



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Update on major anti-money laundering and counter-financing of terrorism regulatory developments

December 2020

Disclaimer and Reminder

Where this presentation refers to certain aspects of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”) and the guidelines on anti-money laundering/ counter-financing of terrorism (“AML/CFT”) published by the Securities and Futures Commission (“SFC”), it provides information of a general nature that is not based on a consideration of specific circumstances. Furthermore, it is not intended to cover all requirements that are applicable to you and your firm. Accordingly, it should not be regarded as a substitute for seeking detailed advice on any specific case from your own professional adviser.

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Agenda

- I. International and Hong Kong AML/CFT regulatory developments
- II. Counter financing of proliferation of weapons of mass destruction regime
- III. SFC's AML/CFT initiatives
- IV. SFC's findings from inspections of AML/CFT controls and compliance practices

International and Hong Kong AML/CFT regulatory developments

(1) Mitigating the money laundering and terrorist financing risks of virtual assets

(2) Use of digital identity for customer due diligence

(3) Other proposed AMLO amendments

Raymond Wong, Director

**Intermediaries Supervision
Intermediaries**

Mitigating the money laundering and terrorist financing (ML/TF) risks of virtual assets

FATF's continued focus on virtual assets

The Financial Action Task Force (FATF), in June 2019,

- revised its Standards to require jurisdictions to regulate and supervise virtual asset service providers (VASPs) for AML/CFT purposes, and
- issued FATF guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers to further assist jurisdictions and VASPs in understanding and implementing the revised standards.

In September 2020, the FATF further published a report Virtual Assets – Red Flag Indicators of Money Laundering and Terrorist Financing to help reporting entities (including financial institutions and VASPs) detect and report potential ML/TF activities involving virtual assets.



Mitigating ML/TF risks of virtual assets

Hong Kong legislative proposal

- To implement the FATF requirements for VASPs, the Government proposes to expand the scope of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap.615) (AMLO) to apply the customer due diligence and record-keeping obligations under Schedule 2 to the AMLO to VASPs.
 - ❑ A licensing regime for VASPs will be introduced, whereby any person seeking to conduct the business of operating virtual assets trading platforms in Hong Kong will be required to be licensed and supervised by the SFC and subject to fit-and-proper criteria.
 - ❑ Licensed VASPs will be required to observe AML/CFT requirements as well as other regulatory requirements designed for investor protection purposes.



Note: More details of the proposal can be found in the consultation document available on the website of the Financial Services and the Treasury Bureau at https://www.fstb.gov.hk/fsb/ppr/consult/consult_amlo.htm. The public consultation period closes on 31 January 2021.

International and Hong Kong AML/CFT regulatory developments

(1) Mitigating the money laundering and terrorist financing risks of virtual assets

(2) Use of digital identity for customer due diligence

(3) Other proposed AMLO amendments

Use of digital identity for customer due diligence

FATF guidance paper on digital identity

- Recognises the potential that robust digital identity (digital ID) systems can improve the reliability, security and efficiency of identifying individuals in the financial sector
- Sets out the risks and benefits of digital ID, and a decision-making process to determine whether a digital ID meets the FATF's requirements for customer due diligence
- Potential for financial inclusion be increased and human internal control weaknesses be reduced

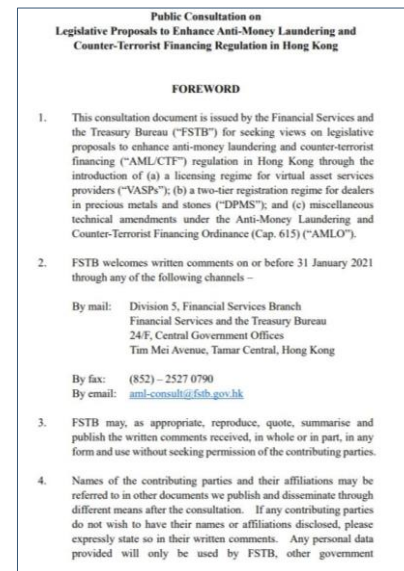


Use of digital identity for customer due diligence

Hong Kong legislative proposal

The Government proposes to amend section 9 of Schedule 2 to the AMLO to add:

- the use of independent and reliable digital identification systems for customer identification and verification purposes as a permissible way to satisfy the special requirements where customer is not physically present for identification purposes.



