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

# Anti-Money Laundering and Counter-Financing of Terrorism Webinar 2021

**December 2021**

# 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 or your firm. Accordingly, it should not be regarded as a substitute for seeking detailed advice on any specific case from your own professional adviser.

# Agenda

- I. Update on major AML/CFT regulatory developments
- II. Inspection findings and other supervisory observations on AML/CFT

# Update on major AML/CFT regulatory developments

**(1) Revised AML/CFT Guidelines**

(2) Mitigating ML/TF risks of virtual assets

(3) New Technologies for AML/CFT

**Speaker:**

**Joyce Pang**

**Associate Director and Head of AML Unit**
**Intermediaries Supervision**

# Background and objectives


**FATF Standards**

To align with the FATF Standards as amplified by the FATF's Guidance for a Risk-Based Approach for the Securities Sector

**Mutual Evaluation**

To address some areas for improvement identified in the latest Mutual Evaluation Report of Hong Kong (MER) which are relevant to licensed corporations

**Industry feedback**

To provide practical guidance to facilitate the implementation of AML/CFT measures in a risk-sensitive manner

# Key milestones

**18 Sep 2020**

Public consultation on proposed amendments to AML/CFT guidelines (3-month)

**15 Sep 2021**

Consultation conclusions on proposed amendments to AML/CFT guidelines

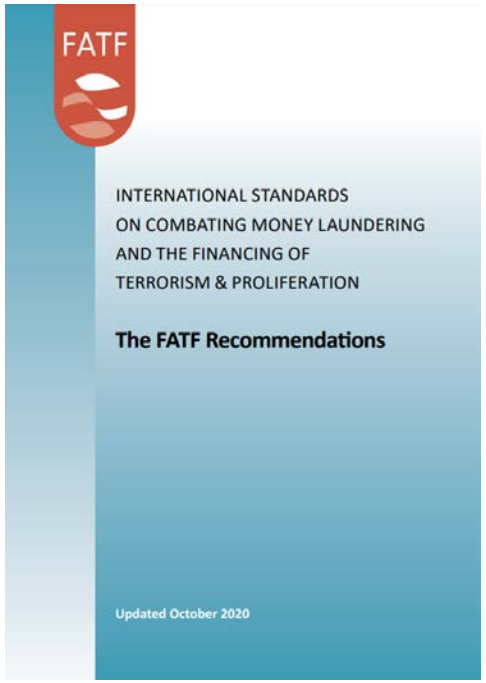
**30 Sep 2021**

Gazettal and effective date of revised AML/CFT guidelines (except for cross-border correspondent relationships requirements)

