



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

- (1) Key findings and areas for improvement from the Mutual Evaluation Report of Hong Kong published by the Financial Action Task Force**
- (2) Update on major AML/CFT regulatory developments**

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Raymond Wong, Director
Irene Pou, Associate Director

Intermediaries Supervision
Intermediaries

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 AML/CFT published by the 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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Key findings and areas for improvement from the Mutual Evaluation Report of Hong Kong published by the FATF

Mutual Evaluation Report of Hong Kong (“MER”)

The MER was published by the Financial Action Task Force (“FATF”) on 4 September 2019. ^{Note}

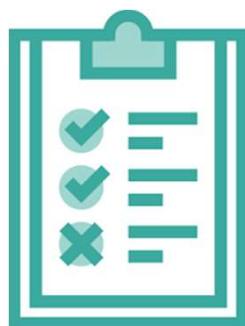
Hong Kong has completed the 4th round of ME, which assesses two components:

^{Note} <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Hong-Kong-China-2019.pdf>



Technical compliance

- 36 out of the 40 FATF Recommendations are rated “compliant” and “largely compliant” (i.e. with no or minor shortcomings)
- The remaining four are rated “partially compliant” (i.e. with moderate level of shortcomings), including R.12 Politically Exposed Persons (“PEPs”) which is relevant to the securities sector



Effectiveness (1st time assessment)

- 6 IOs are rated “Substantial” and 5 IOs are rated “Moderate” level of effectiveness

| Immediate outcomes (IOs) | Level of effectiveness |
|--|------------------------|
| IO.1 Risk, policy and coordination | Substantial |
| IO.2 International cooperation | Substantial |
| IO.3 Supervision | Moderate |
| IO.4 Preventive measures | Moderate |
| IO.5 Legal persons and arrangements | Moderate |
| IO.6 Financial intelligence | Substantial |
| IO.7 ML investigation and prosecution | Moderate |
| IO.8 Confiscation | Substantial |
| IO.9 TF investigation and prosecution | Substantial |
| IO.10 TF preventive measures and financial sanctions | Substantial |
| IO.11 Proliferation financing and financial sanctions | Moderate |

Key findings and areas for improvement from the MER published by the FATF

(1) Areas for improvement for securities sector

(2) Key findings of MER

Areas for improvement for securities sector

As a member of the FATF, Hong Kong is committed to implement recommendations promulgated by this inter-government body to combat money laundering and terrorist financing (“ML/TF”). The MER identifies the following areas for improvement for the securities sector to further increase the effectiveness of Hong Kong’s AML/CFT regime:



To deepen understanding of ML/TF risks

Licensed corporations (“LCs”) should: -

- adequately consider risks in relation to cross-border financial flows, non-resident customers and PEPs in their assessment of ML/TF risks to which the firms are exposed; and
- implement mitigating measures that are commensurate with their ML/TF risks



To strengthen implementation of AML/CFT measures

- Regularly review their AML/CFT policies, procedures and controls for ensuring effectiveness in mitigating the ML/TF risks arising from their businesses, particularly in the implementation of customer due diligence measures to mitigate risks posed by non-resident customers, enhanced due diligence measures for foreign PEPs and targeted financial sanctions



To strengthen suspicious transactions monitoring and reporting

- Regularly review the adequacy and effectiveness of their systems and processes for identifying and reporting of suspicious transactions to the Joint Financial Intelligence Unit (“JFIU”) as soon as reasonably practicable

Key findings and areas for improvement from the MER published by the FATF

(1) Areas for improvement for securities sector

(2) Key findings of MER

Key findings of the MER – Technical compliance

Recommendation 12 – Politically exposed persons (“PEPs”) was rated “partially compliant” mainly due to the following deficiency.

Deficiency in the statutory AML/CFT framework on PEPs



- The foreign PEP regime provided for in the AMLO (which came into effect on 1 April 2012) covers individuals who are or have been entrusted with a prominent public function in a place outside the People’s Republic of China.
- As such, the requirements to apply enhanced due diligence for foreign PEP do not mandatorily apply to PEPs from Mainland China and other parts of China.



Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

1. Understanding of ML/TF risks and AML/CFT obligations

Large financial institutions (“Large FIs”)

- ✓ Demonstrate a good understanding of their ML/TF risks and AML/CFT obligations
- ✓ Periodically identify, assess and review their exposure to ML/TF risks, in line with their line of business, products and services, customer base and geographical footprint
- ✓ Develop their AML/CFT policies and procedures commensurate with their understanding of ML/TF risks
- ✓ Make use of monitoring systems to determine the effectiveness of controls implemented to mitigate those risks

Smaller financial institutions (“Smaller FIs”)

- ✗ Demonstrate a less sophisticated understanding of their risks, particularly those related to terrorist financing
- ✗ Seem to be more focused on domestic risks (e.g. fraud) and do not fully consider the ML/TF risks arising from the cross-border nature of their products and services
- ✗ Controls tend to be driven more by compliance than risk

Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

2. Application of Customer due diligence (“CDD”)

Large FIs



Apply more comprehensive CDD measures as they adopt a risk-based approach and focus on the risks posed by customers



Take into account the distribution channel, the product and services involved, and risk indicators, e.g. if high risk countries are involved in the business relationship or transaction

Smaller FIs



Demonstrate a less sophisticated implementation of CDD requirements



Tend to approach AML/CFT obligations in a rule-based manner



Seem to rely to some extent on banks as a gatekeeper, e.g. in some instances LCs will not always look at the legitimacy of the source of funds when the money of a client is transferred through a bank

Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

3. Implementation of ongoing monitoring

Large FIs



Established transaction monitoring systems to generate alerts for dedicated staff to follow up



Some firms are exploring new ways (e.g. using data analytics) to supplement their transaction monitoring



Alert thresholds are more stringent for high-risk customers and situations

Smaller FIs



Monitoring measures seem to be relatively less developed



Tend to set monitoring parameters on the basis of the value or volume of transactions only, without (periodically) testing the effectiveness of these parameters and, where necessary, adjusting them

Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

4. Application of enhanced due diligence (“EDD”) measures: Politically exposed persons (“PEPs”)

Large FIs

- Adhere to their group policy
- Go beyond the local legal requirements by applying the same enhanced measures (such as account opening approval at a senior level and enhanced monitoring) to both domestic and foreign PEPs
- Generally use commercial databases for screening process, both at the onboarding stage as well as periodically on existing customers

Smaller FIs

- Generally follow the local legal requirements and tend to distinguish between foreign and domestic PEPs
- Mainly use open sources to identify PEPs and conduct their own research and thus screening tools are less robust and sophisticated
- One of the FIs underestimated the risks related to PEPs and suggested that the definition of PEPs only captures PEPs that still are in office

Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

5. Application of EDD measures:

Targeted financial sanctions (“TFS”) relating to terrorist financing (“TF”)

Large FIs

- 1 Have a sound understanding of their requirements in relation to TFS relating to TF, and have measures in place to comply and screen before the establishment and during the course of the business relationship, for potential hits
- 2 Use commercial databases from third-party vendors to screen their customers and beneficial owners against the lists of suspected terrorists or sanctioned persons and entities

Smaller FIs



Mainly depend on a manual screening process, which could be prone to error and delay in implementation

