

REVISED PRACTICE DIRECTION P ("PDP")

June 2023

PROGRESS UPDATE ON AML/CTF INITIATIVES AND SUPERVISION

Michael Lintern-Smith

Chair of the AML Committee
LSHK

Alan Linning

Vice-chair of the AML Committee
LSHK

15 November 2023

AMLO Amendment Ordinance 2022

- Effective from **1 June 2023**
- The Amendment Ordinance introduces a number of miscellaneous amendments to:
 - a) ensure alignment of the regulatory regime with the latest international standards set by the Financial Action Task Force (“FATF”), and
 - b) address technical deficiencies identified in the Mutual Evaluation report on Hong Kong 2019.
- The Law Society made further revisions to the PDP to:
 - better align with the Amendment Ordinance and FATF recommendations;
 - provide additional guidance on some of the requirements; and
 - introduce provisions relating to the combat of **proliferation financing** (“**PF**”) to align the PDP with the corresponding provisions in Hong Kong legislation and with FATF’s expectations in this area.

Key amendments

- Licensing regime for virtual asset service providers (**VASPs**)
- Registration regime for dealers in precious metals and stones (**DPMS**)
- Amendments relevant to the legal profession:
 - Change in the definition of beneficial owner in a trust context – additional CDD requirements :
 - from “individual who is entitled to a vested interest in more than 25% of the capital of” to “**a beneficiary or a class of beneficiaries of the trust entitled to a vested interest**”
 - “trustee” is added to the definition of beneficial owner
 - Additional requirements set out in Schedule 2, Part 2, Division 1, Section 9 and 5 of the AMLO are not required if a digital identification system is used for client identification and verification in situations where client is not present for face-to-face identification
 - EDD not required for former PEPs, subject to a risk-based approach
 - New PEP definition – foreign PEPs are those from outside of Hong Kong **NOT** outside of China. EDD required for all PEPs outside of Hong Kong.

Revised PDP

- The SAR Government gazetted the revised PDP on 25 May 2023 (Gazette No. No. 21 Vol. 27, item 3122)
- The revised PDP with explanatory **Circular 23-310 (SD)** was issued by the Law Society on 25 May 2023
- A copy of the updated **PDP** and the **Circular 23-310 (SD)** can be found at the following Law Society links:

Members Zone: <https://www.hklawsoc.org.hk/-/media/HKLS/Home/Support-Member/Professional-Support/Vol-2-Eng/V-2-CH-24.pdf?rev=50b650fc380444b0abc2313566c8384f&hash=6FE5EEF8FADEB62180C326C32FCE161E>

AML website: <https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AML-Resources>
under the “Regulatory Framework” section

An Overview of Amendments to PDP

Politically Exposed Person

- Enhancement to definition of politically exposed persons (“PEPs”), clarifying that it includes foreign (“**Non-HK PEP**”) and domestic (“**HK PEP**”) PEPs
- Introduces new definition of **International Organisation PEP** in line with the FATF recommendations

Table A,
section 4 of
the PDP

Non-Hong Kong PEP (Foreign PEP)

▪ **A non-Hong Kong PEP means:-**

- (a) an individual who is or has been entrusted with a prominent public function outside Hong Kong and
 - (i) includes a **head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official;**
 - (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);
- (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a), or a spouse or a partner of a child of such an individual; or
- (c) a close associate of an individual falling within paragraph (a).

Table A,
section 5 of
the PDP

Hong Kong PEP (Domestic PEP)

▪ **A Hong Kong PEP means:-**

- (a) an individual who is or has been entrusted with a prominent public function in Hong Kong and
 - (i) includes **head of government, senior politician, senior government, or judicial official, or senior executive of a government-owned corporation and an important political party official;**
 - (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);
- (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a), or a spouse or a partner of a child of such an individual; or
- (c) a close associate of an individual individual falling within paragraph (a).