Note: More details of the proposal can be found in the consultation document available on the website of the Financial Services and the Treasury Bureau at https://www.fstb.gov.hk/fsb/ppr/consult/consult_amlo.htm. The public consultation period closes on 31 January 2021

International and Hong Kong AML/CFT regulatory developments

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Other proposed AMLO amendments

Politically exposed persons (PEPs)

- To extend the additional measures applicable to foreign PEPs to PEPs in other parts of China outside Hong Kong by amending the definition of PEP under the AMLO
- To enable the adoption of a risk-based approach to determine whether to continue to apply the additional measures for foreign PEPs who are no longer entrusted with a prominent public function



Beneficial ownership of trust

- To amend the definition of “beneficial owner” under the AMLO in relation to a trust to include trustees and beneficiaries (including class of beneficiaries)



Other proposed AMLO amendments (cont'd)

Exchange of supervisory information

- To standardize the parameters for exchange of information in the context of AML/CFT supervision among all AMLO regulators by reference to existing relevant provisions under the governing Ordinances of individual financial regulators



Regulation of dealers in precious metals and stones (DPMS)

- To introduce a two-tier registration regime for DPMS and subject registrants engaging in cash transactions at or over the specified amount of \$120,000 to the AML/CFT obligations stipulated in Schedule 2 to the AMLO.



Note: More details of the proposal can be found in the consultation document available on the website of the Financial Services and the Treasury Bureau at https://www.fstb.gov.hk/fsb/ppr/consult/consult_amlo.htm. The public consultation period closes on 31 January 2021

Counter financing of proliferation of weapons of mass destruction regime

Irene Pou, Associate Director

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What is financing of proliferation of weapons of mass destruction (proliferation financing)?

- **FATF Definition –**

... **providing funds or financial services** which are used, **in whole or in part**, for the **manufacture, acquisition, possession, development, export, trans-shipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials** (including both technologies and dual use goods used for non-legitimate purposes)...



Strengthening measures to prevent proliferation financing

Revision of FATF Recommendation 1 (R.1) and its interpretive note

To require jurisdictions, financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and mitigate the risks of potential breaches, non-implementation or evasion of the targeted financial sanctions related to **proliferation financing**, and to take effective action to mitigate these risks.



Revision of FATF Recommendation 2 (R.2) and addition of a new interpretive note to R.2

To enhance domestic co-operation, co-ordination and information exchange related to proliferation financing among national authorities.



Counter proliferation financing regime in Hong Kong

United Nations Security Council
sanctions against
the Democratic People's Republic
of Korea ("DPRK") and Iran



Targeted Financial Sanctions against
designated individuals and entities
**United Nations Sanctions
Ordinance (Cap.537)**



**United Nations
Sanctions
(DPRK) Regulation
(Cap. 537AE)**



**United Nations
Sanctions
(JCPOA - Iran) Regulation
(Cap.537BV)**

**Weapons of Mass
Destruction (Control of Provision
of Services) Ordinance
(Cap.526)**



Counter proliferation financing regime in Hong Kong

Regulations made under the United Nations Sanctions Ordinance

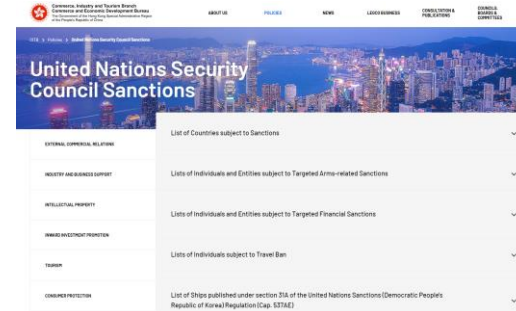
- Prohibit a person from making available economic assets to, or dealing with economic assets of:
 - a) individuals or entities designated by the United Nations Security Council; and
 - b) individuals or entities acting on behalf of, or at the direction of (a); or entities owned or controlled by (a).