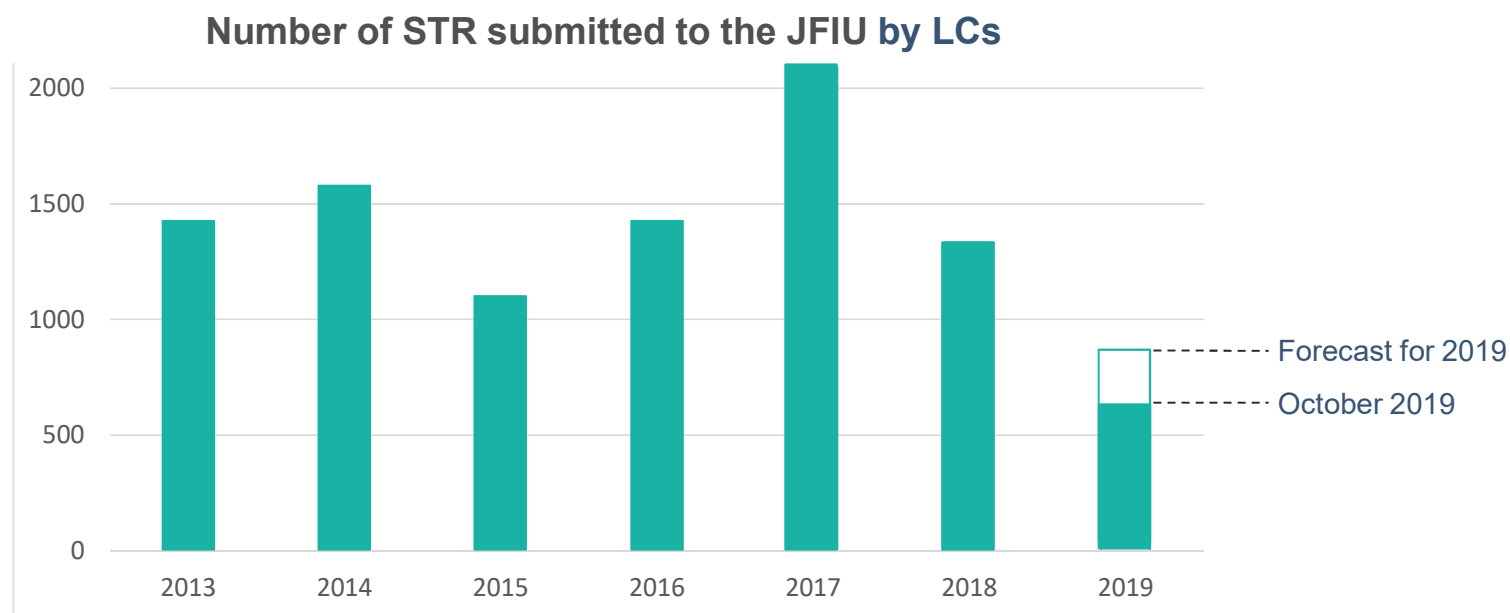


Screening tends to be limited to the moment of the establishment of the business relationship and is not necessarily performed during the course of the business relationship

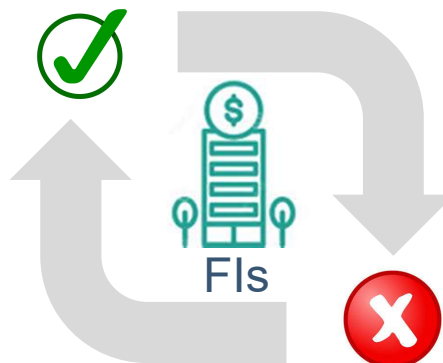
Key findings of the MER – Effectiveness

– *Feedback for the securities sector*

6. Suspicious transaction reporting (“STR”) requirements



Have a good understanding of the STR requirements



Significant variance in the level and quality of STR between sectors

A substantial number of FIs have never filed an STR.

Update on major AML/CFT regulatory developments

(1) Virtual asset and virtual asset service provider

(2) Risk-based approach for the securities sector

(3) Remote client onboarding

Virtual asset and virtual asset service provider – new FATF standards

Background

In October 2018, the FATF revised Recommendation 15 (“R.15”) and added definitions “virtual asset” (“VA”) and “virtual asset service provider” (“VASP”) in order to clarify how AML/CFT requirements apply in the context of virtual assets.

In June 2019, the FATF inserted a new interpretive note to R.15 to further clarify how the FATF requirements should apply in relation to VAs and VASPs.



Virtual asset and virtual asset service provider – new FATF standards

Definition of VA

- a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes
- do not include digital representation of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations



Definition of VASP

- Any natural or legal person who is not covered elsewhere under the FATF Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person –
 - exchange between VAs and fiat currencies;
 - exchange between one or more forms of VA;
 - transfer of VA;
 - safekeeping and/or administering of VA or instruments enabling control over VA; and
 - participation in and provision of financial services related to an issuer's offer and/or sale of a VA.

Virtual asset and virtual asset service provider – new FATF standards

Under the revised FATF R.15 and elaborated by its Interpretive Note, jurisdictions are required to regulate VASPs in much the same way as they regulate financial institutions and designated non-financial businesses and professions for AML/CFT purposes.

