compliant with many of the Recommendations as amended. However, the clearer guidance now issued by FATF, coupled with the tougher action being taken by HK and China regulators, underlines the importance for firms of maintaining awareness of and compliance with their AML and CFT obligations. Firms whose policies do not already comply with the new requirements are therefore advised to consider implementing relevant changes to be in line with the new requirements in advance of the legislative changes coming into effect. We recommend that an AML programme should be individually customised to the particular organization's risk profile and business operations.

We have set out below a table showing the main changes to the FATF Recommendations.

Key changes to the FATF Recommendations

<p>Emphasis on risk-based approach to AML and CTF measures and supervision</p>	<ul style="list-style-type: none"> ■ The revised Recommendations call on financial institutions to apply a risk-based approach to identify, assess, monitor, manage and mitigate AML and CTF risks. A risk-based approach is also required to be taken by competent authorities in setting the rules and supervising financial and other institutions. ■ Where higher risks are identified, enhanced measures are required to manage and mitigate those risks. Simplified CDD measures may be allowed where lower risks are identified ■ The FATF has provided additional guidance in the form of illustrative examples of higher and lower risk factors, and the appropriate measures that might be adopted in certain situations. The FATF has also indicated that it will initiate further work to update existing guidance documents to reflect the changes in the risk-based approach, and to consider developing additional compliance risk indicators and best practices
<p>Inclusion of Tax Crimes as a Predicate Offence for Money Laundering</p>	<ul style="list-style-type: none"> ■ The list of predicate AML offences has been expanded to include tax evasion and other serious tax offences.
<p>Revised CDD Measures in relation to Beneficial Ownership</p>	<ul style="list-style-type: none"> ■ The Recommendations include a new step-by-step process for firms to follow when identifying beneficial ownership and control of companies as part of their CDD measures. Pursuant to that process, financial institutions should first try to identify the natural persons who ultimately have a controlling ownership interest; but if there is doubt over whether such persons hold the beneficial ownership, or when no such natural persons can be identified, any other natural persons that may exercise control over the customer through means other than shareholding should be identified. If these measures fail to identify a natural person exercising such controls, the financial institution should then take reasonable steps to identify the natural person holding a senior management position. ■ The revised Recommendations do not include a numerical threshold for determining controlling ownership of a legal person, but FATF has indicated that such an approach may be reasonable in some cases, and it will be the responsibility of individual countries to determine if appropriate. In the 3MLD, this is currently set at 25%. ■ The revised Recommendations also clarify that for life insurance policies, CDD measures in identifying beneficiaries need only occur at the time of the payout rather than at the beginning of the business relationship.
<p>Strengthening of transparency requirements in relation to Beneficial Ownership</p>	<ul style="list-style-type: none"> ■ Connected to the new Recommendations referred to above, in order to enable financial institutions and others to conduct appropriate CDD on companies and their beneficial owners, the revised Recommendations require national governments to ensure that all companies maintain basic information relating to the company, its directors and shareholders. The Recommendations note that countries have a range of options to determine how additional information relating to beneficial ownership is maintained (e.g. official databases) and that measures should be adopted to ensure these are "<i>adequate, accurate and current</i>". ■ The Recommendations also include new requirements for nominee directors and shareholders to disclose their status to the company registry, or be licensed. ■ In relation to Trusts, the revised Recommendations allow countries to determine if a trust registry should be required, and focuses on the obligations of a trustee. As such, trustees now have to obtain and maintain adequate and accurate beneficial ownership information, including information on the identity of the settler, the trustee(s), and the protector (if any), as well as disclose their status as trustees when entering into a relationship with a financial institution.

PEPs	<ul style="list-style-type: none"> ■ The new Recommendations extend obligations on financial institutions to conduct enhanced due diligence to cover domestic PEPs, PEPs from international organisations and the family and close associates of PEPs. These measures are imposed in relation to increased international concerns on corruption, and unlike the requirements in relation to foreign PEPs (which are always deemed high risk and should be subject to enhanced CDD), are to be implemented on a risk-based approach. ■ In order to facilitate the private sector efforts in implementing the PEP requirements, the FATF has indicated that it intends to develop further guidance that would include guidance on how to identify a PEP, his/her family members and close associates.
Wire Transfers	<ul style="list-style-type: none"> ■ The revised Recommendations include more rigorous requirements on the information which must accompany wire transfers, including information on both the beneficiary and originator (previously the requirements applied only in relation to originator information). ■ The information to be included comprises (i) the name of the originator (ii) account number of the originator (iii) any of either of the originator's address, or national identity number, or customer identification number, or date and place of birth; (iv) the name of the beneficiary; and (v) the account number of the beneficiary.
Third Party Reliance and Group-Wide Compliance Programmes	<ul style="list-style-type: none"> ■ The revised Recommendations provide greater clarity in relation to the circumstances in which financial institutions may rely on third parties to undertake due diligence and on the application of AML and CFT measures in foreign branches and subsidiaries. ■ In particular, amendments have been made to clarify the distinction between an outsourcing and agency relationship, to allow for more flexible intra-group reliance, and for the level of country risk to be mitigated (i.e. no longer limiting eligible third parties to those based in countries that adequately comply with FATF standards), if the third party is part of the same financial group which applies group-wide AML/CFT measures. ■ The new Recommendations also require the implementation of group-wide compliance programme to a financial institution's foreign branches and subsidiaries. ■ The revised Recommendations also recognise the difficulties that the private sector face in relation to data protection and privacy laws in relation to intra-group cooperation and reliance, and FATF have indicated that it is considering a coordinated process to further examine the issue. In the meantime, the revised Recommendations seek to promote cooperation between relevant authorities to facilitate intra-group cooperation and exchange of information.
Requirements for Countries	<p>The revised Recommendations also include various requirements for Countries and national governments to follow:</p> <ul style="list-style-type: none"> ■ To the extent they have not already done so, countries should become party to and implement certain key international instruments, and are encouraged to ratify and implement other relevant international conventions ■ Countries should provide "<i>the widest possible range</i>" of mutual legal assistance, including in relation to asset freezing and confiscation and extradition ■ Countries to co-operate in relation to the provision of basic and beneficial ownership information under appropriate conditions and an assurance of confidentiality ■ To the extent they have not already done so, countries should establish Financial Intelligence Units to receive, analyse and disseminate disclosures from reporting entities ■ Countries should also designate responsibility for AML/CFT investigations to proactive competent authorities with adequate resources and powers to obtain all relevant documents

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