**30 Mar 2022**

Effective date of cross-border correspondent relationships requirements

# Cross-border correspondent relationships – FATF Standards




**FATF Recommendation 13 - Cross-border correspondent banking and other similar relationships:**

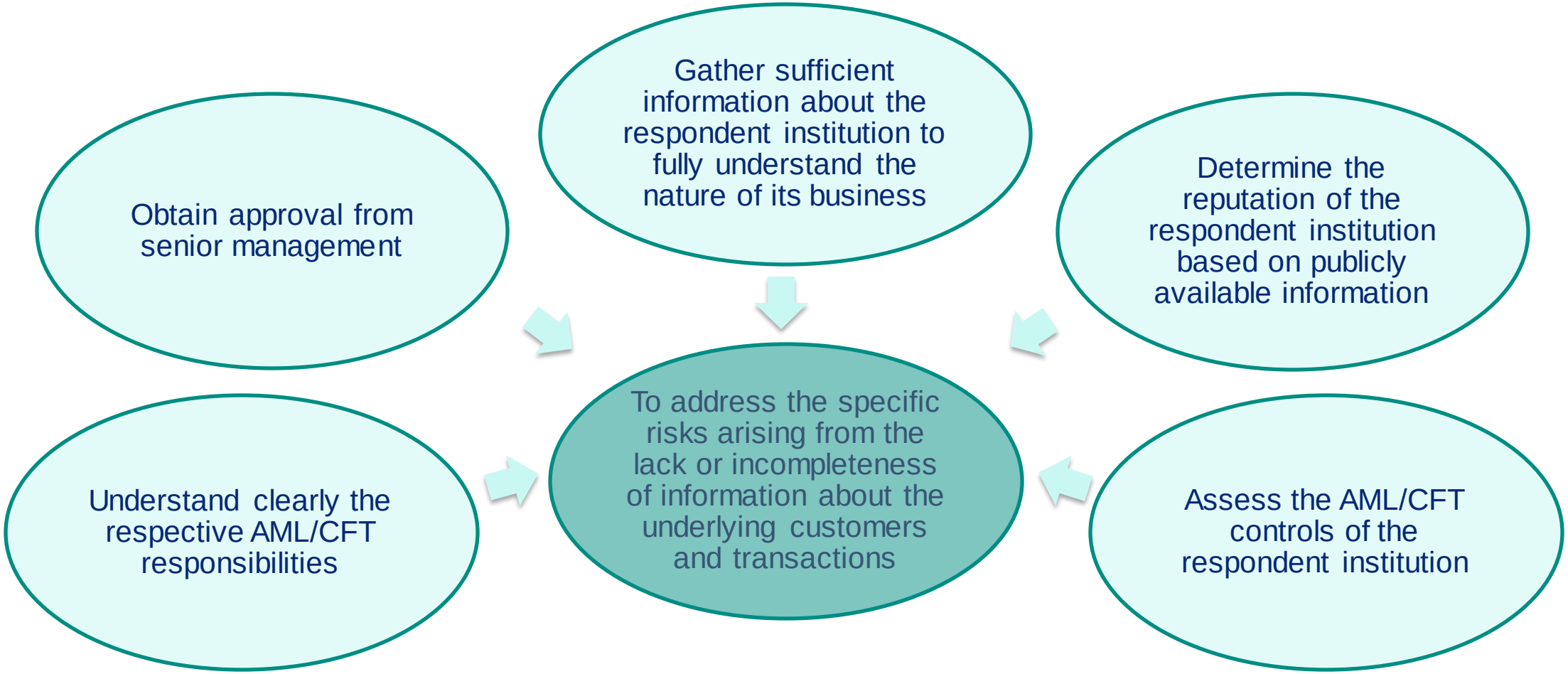
- Requires financial institutions to perform ***additional due diligence and risk mitigating measures*** for cross-border correspondent banking and other similar relationships (in addition to normal customer due diligence measures)
- Examples of similar relationships: those established for ***securities transactions*** or funds transfers, whether for the cross-border financial institution as principal or for its customers

**FATF's Guidance for a Risk-based Approach to the Securities Sector (2018):**

- ***Confirmed and elucidated*** the application of cross-border correspondent relationship requirements to the securities sector