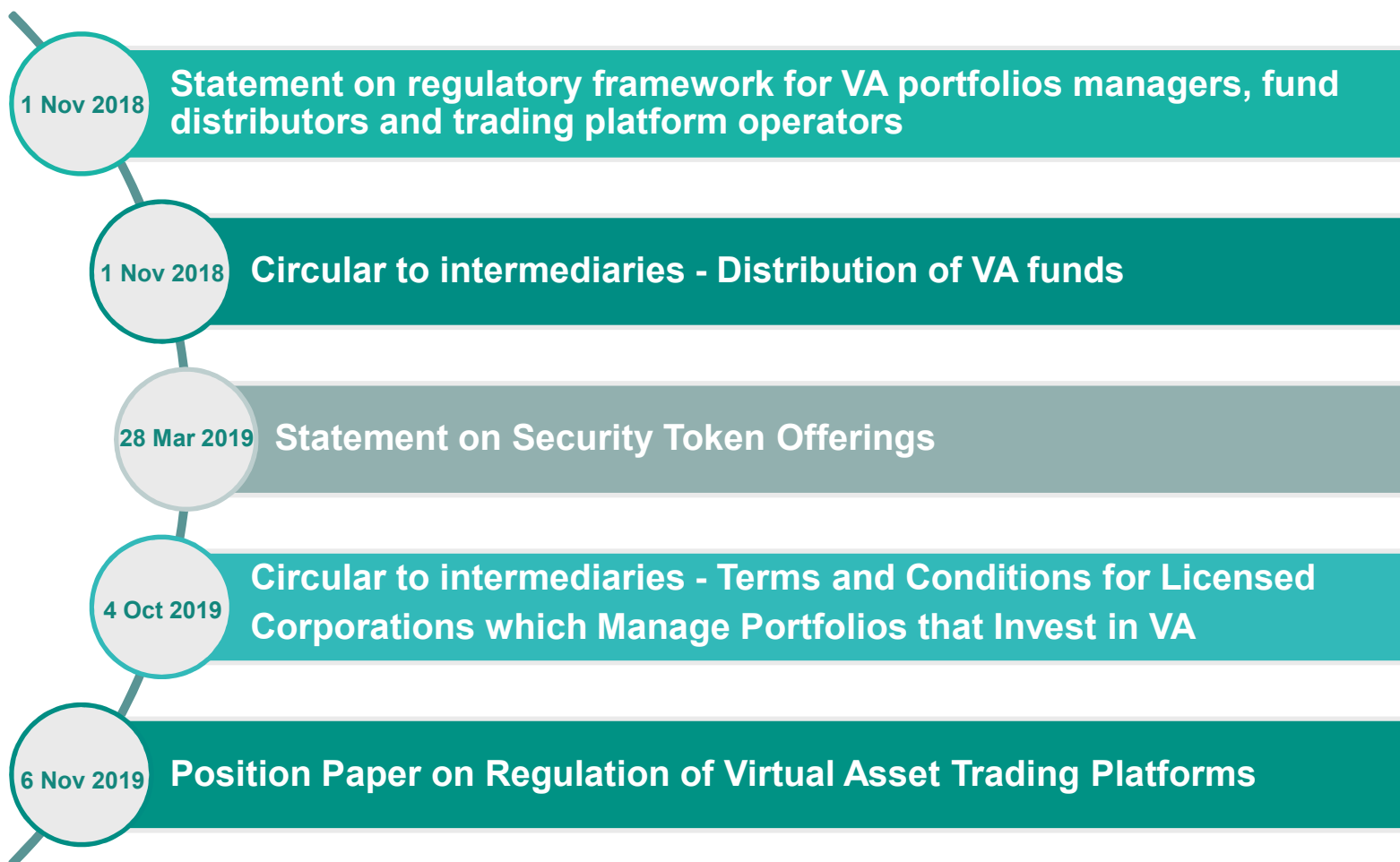
Implications for Hong Kong

Hong Kong's compliance with the revised R.15 will be reviewed in a few years' time during the ME follow-up assessment.



SFC's initiatives in relation to VA and VASP

The SFC issued policy statements, circulars and position paper on regulatory approach for VA and VASP (or VA trading platforms).



SFC's initiatives in relation to VA and VASP

- The SFC has no power to grant a licence to or supervise trading platforms which only trade VAs which do not qualify as securities under the SFO. Hence, an opt-in approach has been designed. This will set those VA platform trading operators who are committed to adhering to the SFC's high standards apart from those who are unwilling or unable to meet the conduct standards set by the SFC.
- The SFC's regulatory framework for VA portfolios managers, fund distributors and trading platform operators is not sufficient for fully complying with the revised R.15 of the FATF.

Update on major AML/CFT regulatory developments

(1) Virtual asset and virtual asset service provider

(2) Risk-based approach for the securities sector

(3) Remote client onboarding

Risk-based approach for the securities sector

- FATF published the ***Risk-based Approach Guidance for the Securities Sector*** (“Guidance”) in October 2018. ^{Note 1}
- Risk-based approach (“RBA”) is central to the effective implementation of the FATF Recommendations. It ensures that securities services providers identify and understand the unique risks they are exposed to, allowing them to prioritise resources on areas where risks are highest.
- The SFC issued a circular on 29 October 2018 to encourage LCs to consider, in designing their AML/CFT policies, procedures and controls, the examples discussed in the Guidance of how the RBA is implemented for different securities products and services. ^{Note 2}
- The SFC is reviewing the need to amend SFC’s AML/CFT Guideline to provide further guidance to the industry on the implementation of the RBA, alongside other updates to the Guideline.