Economic assets means any funds or other financial assets or economic resources.

Weapons of Mass Destruction (Control of Provision of Services) Ordinance (Cap.526)

- Prohibit a person from providing any services where he believes or suspects, on reasonable grounds, that those services will or may assist the development, production, acquisition or stockpiling of weapons of mass destruction in Hong Kong or elsewhere.



Please visit the website of the Commerce and Economic Development Bureau for the latest sanction lists:

<https://www.cedb.gov.hk/citb/en/policies/united-nations-security-council-sanctions.html>

Actions to mitigate proliferation financing risks



Should not establish business relationship or conduct transactions with sanctioned individuals or entities.



- **Should** implement an effective screening mechanism, which should include screening customers and their beneficial owners against the most up-to-date sanction lists.
- **Should** file a suspicious transaction report with the Joint Financial Intelligence Unit for any genuine hits identified during screening.



SFC's AML/CFT initiatives

(1) ML/TF risk assessment of the Hong Kong securities sector

(2) Public consultation on proposed amendments to AML/CFT guidelines

Irene Pou, Associate Director

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ML/TF risk assessment of Hong Kong securities sector

- FATF Recommendation 1 requires jurisdictions to:
 - identify, assess and understand the ML/TF risks to which the jurisdiction is exposed; and
 - keep their risk assessment up-to-date
- The Government published the first Hong Kong's ML/TF risk assessment report in 2018
- The SFC is in the process of conducting an assessment to identify the latest ML/TF risks of the securities sector of Hong Kong is exposed, which will contribute to an updated Hong Kong's ML/TF risk assessment report to be published



SFC's AML/CFT initiatives

(1) ML/TF risk assessment of the Hong Kong securities sector

(2) Public consultation on proposed amendments to AML/CFT guidelines

Background and objectives

- On 18 September 2020, the SFC launched a three-month public consultation on proposals to amend its AML/CFT guidelines
- The key proposed amendments aim to achieve the following objectives:



FATF Standards

- To keep in line with the FATF standards amplified by the FATF's Guidance for a Risk-based Approach for the Securities Sector

Mutual Evaluation

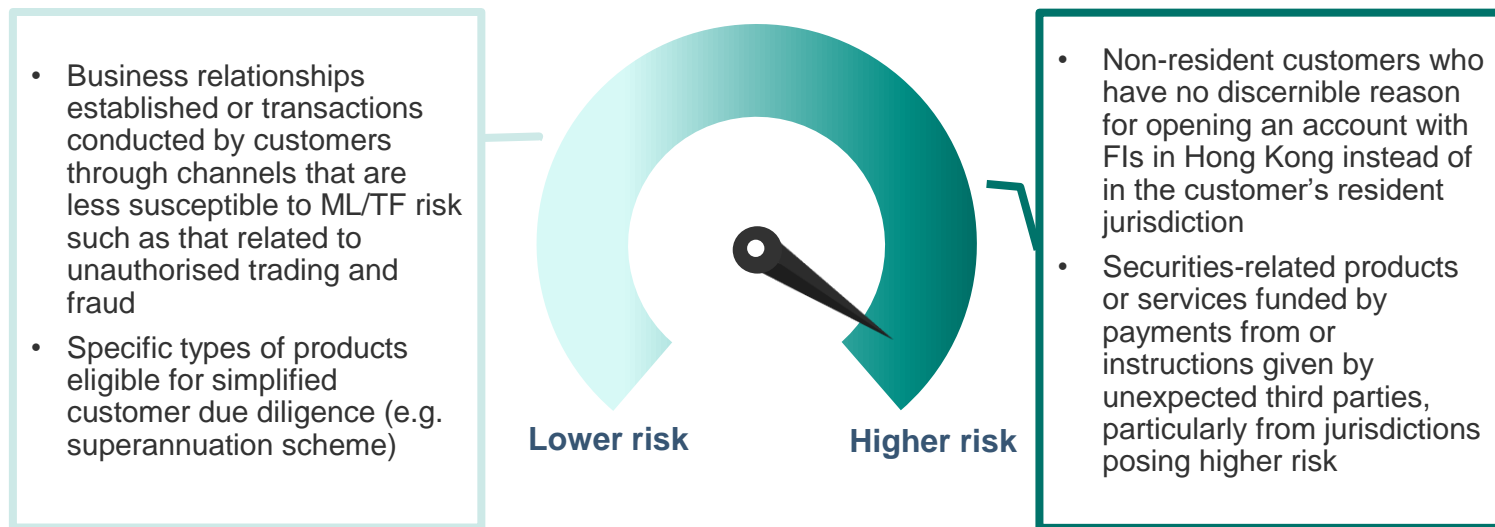
- To address areas for enhancement identified in the Mutual Evaluation Report of Hong Kong that are relevant to the securities sector