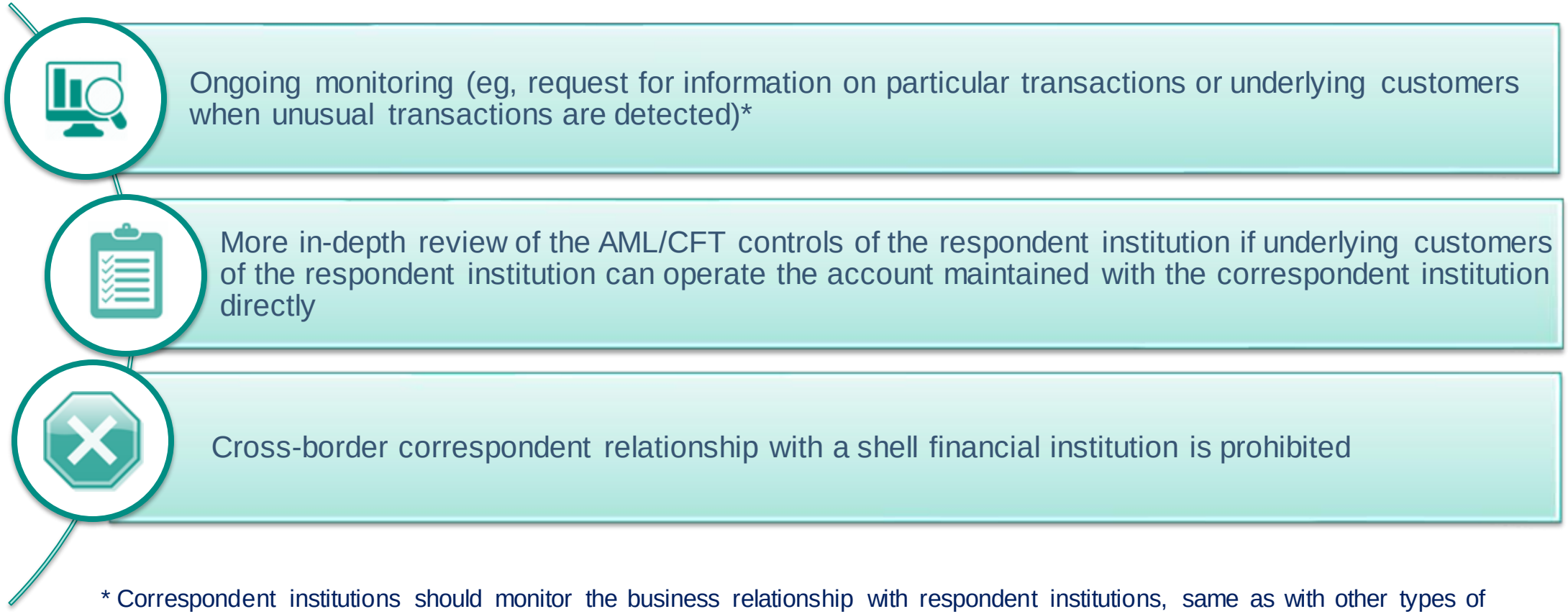
# Major cross-border correspondent relationship requirements

## Additional due diligence measures



# Major cross-border correspondent relationship requirements

## Other risk mitigating measures




* 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 AML/CFT guidelines. 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.

# Scope of application

## Illustrative diagram of an <u>in-scope</u> business relationship

**Hong Kong broker**
(LC)

1 Provides dealing services

4 Places orders for HK stocks

**Overseas broker** 2
(LC's customer)

Place orders for HK stocks

3

**Underlying customers**
(Not LC's customers)

| | |
|---|---|
| 1 | Provision of services to the non-Hong Kong financial institution for dealing in securities, dealing in futures contracts or leveraged foreign exchange trading |
| 2 | The non-Hong Kong financial institution is a customer of the licensed corporation (LC) and is located in a place outside Hong Kong |
| 3 | The non-Hong Kong financial institution's underlying customers are not customers of the LC for customer due diligence (CDD) purposes |
| 4 | The transactions are initiated by the customer |

HK broker has limited or no information on the underlying customers and the nature or purposes of their transactions

# Scope of application

## Illustrative diagram of an <u>out-of-scope</u> business relationship

**Delegates asset management function**

**Hong Kong asset manager**
(LC - Delegated asset manager)

**Overseas asset manager**
(LC's customer -
Delegating asset manager)

Place orders to brokers

(Transactions initiated by LC based on a delegated mandate)

Under a delegated asset management, the transactions are ***initiated by the LC based on a delegated mandate*** *rather than by the customer (ie, the delegating asset manager).*

<u>* Where a delegated asset management relationship is exposed to higher risks, LCs may apply enhanced measures similar to those applicable to a cross-border correspondent relationship as appropriate (see 2(i) of Appendix C to the AML/CFT Guideline for details).</u>