Table A,
section 6 of
the PDP &
footnote 5

New definition

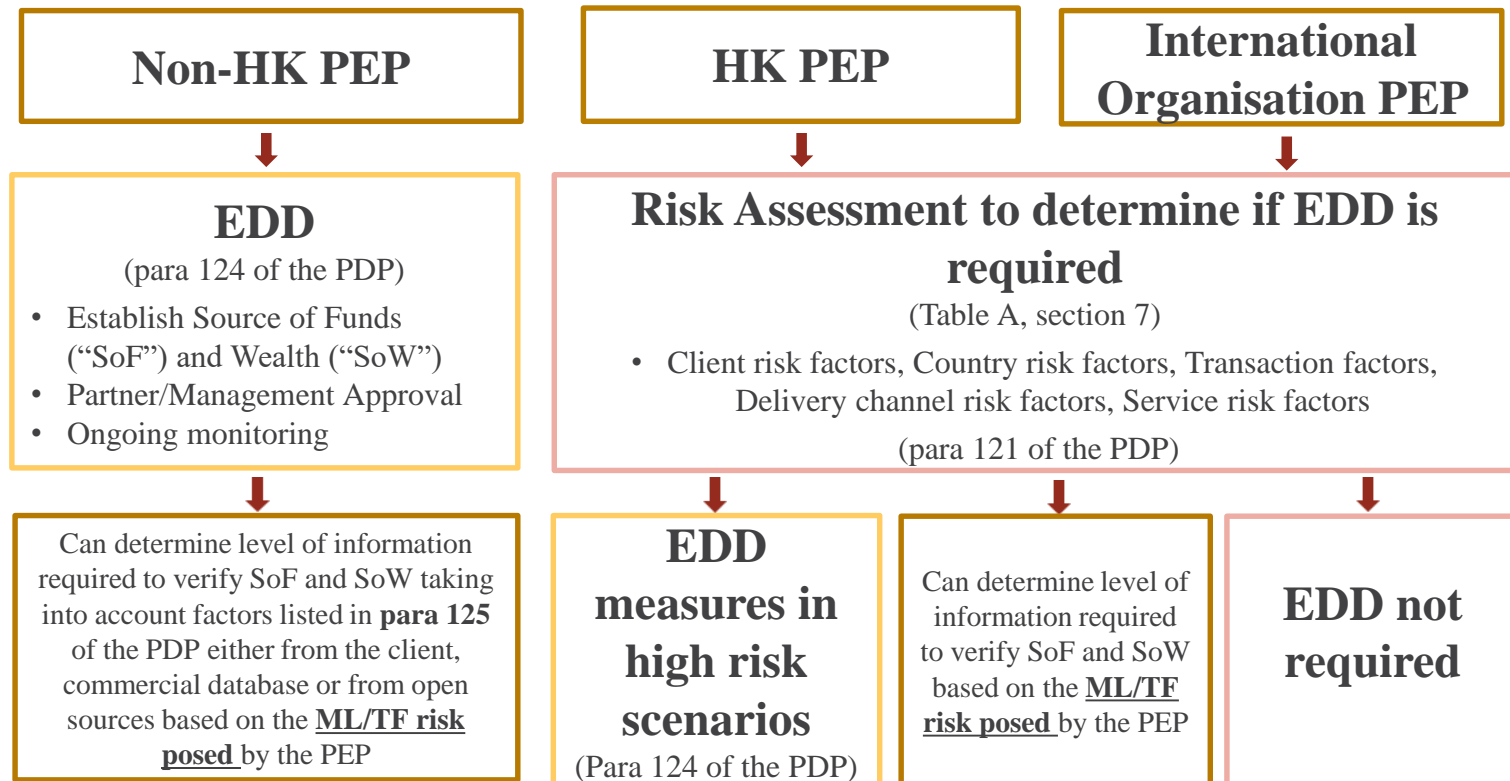
International Organisation PEP

▪ **An international organisation³ PEP means:-**

- (a) an individual who is or has been entrusted with a prominent function by an international organisation, and
 - (i) includes **members of senior management, i.e. directors, deputy directors and members of the board or equivalent functions;**
 - (ii) but does not include a middle-ranking or more junior official of the international organisation;
- (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a), or a spouse or a partner of a child of such an individual; or
- (c) a close associate of an individual falling within paragraph (a).

Enhanced Due Diligence for PEPs

- Clarification on the status of HK and International Organisation PEPs – not automatically a high risk client, EDD subject to risk-based approach – (PDP, Table A, section 7)



Treatment of Former PEP

- EDD not required subject to risk-based approach - **PDP, Table A, section 8**
- Risk factors to determine whether former PEP no longer presents a high risk of ML/TF:

- **A former PEP means:-**
 - (a) an individual who has been but is not currently entrusted with a prominent public function;
 - (b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a), or a spouse or a partner of a child of such an individual; or
 - (c) a close associate of an individual falling within paragraph (a)

- (a) the level of (informal) influence that the individual could still exercise;
- (b) the seniority of the position that the individual held as the PEP; and
- (c) whether the individual's previous and current function are linked in any way (e.g. formally by appointment of the PEP's successor, or informally by the fact that the PEP continues to deal with the same substantive matters).