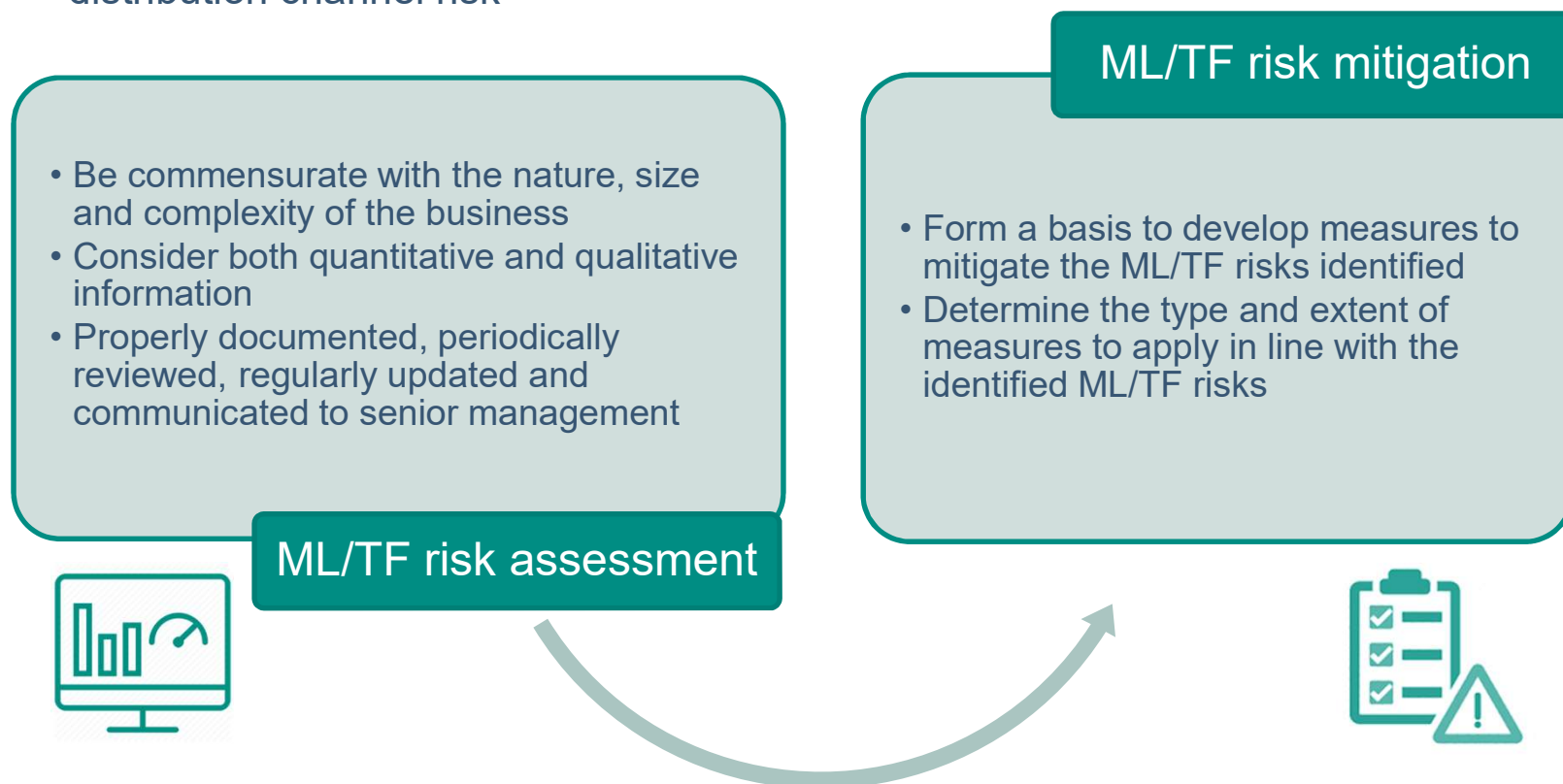
Note 1 <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/RBA-Securities-Sector.pdf>

Note 2 <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/aml/doc?refNo=18EC76>

RBA Guidance for the Securities Sector

Risk assessment

- Risk assessment is a key starting point for the application of RBA by securities services providers
- The Guidance provides examples of risk factors under the most commonly used risk criteria: country / geographic risk, customer risk, product/service/transaction risk, and distribution channel risk



RBA Guidance for the Securities Sector

Senior management responsibility

- The successful implementation and effective operation of a RBA to AML/CFT depends on strong leadership by a securities services provider's senior management.
- Senior management should: -
 - foster and promote a culture of compliance to ensure that the securities services provider is committed to manage ML/TF risks before establishing or maintaining business relationships;
 - take responsibility for setting up robust risk management governance and controls mechanisms; and
 - understand the ML/TF risks to which the securities services provider is exposed and understand how its AML/CFT control framework operates to mitigate those risks.
- A sufficiently senior person within a securities services provider should have the responsibility to ensure the effectiveness of AML/CFT controls.