# Cross-border correspondent relationships with affiliated companies

## Illustrative diagram of a cross-border correspondent relationship with affiliated company

**Hong Kong broker**
(LC)

1 Provides dealing services

4 Places orders for HK stocks

2

**Overseas affiliated broker**
(LC's customer)

Place orders

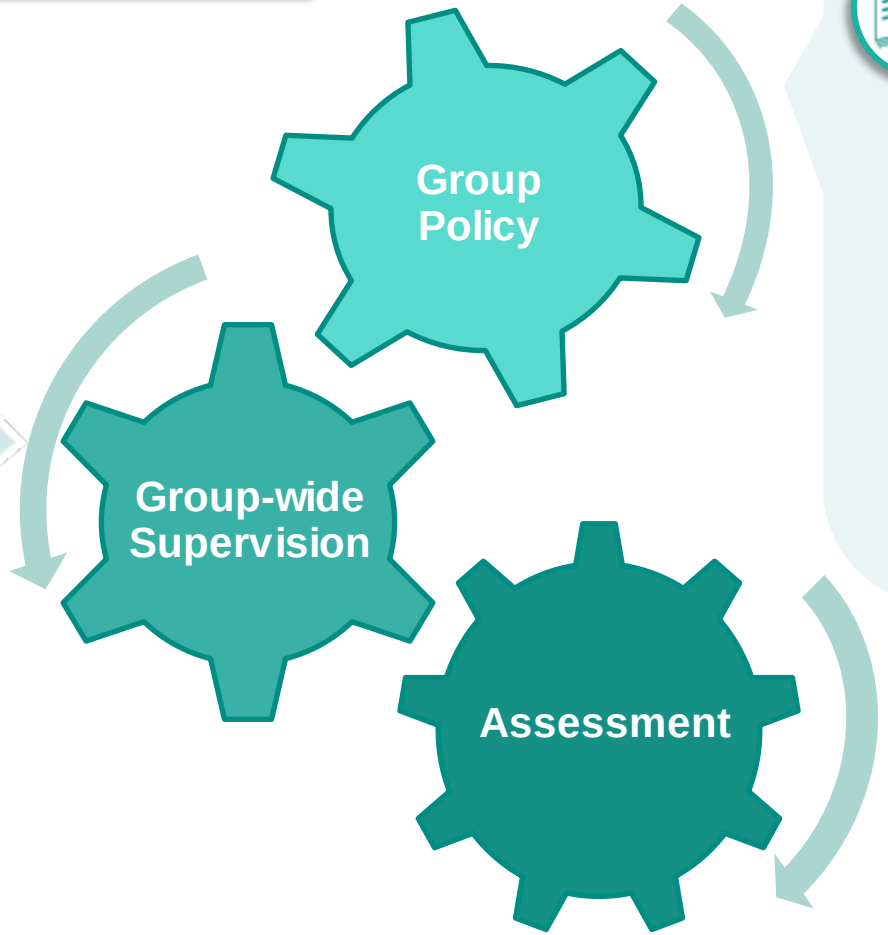
3

**Underlying customers**
(Not LC's customers)

- The FATF Recommendations ***do NOT exclude overseas affiliates*** from the scope of application of the provisions of cross-border correspondent banking and similar relationships
- Transactions conducted for a respondent institution which is an overseas affiliated company ***do NOT necessarily pose lower ML/TF risk***

# Cross-border correspondent relationships with affiliated companies

**Streamlined approach**




Be satisfied that the ***group policy*** that applies to the respondent institution:

- includes-
  - ***(i) CDD, ongoing monitoring and record-keeping requirements*** similar to Schedule 2 to AMLO;
  - (ii) AML/CFT responsibilities of the respondent institution;
  - ***(iii) group-wide AML/CFT Systems****; and
- can adequately mitigate any higher risk factors to which the respondent institution is exposed throughout the business relationship

Effective implementation of the group policy and group-wide AML/CFT Systems is ***supervised*** at a group level by a ***competent authority***

Assessment should be ***documented, and approved*** by an MIC of AML/CFT, MIC of Compliance or other appropriate senior management personnel

** Group-wide AML/CFT Systems include compliance and audit functions; provision of customer, account and transaction information to the group-level compliance, audit and AML/CFT functions and sharing of such information for CDD and group-wide ML/TF risk management purposes.*

# Senior management approval for cross-border correspondent relationships

## Can senior management approval be delegated or exempted for lower risk cross-border correspondent relationships?

- Senior management approval is required for all cross-border correspondent relationships
- The level of seniority of the senior management in making such approval should be commensurate with the assessed ML/TF risk
- Designated management personnel may delegate the authority to approve to other staff members for carrying out the approval process on their behalf while remaining responsible for the approval decision
- The delegation and approval processes should be governed by proper internal policies and oversight mechanisms

**For details, please refer to Q17 of AML/CFT FAQs*

# Third-party deposits and payments

SECURITIES AND FUTURES COMMISSION
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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 circulars[1].