Industry feedback

- To provide additional and facilitative guidance in various areas to address feedback from market participants

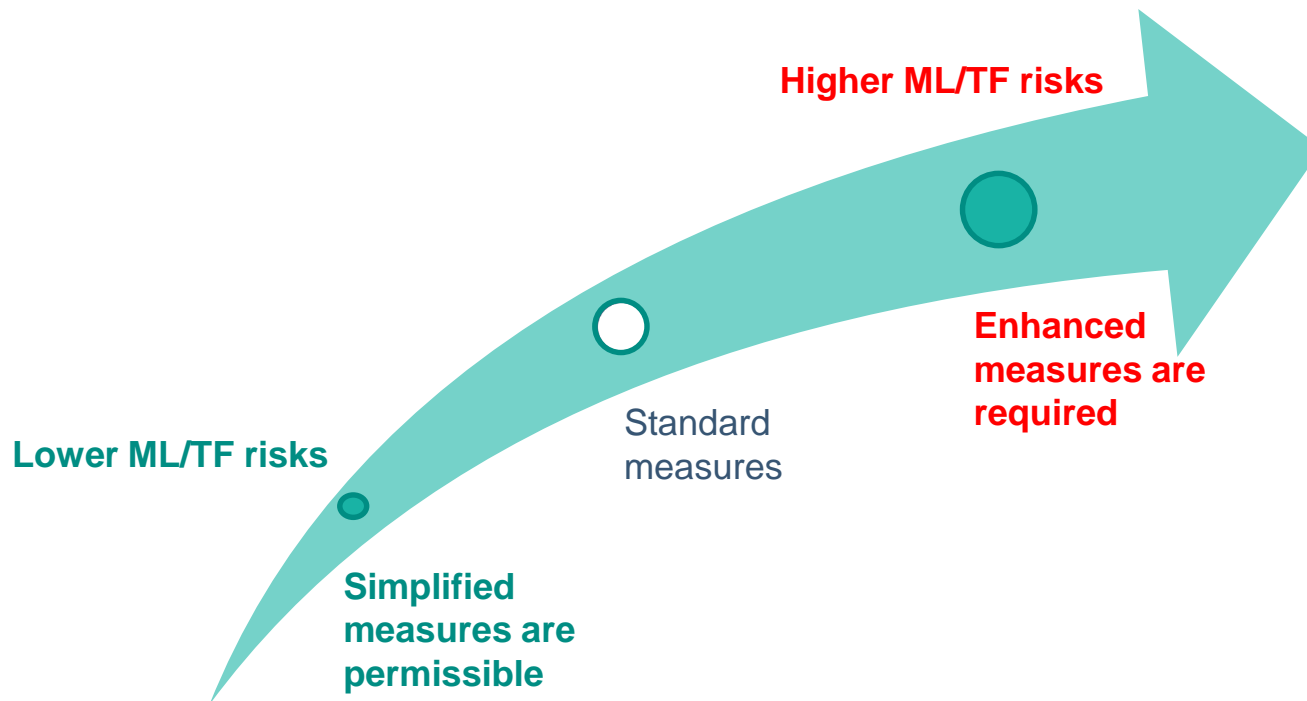
Proposed amendments – ML/TF risk assessments and illustrative risk indicators

- Incorporate requirements in existing guidance circulars on the assessment of ML/TF risks arising from businesses (ie, institutional risk assessment or IRA)
- Expand the list of illustrative higher or lower risk indicators to assist licensed corporations (LCs) in conducting both IRA and customer risk assessment