RBA Guidance for the Securities Sector

Highlights for certain areas of risk controls in the Guidance

Correspondent relationships



- A correspondent institution executes transactions for a cross-border financial institution, which acts as respondent institution for its underlying customers
- Perform risk-based due diligence on the respondent institution and additional due diligence on the correspondent relationship

Reliance on third parties



- May rely on third party to conduct initial CDD, but not ongoing monitoring, ongoing due diligence and scrutiny of transactions
- Conduct appropriate due diligence on the third-party to determine whether reliance can be placed
- Check the CDD standards by the third party

Outsourcing



- May cover CDD, ongoing monitoring and transaction monitoring
- Put in place formal agreements, settling out the roles and responsibilities of both the outsourced entity and the securities provider
- Monitor the performance of the outsourced entity

RBA Guidance for the Securities Sector

Highlights for certain areas of risk controls in the Guidance

Suspicious transaction monitoring



- Include surveillance of transactions and fund movements, and identifying changes of customer risk profile
- Adjust the extent and depth of monitoring based on the institutional risk assessment and customer risk profile
- Up-to-date examples of indicators of suspicious activity provided

Vetting and recruitment



- The level of vetting procedures should reflect ML/TF risks to which individual staff are exposed and not focus merely on senior management's roles

Training and awareness



- Training should be relevant to the firm's ML/TF risks and obligatory for all appropriate staff
- Tailored to particular business lines and complemented by AML/CFT information and updates

Update on major AML/CFT regulatory developments

(1) Virtual asset and virtual asset service provider

(2) Risk-based approach for the securities sector

(3) Remote client onboarding

Regulatory development on remote onboarding of clients

The SFC has been and continue providing guidance to the industry on account opening procedures to cope with the technological development.



Remote onboarding of overseas individual clients

The SFC issued a circular on 28 June 2019 setting out an acceptable approach for online onboarding of overseas individual clients who do not have bank accounts in Hong Kong. ^{Note}

Issues of remote onboarding of overseas clients

Impersonation risks

- Clients are not physically present for identification purposes
- Current technology cannot completely eliminate impersonation risks