Third-party deposits and payments may be used to facilitate the misappropriation of client assets, money laundering and other misconduct[2]. 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 payments[3].

- Incorporated existing guidance provided in circulars
- Provided additional facilitative guidance relating to third-party deposits

**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

# Definition of “third party”

**Who are the in-scope third parties for the purposes of the third-party deposits and payments provisions and whether fund transfers to or from a bank account jointly owned by a customer and a third party are in-scope?**

- “Third party” means any person other than the customer (see footnote to paragraph 11.1 of the AML/CFT Guideline)
- Where an LC’s customer made a deposit or payment from or to a jointly owned bank account, the joint owner who is not the relevant customer is a third party for the purposes of these provisions. LCs should apply policies and procedures for handling third-party deposits and payments to transactions with such a jointly-owned bank account.

**For details, please refer to Q26 of AML/CFT FAQs*

# Due diligence process for assessing third-party deposits and payments

Critically ***evaluate the reasons*** and the need for third-party deposits or payments

Take reasonable measures on a risk sensitive basis to (i) ***verify the identities*** of the third parties and (ii) ***ascertain the relationship*** between the third parties and the customers

***Obtain the approval*** of the MIC of AML/CFT, another member of senior management with a relevant role at the LC with respect to AML/CFT or MLRO for the acceptance for a third-party deposit or payment

***Document*** the findings of inquiries made and corroborative evidence obtained during the due diligence process as well as the approval of a third-party deposit or payment

# Approval of third-party deposits and payments

## Can the approval process for the acceptance of a third-party deposit or payment be delegated?

- ❑ Yes, so long as the third-party deposit or payment approvers remain responsible for the approval decision
- ❑ The delegation and approval processes should be governed by proper internal policies and oversight mechanisms

**For details, please refer to Q27 of AML/CFT FAQs*

# Other areas of major amendments

Institutional risk assessments

Red-flag indicators of suspicious transactions and activities

Risk indicators for institutional and customer risk assessment

Person purporting to act on behalf of the customer (PPTA)

Simplified and enhanced measures under a risk-based approach

# Update on major AML/CFT regulatory developments

(1) Revised AML/CFT Guidelines

**(2) Mitigating ML/TF risks of virtual assets**

(3) New Technologies for AML/CFT

**Speaker:**

**Irene Pou**
**Associate Director**
**Intermediaries Supervision**

# Mitigating ML/TF risks of virtual assets

## FATF's updated guidance

In October 2021, the Financial Action Task Force (FATF), published the *Updated Guidance for a Risk-based Approach to Virtual Assets (VAs) and Virtual Asset Service Providers (VASPs)*, which includes updates focusing on six key areas:

- **Clarification of the definitions of VA and VASP**
- **Guidance on how the FATF standards apply to stablecoins**
- **Additional guidance on the risks and tools available to address the ML/TF risks for peer-to-peer transactions**
- **Updated guidance on the licensing and registration of VASPs**
- **Additional guidance on the implementation of the "travel rule"**
- **Principles of information sharing and co-operation amongst VASP supervisors**

# Mitigating ML/TF risks of virtual assets

## Hong Kong legislative proposal

In May 2021, the Government published the *Consultation Conclusion on the Legislative Proposals to enhance AML/CFT Regulation in Hong Kong* which seeks to, among others, introduce a licensing regime for VASPs.


- There is general support for the proposed direction and framework of the VASP regulatory regime, and for the SFC to become the regulatory authority of the regime.
- The Government targets to introduce the amendment bill into the Legislative Council in the beginning of 2022 legislative year.