- Risk assessment must be documented
- Decision not to apply EDD to former PEP requires Partner's/Management approval

Beneficial Owner definition for Trust

- Align the definition of “**beneficial owner**” in relation to a trust under the Amendment Ordinance with that of “**controlling person**” under the Inland Revenue Ordinance (Cap.112), by clarifying that, where a trust is concerned, it includes **trustees, beneficiaries and class(es) of beneficiaries** – **PDP, Annexure 8**

New definition

- (c) in relation to a trust, means—
- (i) a beneficiary or a class of beneficiaries of the trust entitled to a vested interest in the trust property, whether the interest is in possession or in remainder or reversion and whether it is defeasible or not;
 - (ii) the settlor of the trust;
 - (iii) the trustee of the trust
 - (iv) a protector or enforcer of the trust; or
 - (v) an individual who has ultimate control over the trust; and

Superseded definition

- (c) in relation to a trust, means—
- (i) an individual who is entitled to a vested interest in more than 25% of the capital of the trust property, whether the interest is in possession or in remainder or reversion and whether it is defeasible or not;
 - (ii) the settlor of the trust;
 - (iii) a protector or enforcer of the trust; or
 - (iv) an individual who has ultimate control over the trust; and

Recognized digital identification system

- “**recognized digital identification system**” allowed for identification and verification of client’s identity in non-face-to-face situations - **Schedule 2, Part 2, Division 1, Section 2(1) (ab) (iia)** of the AMLO
- If, recognized digital identification system is used, additional requirements set out in:
 - **Section 9** (Special requirements when customer is not physically present for identification purposes), and
 - **Section 5(3)** (Duty to continuously monitor business relationships) of **Schedule 2, Part 2, Division 1 to the AMLO** do not apply
- iAM Smart is a recognized digital identification system by the Law Society – another method of ID&V
- Interested firms can get in touch with the Law Society for further information regarding integration with the iAM Smart platform



iAM Smart adoption process by law firms

Application to
the Law
Society for
integration with
the iAM Smart
Platform

Law Society
informs the
Office of the
Government
Chief
Information
Officer
("OGCIO")

Testing of firms
IT system in the
"Sandbox
Programme"
with the iAM
Smart
Cyberport
Team

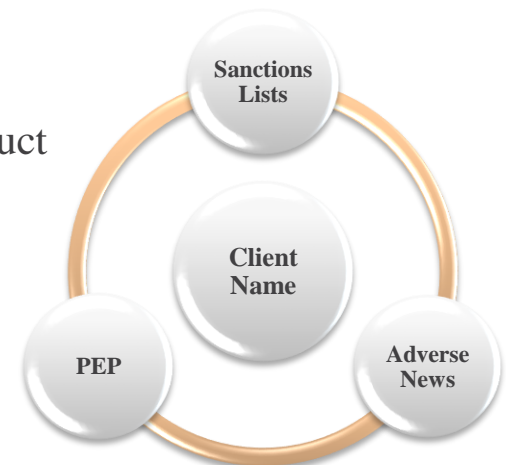
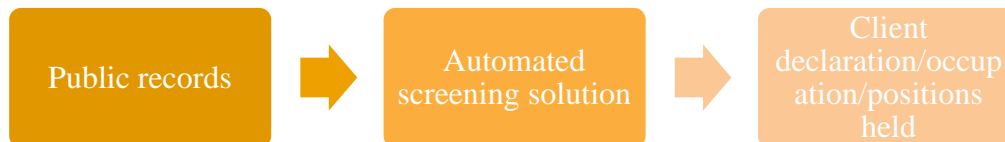
Security
checking and
Privacy Impact
Assessment
testing by a
third-party
before
integration

Detailed information can be found on the AML website under the "*Tools and Templates*", "*Guidance on Alternative Processes to Verify a Client's Identity*" tab:
<https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AML-Resources>

Name Screening requirement

Lawyers are required to:

- Screen the names of their **clients** and **beneficial owner(s)** against United Nations Sanctions list and the list of terrorist or terrorist associates – **PDP, Table A, section 2 (Client due diligence), limb “How” (iv)**; and
- Apply a risk-based approach to screening of **connected parties** before legal services are provided and before the CDD assessment is undertaken on the client – **PDP, footnote 2**
- The screening should be completed against the:
 - the names (and aliases) of designated individuals and entities on the UN Sanctions List and UNATMO List of terrorists and terrorist associates;
 - PEP lists; and
 - adverse media, such as reports of criminality or misconduct
- How?