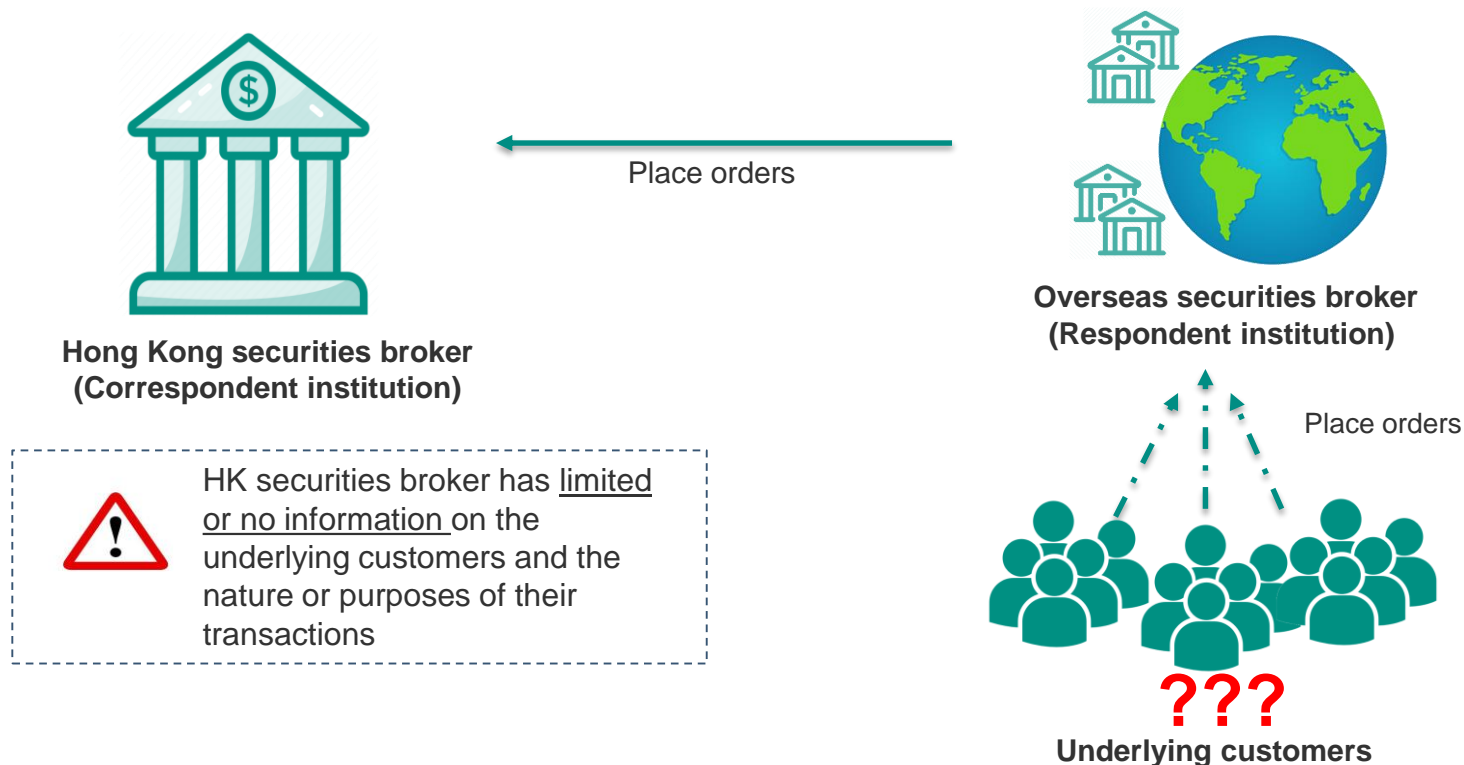
Proposed amendments – Illustrative examples of enhanced and simplified measures under a risk-based approach

- Expand the list of examples to assist LCs in conducting CDD and ongoing monitoring in a more risk-sensitive manner



Proposed amendments – Cross-border correspondent relationships

Example of cross-border correspondent relationship in the securities sector:



Scope of application

- The provision of services to an overseas financial institution for conducting transactions that constitute:
 - Type 1 regulated activity: dealing in securities;
 - Type 2 regulated activity: dealing in futures contracts; or
 - Type 3 regulated activity: leveraged foreign exchange trading.