# Proposed licensing regime for VASPs

## Scope of regulated activities

- Operating a VA exchange
- The Government will keep in view the need for regulation of a broader range of VA activities as the market evolves. Flexibility will be built in the licensing regime such that it may be expanded to cover forms of VA activities other than VA exchanges where the need arises in future

## Definition of VA

- Both securities and non-securities tokens will be covered
  [***Carve out**: digital representations of fiat currencies (including digital currencies issued by central banks); financial assets (eg, securities and authorised structured products) and stored value facilities which are already subject to regulations; and closed-loop, limited purpose items (such as air miles, credit card rewards, etc.)*]
- Flexibility will be built in the legislation by empowering the SFC to prescribe characteristics that constitute the definition of a VA, and the Secretary for Financial Services and the Treasury to determine whether any digital representation of value is to be regarded as a VA or not

# Proposed licensing regime for VASPs

## Eligibility

- Locally incorporated companies with a permanent place of business in Hong Kong or companies incorporated elsewhere but registered in Hong Kong under the Companies Ordinance
- Satisfaction of fit-and-proper test

## Regulatory requirements


- Subject to the AML/CFT requirements stipulated in Schedule 2 to the AMLO, as well as other regulatory requirements for investor protection purposes
- Can only offer services to professional investors
- Must impose rigorous criteria for the inclusion of VAs to be traded on its platform

# Proposed licensing regime for VASPs

## Licence period and exemption

- Licence will remain valid until revoked by the SFC, for example, due to misconduct or cessation of operation
- No exemption is proposed except for VA exchanges that are already regulated as a licensed corporation in the voluntary opt-in regime pursuant to the SFO


## Prohibitions

- Any person who is not a licensed VASP is prohibited from actively marketing, whether in Hong Kong or elsewhere, to the public of Hong Kong a regulated VA activity or a similar activity elsewhere

## Transitional period

- 180 days upon commencement of operation of the licensing regime

# Update on major AML/CFT regulatory developments

(1) Revised AML/CFT Guidelines

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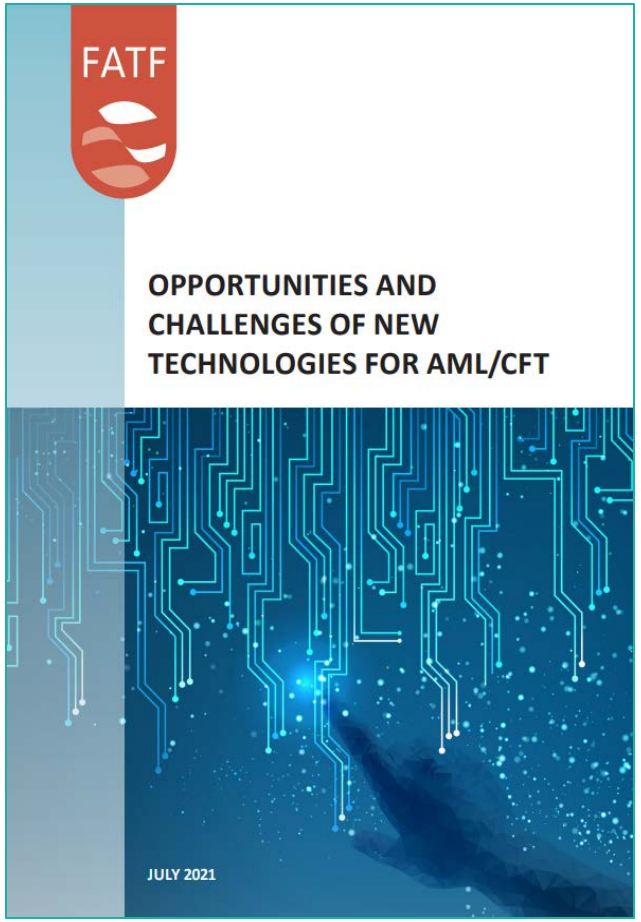
**(3) New Technologies for AML/CFT**

# New Technologies for AML/CFT

On 1 July 2021, the FATF published a report on *Opportunities and Challenges of New Technologies for AML/CFT*.