Risk Assessment for New services, business practices and technologies

- New and developing technologies, legal services and firm's new business practice(s) can present unknown ML/TF and potential PF risks and vulnerabilities. In addition, new methods of delivery may be able to bypass existing AML/CFT measures to allow anonymity and disguise beneficial ownership.
- Firms are required to perform a **risk assessment** in the following situations:
 - introduction of **new legal service(s)** e.g. new area of practice;
 - opening a **new office**;
 - a **firm's restructuring** which involves for example, merger with another law firm, acquisition of another law firm;
 - **outsourcing** KYC/CDD processes(es); or
 - deployment of **new technologies** for example, automated KYC/CDD, screening solutions or case management system



To understand if regulatory requirements are met and whether appropriate procedures, policies and controls are implemented to mitigate the risk.

Firm-wide Risk Assessment

- Law firms are required to conduct a periodic firm-wide risk assessment, depending on the size and complexity of the law firm – **PDP, para 41**

What is practice-wide risk assessment?

- It identifies which areas of the business could currently be exploited or are vulnerable to ML/TF/PF
- It sets out information on specific ML/TF and PF risks applicable to the nature of the firm's services provided, type of clients, size and complexity
- It states what the firm does when it identifies a high-risk client or matter
- It references the firm's policies, controls and procedures to address the risk
- It must be documented, approved by senior management and reviewed at least on a bi-annual basis (if there are no major changes to the operation of the firm)

- The practice-wide risk assessment comprises the following five risk factors:



Practice-wide Risk Assessment Key Considerations

Type of Clients	Geographical Location	Products and Services	Type of Transactions	Delivery Channel
<p>Does your practice deal with the following type of clients?</p> <ul style="list-style-type: none"> Politically exposed person (PEP), their close associates and family members; Clients from cash-intensive/ risky sectors or businesses; Unusual or excessively complex ownership structures; Clients seeking anonymity or who cannot prove their identity; High-net-worth individuals (tax evasion and corruption) 	<p>Does your practice provide services to clients from or is directly or indirectly connected to:</p> <ul style="list-style-type: none"> High-risk jurisdictions identified by FATF or United Nations Sanctions Lists (Client may not operate in a high-risk jurisdiction or be subject or sanctions restrictions itself but obtain funding from, purchase or sell most of their goods and services from those jurisdictions). Links to countries with significant levels of corruption. 	<p>Does your firm provide the following services?</p> <ul style="list-style-type: none"> Commercial or property transactions; The establishment of trusts or corporate structures (which could have an ulterior motive such as obscuring the property identity of the owner/beneficiary of property); Payments that are made to, or received from, third parties who are not obviously connected with any transaction; Tax Mitigation Strategies; Misuse of client accounts: performing high-value financial transactions for clients with no clear business rationale; Transactions involving inter-company loans; Transactions involving the purchase of valuable assets (for example, real estate); Cross-border transactions (including transactions which require involvement by offshore banks/businesses, including trust company service providers); Transactions involving the use of shell companies /corporations; New or developing technologies, or products, that might favour anonymity 	<p>What are the characteristics of transactions that your firm undertakes?</p> <ul style="list-style-type: none"> Large and valuable transactions; Transactions involving cash payments, wire transfers other methods; Sending/receiving funds to third parties or overseas and in what circumstances. 	<p>Does your practice deliver services through:</p> <ul style="list-style-type: none"> Non-face-to-face interaction, for example telephone, video calls, email; Instructions taken from agents or intermediaries.