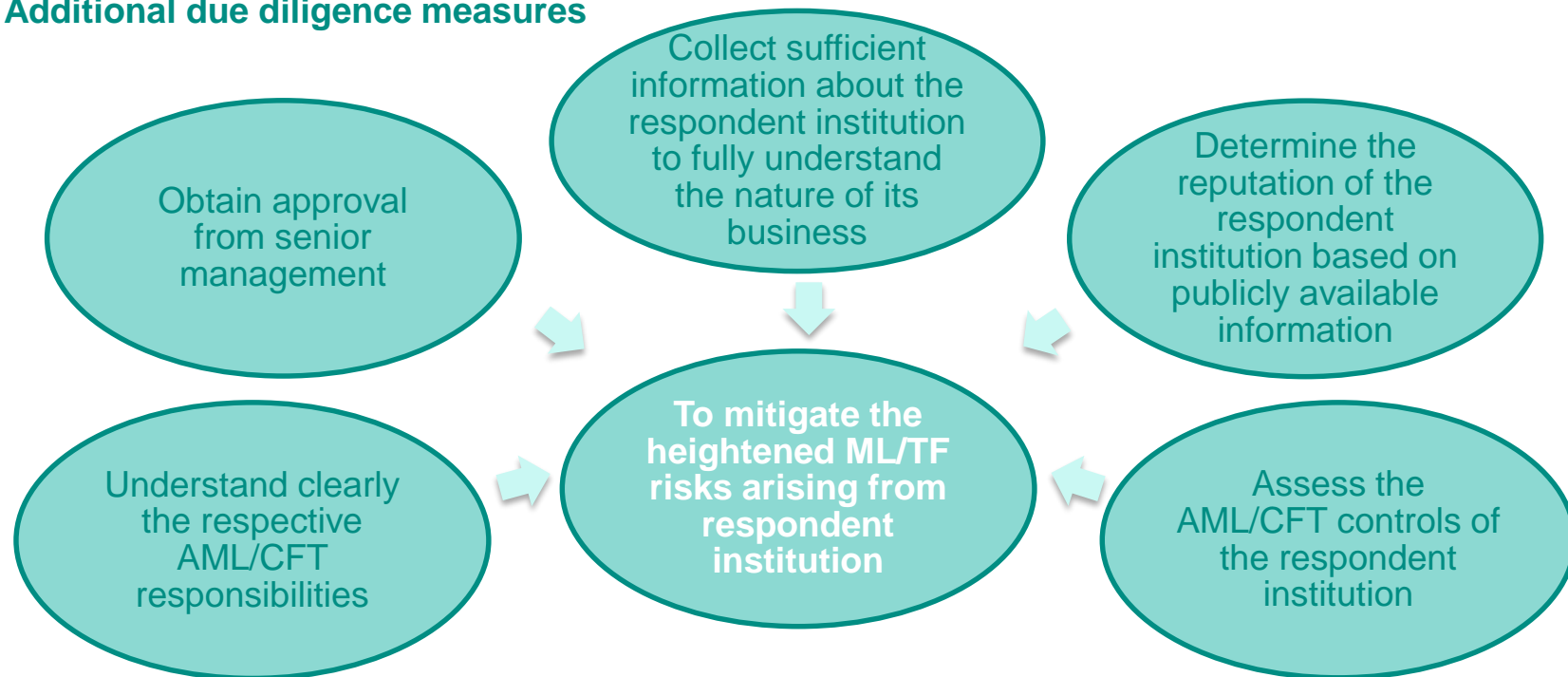


Proposed amendments – Cross-border correspondent relationships

FATF Recommendation 13

- requires correspondent institutions to perform **additional due diligence measures** and other risk mitigating measures; applicability to the securities sector is elucidated by the FATF's Guidance for a Risk-based Approach for the Securities Sector