The report:

- Identifies opportunities to leverage new technologies and emerging and available technology-based solutions
- Examines the challenges and obstacles to implement new technologies and how to mitigate them



# Opportunities of new technologies for AML/CFT

***(Based on responses to digital transformation questionnaire disseminated to government authorities and public and private sector experts by FATF)***

## Who is using new technologies?

**Multinational financial institutions**


**Retail and commercial banks**

**Internet-based firms such as financial technology (FinTech) firms**

# Opportunities of new technologies for AML/CFT

***(Based on responses to digital transformation questionnaire disseminated to government authorities and public and private sector experts by FATF)***

## What advantages new technologies can bring to private sector?

- Process and analyse larger sets of data in a quicker, speedier and more accurate manner
- Reduce costs and release human resources to more complex areas of AML/CFT
- Better identification, understanding and management of ML/TF risks
- Efficient digital onboarding
- Greater auditability, accountability and overall good governance
- Improve the quality of suspicious activity report submissions

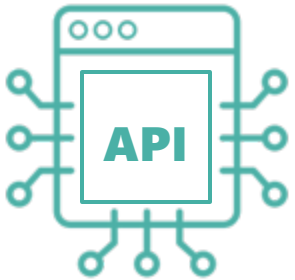
# Opportunities of new technologies for AML/CFT

***(Based on responses to digital transformation questionnaire disseminated to government authorities and public and private sector experts by FATF)***

## Which technologies offer the most potential to AML/CFT?

Respondents to FATF's digital transformation questionnaire cite machine learning and natural language processing (both are subsets of artificial intelligence) and Application Programming Interfaces as having the most potential for contributing to AML/CFT effectiveness.

However, it is essential to ensure that there is no over-reliance on new technologies. Human input and capacity building continue to be essential, in particular regarding elements that technology still cannot overcome, regional inequalities or expertise on emerging issues.



# Challenges of implementation of new technologies for AML/CFT

**Operational challenges** such as complexities and costs involved in developing and implementing new technologies; difficulties with the explainability and interpretability of digital solutions, etc.

**The unintended consequences of new technologies,** such as ethical and legal issues, can arise from a misguided implementation of new technologies.

# Key to overcome the implementation challenges

Create an enabling environment for the use of new technologies in AML/CFT:

- get management buy-in;
- responsible innovation to enhance AML/CFT effectiveness (eg, enhancing the ability to collect data, making a more efficient use of resources); and
- ensure the use of innovative AML/CFT solutions is compatible with international standards of data protection, privacy and cybersecurity.

# Inspection findings and other supervisory observations on AML/CFT

**(1) Deficiencies and inadequacies found in LCs' AML/CFT systems and controls**

(2) Guidance on the identification and reporting of suspected "ramp and dump" scams involving market manipulation activities

**Speaker:**

**Sharon Wong**
**Senior Manager**
**Intermediaries Supervision**

# Management oversight and controls

## Example 1: Policies and procedures

Senior management failed to identify non-compliance with customer due diligence policies and procedures during the account opening approval process

- For example, an LC concluded a corporate client with multiple layers in its ownership structure that it did not have any natural person beneficial owner simply by reference to the indirect ownership percentages of the companies in the topmost layer of the corporate client's ownership structure.

# Management oversight and controls

## Example 2: Documentation of AML/CFT control measures performed

Failed to establish, maintain and/or enforce policies and procedures to ensure proper records and documentation were maintained

- For example, inadequate documentation was maintained for the assessment results of the sanctions and politically exposed persons screening of their clients as well as the transaction monitoring process.

# Implementation of risk assessments

## Example 3: Institutional risk assessment

On areas of controls identified in the assessment that require enhancements, no elaboration on the enhancements required or action plan developed for the enhancements.