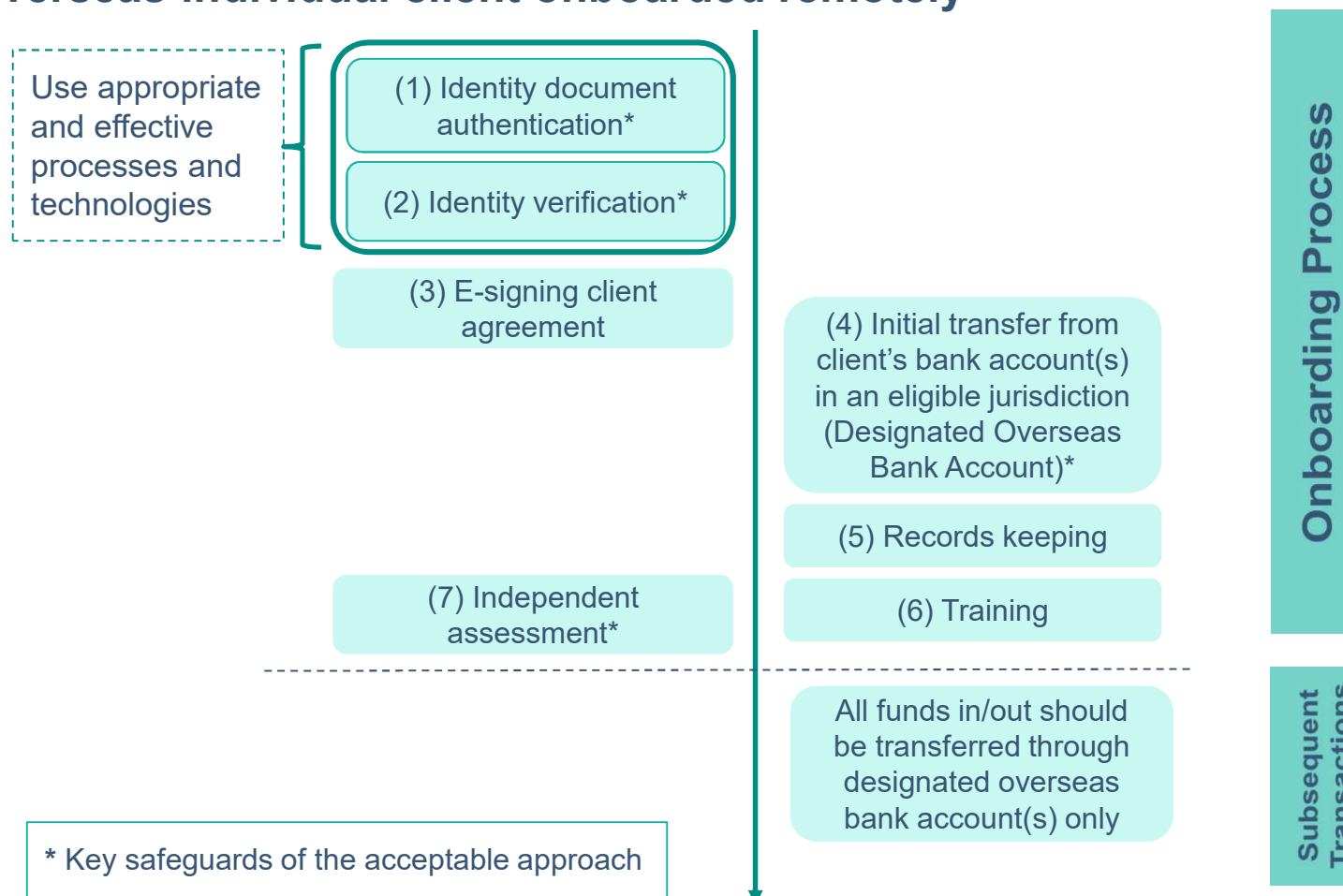
Identity verification by overseas banks

- Procedures used by overseas banks to verify client identities may not satisfy regulatory requirements in Hong Kong
- Difficult for the SFC to conduct an investigation when verification procedures are performed by overseas banks



Remote onboarding of overseas individual clients

Overview of the acceptable approach to verify the identity of an overseas individual client onboarded remotely



Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

1. Identity document authentication



- Access the embedded data in the client's official ID document, e.g. biometric passport or identity card; or
- Obtain electronic copy of relevant sections of the ID document including a high-quality photograph of the client

Use appropriate and effective processes and technologies to authenticate the client's ID document, e.g.

- check the security features of the ID document; or
- verify the data using a reliable and independent source



If a third-party is engaged to carry out account opening procedures involving clients' personal information, prior consent and authorisation should be obtained from the client and proper protection measures should be put in place to ensure the security and confidentiality of their personal information.

Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

2. Identity verification

- Use appropriate and effective processes and technologies to obtain the client's biometric data and match it with the authenticated data in the client's ID Document or other reliable and independent sources to verify the client's identity
- Implement appropriate safeguards such as data encryption and presentation attack detection to protect the client's biometric data and the integrity of the identity verification process



3. Execution of client agreements

- Obtain a client agreement signed by the client by way of an electronic signature



Remote onboarding of overseas individual clients

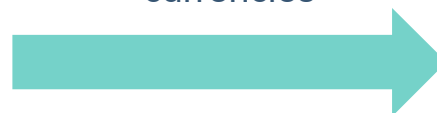
Steps to verify the identity of an overseas individual client

4. Designated overseas bank accounts



An account in client's name maintained with a bank which is supervised by a banking regulator in an eligible jurisdiction
(Designated Overseas Bank Account)

Successful initial deposit of not less than \$10,000 or an equivalent amount in other currencies



Intermediary's bank account

All future deposits and withdrawals for the client's investment account must be conducted only through a Designated Overseas Bank Account

Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

4. Designated overseas bank accounts

Currently, the eligible jurisdictions are:

- Australia
- Austria
- Belgium
- Canada
- Ireland
- Israel
- Italy
- Malaysia



- Norway
- Portugal
- Singapore
- Spain
- Sweden
- Switzerland
- UK
- US

- The SFC will update the list of eligible jurisdictions, publish on the SFC's website, after taking into account the results of the FATF's mutual evaluation;
- Any removal of a jurisdiction from the list does not have retrospective effect;
- Whilst a client's bank accounts should be located in an eligible jurisdiction, the client is not required to reside there.

Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

5. Record keeping

- Maintain proper records for each client's account opening process in a manner which is readily accessible for compliance checking and audit purposes



6. Training

- Ensure that staff responsible for online onboarding have received adequate training and possess sufficient knowledge and skills to perform and oversee the relevant procedures



Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

7. Assessment



Conduct
1) pre-implementation
assessment; and
2) annual reviews
thereafter
of the adopted processes
and technologies

To be performed by assessors who
are qualified (and independent in the
case of pre-implementation
assessment).



Remote onboarding of overseas individual clients

Steps to verify the identity of an overseas individual client

7. Assessment

Scope of the assessment and reviews

- Whether the adopted processes and technologies are appropriate and effective to establish the true identities of clients
- Whether ongoing monitoring and review processes have been appropriately and effectively implemented
- Whether the adopted processes and technologies as well as all subsequent changes have been properly implemented and tested with satisfactory results
- Whether all the requirements set out in steps 1 to 6 above have been properly followed

Assessment report should cover:

- A detailed description of the processes and technologies adopted
- Details of the work performed, including an explanation of the scope and methodology of the assessment
- A confirmation that the adopted processes and technologies are appropriate and effective for establishing the true identities of clients and the basis and justification for the confirmation
- An explanation of the potential limitations (if any) of the assessment as well as the processes and technologies adopted
- Recommendations for improvement (if any) and management's responses

Amendments to paragraph 5.1 of the Code of Conduct

Paragraph 5.1 of the Code of Conduct was amended with effect from 5 July 2019.

Objectives

- To facilitate introduction of specific guidelines on new approaches for opening accounts
- To cater for the growing need of intermediaries to adapt their account opening practices as business activities are increasingly conducted online

Information about clients

5.1 Know your client: in general

~~(a) — A licensed or registered person should take all reasonable steps to establish the true and full identity of each of its clients¹, and of each client's financial situation, investment experience, and investment objectives. Where an account opening procedure other than a face-to-face approach is used, it should be one that satisfactorily ensures the identity of the client. Where the account opening documents are not executed in the presence of an employee of the licensed or registered person, the signing of the Client Agreement (as defined in paragraph 6.1) and sighting of related identity documents should be certified by any other licensed or registered person, an affiliate of a licensed or registered person, a JP (Justice of the Peace), or a professional person such as a branch manager of a bank, certified public accountant, lawyer or notary public. Certification services that are recognized by the Electronic Transactions Ordinance (Cap. 553), such as the certification services available from the Hongkong Post, may also be employed.~~

~~(b) — Alternatively, the identity of the client (other than corporate entities), may be properly verified if the licensed or registered person complies with the following procedural steps:~~

- ~~(i) — the new client sends to the licensed or registered person a signed physical copy of the Client Agreement (see paragraph 6.2) together with a copy of the client's identity document (identity card or relevant sections of the client's passport) for verification of the client's signature and identity;~~
- ~~(ii) — the licensed or registered person should obtain and encash a cheque (amount not less than HK\$10,000² and bearing the client's name as shown in his identity document) issued by the new client and drawn on the client's account with a licensed bank in Hong Kong;~~
- ~~(iii) — the signature on the cheque issued by the client and the signature on the Client Agreement must be the same;~~
- ~~(iv) — the client is informed (in the Client Agreement or by way of a notice) of this account opening procedure and the conditions imposed, in particular the condition that the new account will not be activated until the cheque is cleared; and~~
- ~~(v) — proper records are kept by the licensed or registered person to demonstrate that the client identification procedures have been followed satisfactorily.~~

¹ Please refer to the Commission's website regarding account opening approaches that the Commission would consider to be acceptable for the purposes of this paragraph.

² The minimum cheque amount required is subject to periodic review and will be revised when appropriate.

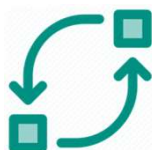
Amendments to paragraph 5.1 of the Code of Conduct

Launch of a designated webpage ^{Note}



Acceptable account opening approaches will now be published on a designated webpage

Also feature relevant circulars and frequently asked questions (FAQs)



The information on the dedicated webpage will supersede previous circulars and FAQs on client onboarding

Intermediaries will be notified of the updates in other acceptable options for client onboarding in the future as a result of advances in technology via circulars and publication on the designated webpage



For the avoidance of doubt, all currently acceptable account opening approaches will remain applicable.

A large, stylized teal graphic of a bird, possibly a phoenix, is positioned in the background. The bird is shown in profile, facing right, with its wings spread upwards and outwards. The graphic is semi-transparent and serves as a decorative element for the slide.

Thank you

AML/CFT section on the SFC's website:

<https://www.sfc.hk/web/EN/rules-and-standards/anti-money-laundering-and-counter-terrorist-financing/>