Client Risk Assessment

- Additional guidance regarding the conduct of a client risk assessment as part of the CDD process – PDP, Table A, section 2 (Client due diligence), limb “How” (v), paragraph 120.5 and 121
- The client risk assessment comprises the following five risk factors:



- A client risk assessment is linked to a specific client, and should assess the higher level of ML/TF risks associated with the above factors to understand what level of CDD should be applied
- The Law Society developed *Client Due Diligence Templates* in 2022 to show how the Client Risk Assessment can be documented with examples of the high risk factors

Simplified Client Due Diligence

- Definition of Simplified Due Diligence (“SDD”) aligned with Section 4, Division 1, Part 2, Schedule 2 of the AMLO allowing for application of SDD in a wider number of circumstances – **PDP, Table A, section 9 (SDD)**

A government or public institution established in HK or in equivalent jurisdiction that has measures in place to ensure compliance with requirements similar to those imposed under AMLO

A financial institution incorporated in Hong Kong or jurisdiction subject to and supervision for compliance with AML/CTF consistent with standards set by FATF

A company listed on a regulated market subject to disclosure requirements

An investment vehicle fulfilling requirements contained in Section 4 (3) (d) of the AMLO

Low risk products such as a provident, pension retirement or superannuation scheme that provides retirement benefits, an insurance policy that does not contain a surrender clause or can be used as collateral for the purpose of the above products, a life insurance as defined in Section 4 (5) (c) of the AMLO

- No requirement to identify and verify beneficial owner
- Can accept other documents, data or information (e.g. proof of FI’s license, listed status or authorization status only etc.)
- Can reduce the degree of ongoing monitoring
- Do not have to collect specific information or carry out specific measures to understand the purpose and intended nature of the business relationship, but can infer the purpose and intended nature from the type of transactions or business relationship established.

Guidance on identification and verification of Beneficial Owner

- Additional guidance regarding the use of documents and information to identify and verify a beneficial owner or persons having ultimate ownership or control over the client – **PDP, para 108**
- Lawyers must take **reasonable steps** to verify the identity of a beneficial owner or persons having ultimate ownership or control over the client
- Type of information / documents that can assist in the verification process:



Publicly available records of beneficial owner(s) available in the public domain (e.g. register of significant controllers (this will depend on the jurisdiction involved) or from the client e.g. the significant controllers register maintained in accordance with the Companies Ordinance of Hong Kong.



Documents or information in relation to the beneficial owner's identity obtained from a reliable and independent source



Client's undertaking or declaration in relation to the beneficial's owner identify in complex structures (corroborated with publicly available information if needed)

What's New?

AML/CTF Risk Assessment of the Legal Sector 2023

Key ML/TF Risks	Inherent Risk Rating
Geographical Risk Factors	
Clients/matters with links to higher risk jurisdictions	
Client Risk Factors	
Politically Exposed Persons (PEPs)	
Familiar Clients	
Situations where underlying client identity is obscured	
Cash intensive/risky sectors or businesses	Not assessed as part of the AML Review, firms should make an independent assessment of the risk
Products and Services Risk Factors	
Conveyancing	
Trust & Company Service Provision	
Tax advice	
Sham Litigations	
Delivery Channels Risk Factors	
Non-Face-to-Face Delivery Channels	
Transaction Risk Factors	
(i) Size/value/complexity of the transaction	
(ii) Methods of payment: use of cash and cheques	
Third-Party Payments	
Emerging/Other Risks	
Pandemic and Post Pandemic-related risks	
Internal Fraud	
Cryptocurrencies	Not a indep



- Assesses inherent risks specific to the legal profession in Hong Kong
- Helps to understand which areas of legal practice and which other ML/TF risks can make a firm vulnerable to ML/TF threats
- Should be factored in the firm's-wide risk assessment and when assessing ML/TF risks applicable to a client

Available for legal professionals in the **Member's Zone** under the tab **“Support for Members / Law Firms”**, **“AML/CTF Sectoral Risk Assessment”**
<https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AMLCTF-Sectoral-Risk-Assessment>

Key Risks and Best Practice Leaflet for Conveyancing transactions

English version

- A guide with examples of red flags related to corruption and money laundering in conveyancing and related transactions, handling of title deeds and clients' money
- Lists internal control measures to mitigate corruption/money laundering or related malpractice risks
- Should be shared with all staff within the firm, not only fee earners