## Example 4: Customer risk assessment (CRA)

Failure to institute appropriate and effective measures to ensure that the High Risk Countries List used in the assessment of country risk associated with a customer during the CRA process, is complete and timely updated for proper categorisation of ML/TF risks of the customer.

# Identification and evaluation of third-party deposits

## Example 5: Identification of third-party deposits

Only deposits with amount exceeding the predetermined threshold would be subject to review to ascertain whether they originated from third-party payors.

## Example 6: Evaluation of third-party deposits


No enquiry on the reason or intended use of the third-party deposit, or evaluation of whether there was a genuine need for the client to use his securities trading account to receive the fund from third-party source.

# Sanctions screening

**Example 7: Use of automated system to filter screening alerts**

An LC developed its own automated system to filter screening alerts (or potential hits) generated from screening platform by reference to key personal details such as name, date of birth, gender and nationality of its clients and the persons identified in the potential hits.

Potential hits would be discounted automatically if the date of birth information of a person identified in the potential hit is not available in the screening database, even though the other key personal details of the person match with the client concerned.

The automated system was unable to distinguish names with a title attached. For example, the system automatically disposed of a potential hit involving a person in the name of "Dr. XYZ", based on the determination that such name did not match with the client concerned who was in the name of "XYZ", even though the other key personal details of the person match with the client concerned.

# Ongoing monitoring

**Example 8: Keeping customer information up-to-date and relevant**

An LC reviewed customer due diligence (CDD) records of its customers on a periodic basis and upon the occurrence of trigger events.

The review process was limited to negative news screening of the customers, without reviewing the veracity and adequacy of the CDD information previously obtained and taking appropriate follow-up steps.

# Inspection findings and other supervisory observations on AML/CFT

(1) Deficiencies and inadequacies found in LCs' AML/CFT measures and controls

**(2) Guidance on the identification and reporting of suspected "ramp and dump" scams involving market manipulation activities**

# Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

On 29 June 2021, the SFC issued a circular highlighting the concerns about the rising number of suspected ramp and dump scams.

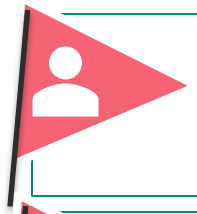
The circular serves to:

- Encourage intermediaries to provide information or documents which may facilitate the SFC's immediate assessment of the impact of potential market misconduct, in particular where a ramp and dump scam is suspected.

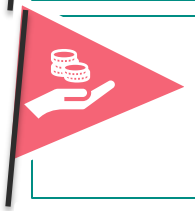
- Remind intermediaries of their existing obligations under paragraph 12.5(f) of the *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission* to report market misconduct suspected to have been committed by their clients to the SFC in a timely manner.

# Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

The circular also provides guidance on red flags which may arouse the reasonable suspicion of intermediaries or their staff about suspected ramp and dump scams. The following is a list of non-exhaustive illustrative red flags set out in the circular:



Clients whose transaction amounts are generally incommensurate with their reported profiles.



Clients who regularly acquire shares through bought and sold notes or on a free-of-payment basis or who receive large third-party deposits in their accounts.

Clients who bought shares on a delayed settlement basis, following which the share price rose substantially during the delayed settlement period, and then gave instructions before the payment date to sell these shares.

Clients who bought shares in a particular stock towards the end of the trading day in a way that had the effect of substantially raising the closing price on a number of days.

# Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

Clients who sold a large volume of shares in a particular company shortly before a collapse of the share price which cannot be explained by any corporate or sector-specific news.

A group of clients, some of whom are identified from the trading behaviour set out above, traded in the same stock in the same direction, at more or less the same price or at the same time, and exhibit any of the following characteristics:

- they have authorised the same third party to operate their accounts;
- they have effected fund transfers amongst themselves;
- they opened accounts on or around the same day, were served by the same account executive or referred to the intermediary by the same person at account opening; or
- they share the same personal particulars such as telephone numbers or email addresses.

Paragraph 7.12 of AML/CFT Guideline requires LCs to “have reasonable policies and procedures to identify and analyse relevant red flags of suspicious activities for its customer accounts”.

## 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