Additional due diligence measures



Proposed amendments – Cross-border correspondent relationships



FATF Recommendation 13

- requires correspondent institutions to perform additional due diligence measures and **other risk mitigating measures**; applicability to the securities sector is elucidated by the FATF's Guidance for a Risk-based Approach for the Securities Sector

Other risk mitigating measures



Ongoing monitoring (eg, request for information on particular transactions or underlying customers when unusual transactions are detected)*



More in-depth review of the AML/CFT controls of the respondent institution if underlying customers of the respondent institution can operate the account maintained with the LC directly



Cross-border correspondent relationship with a shell financial institution is prohibited

*Correspondent institutions should monitor the business relationship with respondent institutions, same as with other types of customers, pursuant to the ongoing monitoring requirements currently set out in the AMLO and Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) (AML/CFT Guideline). In addition, under the existing AMLO and AML/CFT Guideline, if there is any suspicion that a customer or a customer's account is involved in ML/TF, LCs should, among others, identify the person on whose behalf the customer is acting.

Proposed amendments - Third-party deposits and payments



Circular

31 May 2019

Circular to licensed corporations and associated entities

Third-party deposits and payments

The Securities and Futures Commission (SFC) wishes to reiterate the importance of mitigating the risks associated with third-party payments to or from accounts maintained by clients with licensed corporations (LCs) and associated entities (AEs). LCs and AEs are reminded to enforce appropriate and effective control measures which are capable of addressing these risks and meeting the requirements set out in the relevant guidelines and circulars¹.

Third-party deposits and payments may be used to facilitate the misappropriation of client assets, money laundering and other misconduct². When a client uses a third party to pay for or receive the proceeds of investment transactions, there is a risk that the arrangement may be used to disguise the true beneficial owner or the source of funds.

Expected standards

In several recent enforcement cases, the policies, procedures and controls put in place by LCs for handling third party deposits and payments were found to fall short of the expected standards or were not properly enforced by the managers and staff members responsible.

To assist LCs and AEs in reviewing the adequacy of their policies and procedures for mitigating the risks associated with third-party deposits and payments, we have summarised in the **Appendix** the key control measures which should be in place and also provide non-exhaustive examples of effective practices to implement them. These control measures aim to protect client assets as well as to detect and prevent money laundering and terrorist financing (ML/TF) and other illicit activities involving third-party deposits and payments.

LCs and AEs should critically assess the risk that they could be inadvertently exposed to financial crime as well as legal and compliance risks, and give serious consideration to refusing third-party deposits and payments³.

- Incorporate existing guidance provided in circulars
- Provide additional facilitative guidance relating to third-party deposits to address industry feedback

Existing guidance for facilitating prompt identification of the source of deposits:

- Inform clients in writing of the LCs' policies for handling third-party deposits and payments
- Encourage the deposit of funds by clients only through designated bank accounts (in the clients' own names or the names of any acceptable third parties) for facilitating easy identification of the source

Proposed amendments – Delayed third-party deposit due diligence



Whether third-party deposit due diligence procedures can be completed after settling transactions with client deposited funds?



Exceptional situations



Stringent conditions under which delayed third-party deposit due diligence may be allowed



Adopt appropriate risk management policies and procedures



If completion of third-party deposit due diligence has exceeded stipulated timeframe, LCs should refrain from carrying out further transactions for the customers, and if there are grounds for knowledge or suspicion of ML/TF, file an STR with the JFIU

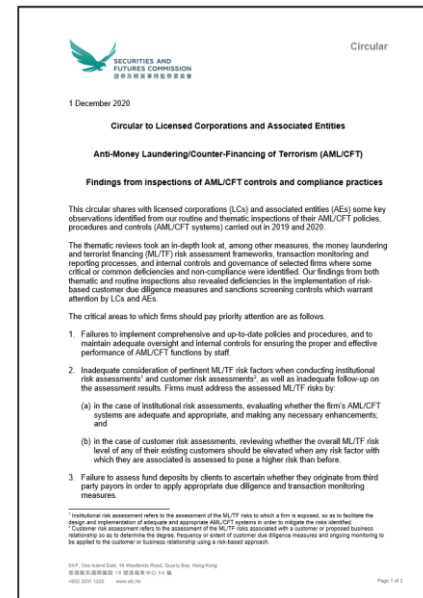
SFC's findings from inspections of AML/CFT controls and compliance practices

Sharon Wong, Manager

Intermediaries Supervision
Intermediaries

SFC's findings from inspections of AML/CFT controls and compliance practices

- The SFC issued a circular on findings from inspections of AML/CFT controls and compliance practices on 1 December 2020 to share some key observations identified from our routine and thematic inspections of their AML/CFT policies, procedures and controls carried out in 2019 and 2020.
- Our findings from both thematic and routine inspections revealed deficiencies in some critical areas as well as some other areas to which firms should pay attention to.