Chinese version

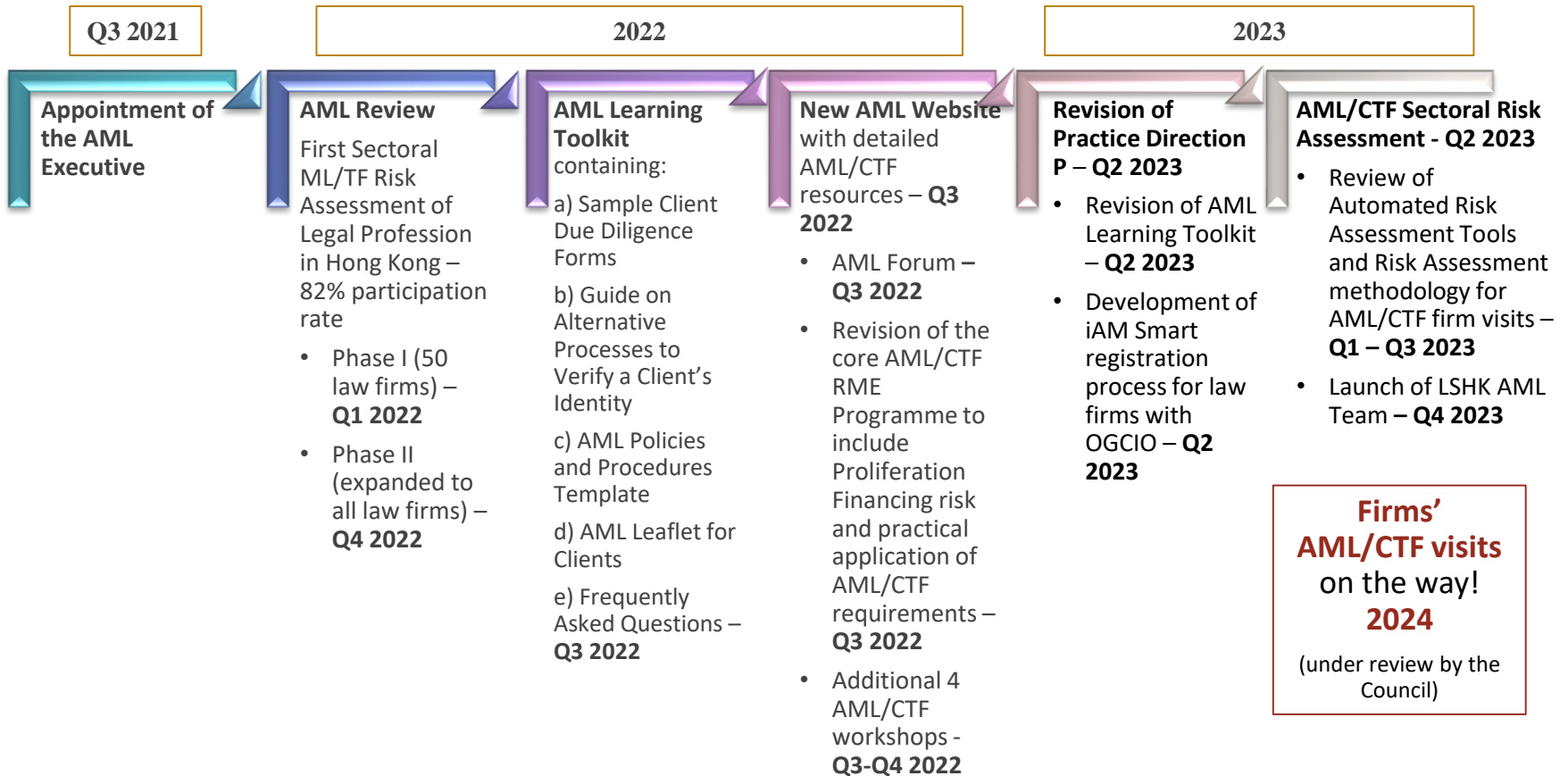


Leaflets are available on the AML website under the tab: “**Tools and Templates**”, “**Conveyancing and Related Transactions – Key Risks and Best Practice Leaflet**”

<https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AML-Resources>

AML/CTF Supervision

What's next?



Regular AML Seminars and AML/CTF Risk Management Education courses for legal practitioners

Questions?

Disclaimer:

- These materials are provided by the Law Society of Hong Kong and reflect information as of 15 November 2023.
- The contents are intended to provide a general guide to the subject matter only and should not be treated as a substitute for specific advice concerning individual situations.
- You may not copy or modify the materials or use them for any purpose without the Law Society's express prior written permission.