Note: More details can be found on the SFC's circular dated on 1 December 2020, available on the website of the SFC at <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/aml/doc?refNo=20EC73>

SFC's findings from inspections of AML/CFT controls and compliance practices

Critical areas to which firms should pay priority attention

1. Implementing comprehensive and up-to-date policies and procedures, and maintaining adequate oversight and internal controls for ensuring the proper and effective performance of AML/CFT functions by staff
2. Considering pertinent ML/TF risk factors when conducting institutional and customer risk assessments, as well as following up on the assessment results
3. Assessing fund deposits by clients to ascertain whether they originate from third party payors in order to apply appropriate due diligence and transaction monitoring measures
4. Establishing source of wealth and source of funds for high-risk customers
5. Screening existing customers, their beneficial owners and other relevant connected parties against updated sanctions lists

Example of deficiencies and non-compliance in the critical areas identified by our inspection

Internal control and governance

- Failed to update their **policies and procedures** promptly to ensure they remain up-to-date and relevant after amendments were made to the AMLO and AML/CFT Guideline in 2018



- Failed to provide sufficient information for **senior management** to maintain adequate oversight of the implementation of the firm's AML/CFT systems
 - Accumulated backlogs of sanctions screening and transaction alerts pending for review;
 - Delays in performance of periodic reviews of customer information

Example of deficiencies and non-compliance in the critical areas identified by our inspection

ML/TF risk assessments



- Inadequate consideration of all key, relevant ML/TF risk factors in **institutional risk assessment** and **customer risk assessment** processes
 - ❑ Simply made reference to a list of jurisdictions identified by the FATF as having strategic deficiencies in their AML/CFT regimes
 - ❑ Deemed all countries which are a member jurisdiction of a FATF-style regional body as non-high risk without conducting a proper assessment

Transaction monitoring systems and processes

- Not all fund deposits by clients were assessed to ascertain whether they came from third party payors and should be subject to the LC's due diligence and transaction review processes



Example of deficiencies and non-compliance in the critical areas identified by our inspection

Establishing source of wealth and source of funds

- Merely collected general financial information from high-risk customers in account opening forms and failed to take reasonable measures to establish the sources of wealth and source of funds
- Wrongly concluded that a customer's source of funds had been established after confirming that the funds were transferred from the customer's bank account without determining what activity generate the funds



Sanctions screening systems



- Low-risk customers, such as listed companies, financial institutions and its own affiliated companies, shareholders and employees, are not subject to sanctions screening
- Conduct ongoing screening only at a fixed interval without paying regard to new or updated designations promulgated in the meantime

SFC's findings from inspections of AML/CFT controls and compliance practices

Senior management responsibilities

To properly discharge their role, senior management should ensure, among other actions,:

1. appropriate mechanisms are in place to develop and continuously review the firm's AML/CFT policies and procedures;
2. adequate training tailored to their specific job functions and responsibilities is provided to staff;
3. appropriate ongoing compliance monitoring and periodic independent reviews are in place to detect and remedy any deficiencies or non-compliance in critical AML/CFT controls in a timely manner;
4. appropriate reporting mechanisms are in place for senior management to be apprised of key ML/TF risks and concerns in a timely manner.



A large, stylized teal bird graphic, possibly a phoenix, is positioned on the left side of the slide. It has long, flowing wings and a long tail, rendered in a light teal color.

Thank you

AML/CFT section of the SFC website:

<https://www.sfc.hk/en/Rules-and-standards/Anti-money-laundering-and-counter-financing-of-terrorism>