

Anti-Money Laundering and Counter-Terrorist Financing Compliance Requirements for Legal Professionals in Hong Kong

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AML Policies and Procedures

Law firms should have in place appropriate policies and procedures of internal control for identifying and (where appropriate) reporting suspicious transactions.

What should AML policies and procedures cover?

- Risk management practice (such as client/matter risk assessment)
- Internal controls
- Customer due diligence
- Reliance and record keeping
- Unusually large transactions
- Complex transactions / unusual patterns of transactions
- Politically exposed persons
- Suspicious activity reporting



Firm-wide Risk Assessment and Client Risk Assessment

Firm-wide risk assessment

A firm-wide risk assessment should evaluate the money laundering risk that firm's whole business is exposed to

What you should consider:

- Clients you act for (PEPs, high risk jurisdictions, complexity of client's ownership structure, nature of business)
- Whether you work in or with clients from countries that, for example, have significant levels of corruption or are subject to sanctions
- Whether you offer services in practice areas deemed 'high risk' due to holding client money
- Type of transactions and Source of Funds
- Type of delivery channels (face-to-face, use of agents and intermediaries)

Client risk assessment

A matter or client risk assessment is linked to an individual client and should assess money laundering risk associated with that client or client matter

Factors presenting a higher AML risk may include:

- Dealing with Politically Exposed Persons ("PEP")
- Client involved in cash-intensive business
- Origin of wealth or ownership (for corporate customers) cannot be easily verified
- Shareholding structure too complex and without legitimate commercial rationale
- Client domiciled in a high risk jurisdiction
- Client not present for face-to-face identification

Practice Direction P and AMLO

December 2007
Practice Directions P
("PDP")

The Law Society has issued Practice Direction P "Guidelines on Anti-Money Laundering and Terrorist Financing".

Any law firm or solicitor who fails to follow the mandatory elements of PDP can be subject to disciplinary proceedings.

The mandatory requirements include rules on client identification and verification, client due diligence, record keeping and staff training.

April 2012
Enactment of AMLO

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("**AMLO**") required only financial institutions to, among other things, comply with strict customer due diligence ("**CDD**") and record-keeping requirements

March 2018
AML Amendments
Ordinance

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018 (Cap. 615) ("**AML Amendment Ordinance**")

- a) Extends the statutory CDD and record-keeping requirements to **solicitors and foreign registered lawyers**, accountants, estate agents and trust or company service providers (collectively known as designated non-financial business and professions ("**DNFBPs**") : See section 5A and Schedule 2
- b) Establishes new regulatory regimes for DNFBP's, i.e. Hong Kong Law Society monitors compliance of solicitors and foreign registered lawyers
- c) Introduces a new licensing regime for trust and company service providers ("**TCSPs**") which is administered by the Registrar of Companies ("**Registrar**").

September 2018
Revision of PDP

The PDP was amended to reflect changes introduced by the AML Amendment Ordinance.

Key amendments are:

- a) Maintains a "risk-based approach"
- b) Maintains geographical definition of a "politically exposed person"
- c) Provides further details on client identification and verification in exceptional or urgent circumstances where it is not practicable to verify a client's identity
- d) The record keeping requirement for criminal cases is extended from 3 years to 5 years from expiration of any appeal period.

AMLO (Amendment)
Bill 2022

- a) AML/CTF and Licensing regime for virtual asset service providers (VASPs)
- b) AML/CTF and Registration regime for dealers in precious metals and stones (DPMS)

Further amendments to **CDD requirements** in Sch 2, Part 2 to AMLO:

- i. Enhanced **PEP definition** to include PEPs from other parts of China **outside Hong Kong** – AMLO will now be consistent with PDP
- ii. Adding "trustee" to the definition of beneficial owner and removing "25% vested interest" rule to include beneficiary or a class of beneficiaries
- iii. EDD not required if digital identification system is used for client's identification and verification
- iv. EDD not required for former PEPs with low risk, subject to risk based approach

AMLO (Amendment) Bill 2022

- Licensing regime for virtual asset service providers (VASPs)
- Registration regime for dealers in precious metals and stones (DPMS)
- Amendments relevant to 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 in”**
 - “trustee” is added to the definition of beneficial owner
 - EDD not required if digital identification system is used for client’s identification and verification in situations where client is not present for face-to-face identification
 - EDD not required for former PEPs with low risk, subject to risk based approach
 - New PEP definition to include PEPs from other parts of China outside Hong Kong – AMLO will now be consistent with PDP

Practice Direction P and Schedule 2, AMLO

Identification & Verification

Client Due Diligence

Enhanced Due Diligence

Simplified Due Diligence

Staff Training

Record Keeping

Identification & Verification

Applicable Situations

Identification ➡ in all situations

Verification (new or existing client) ➡ in the
a) **Applicable Circumstances** (para 20)
b) **Applicable situations** (Section 2 A (client due diligence))

Applicable Circumstances/Situations:

- Financial transactions (e.g. buying and selling of real estate, business, company, securities and other assets and property)
- Managing client money, securities or other assets
- Management of bank, savings or securities accounts
- The formation, structure, re-organisation, operation or management of companies and other entities and legal arrangements
- Insolvency cases and tax advice
- Other transactions involving custody of funds as stakeholder or escrow agent or transfer of funds through their bank accounts

When

Acting for a client or instructing on behalf of such client when:

- Establishing business relationship
- Carrying out occasional transactions
- In exceptional or urgent circumstances where it is not practicable to verify client's identity before accepting instructions (as, for example, if it is necessary not to interrupt the normal conduct of business) and any risk of money laundering or terrorist financing that may be caused by carrying out the verification procedure after accepting the instruction is effectively managed, verification should be made as soon as practicable after accepting the instructions.

How

• **Individuals:**

Identify and Verify – name, address, date of birth and nationality occupation or business using documents, data or information provided by a reliable and independent source


• **Companies:**

Identify and Verify - person giving instructions and his/her authorization to act on behalf of the company, beneficial owner or the persons who have control of the legal entity and the legal entity itself

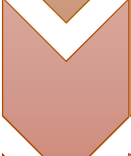
Client Due Diligence

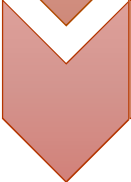
What are the Client Due Diligence requirements?

- 
- Verify the nature and intended purpose of the transaction

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- Verify the business relationship between the client and other interested parties to the transaction

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- Verify and understand the Source of Funds for every transaction and Source of Wealth for High-risk clients

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- Screen client's name against the Sanctions, PEP and Terrorist Lists at appointment and on an ongoing basis (for companies that should include all directors, beneficial owners/controlling person and person giving instructions)

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- Apply risk-based approach to determine the level of information required
 - Risk rate each client file (Low/Medium/High) and document your rationale

Enhanced Due Diligence

High-risk situations for which EDD measures apply include:

- Any transaction or business relationship involving a 'politically-exposed person' (PEP), or a family member or known associate of a PEP.
- A person, entities or a transaction connected with a high-risk or other monitored jurisdiction
- Corporate client having issued bearer shares or with complex multi-layer corporate structures
- When handling complex, unusually large transactions or an unusual pattern of transactions, which have no apparent economic or lawful purpose
- When there is a doubt about the veracity or adequacy of client documentation and in the case of overseas entities, information about beneficial ownership and management is not readily accessible or available

Simplified Due Diligence

In terms of s.4, sch. 2, AMLO and PDP, SDD may be applied in a number of different circumstances including when the client is:

The Government or any public body in Hong Kong or the government of an equivalent jurisdiction or a public body in such a jurisdiction

- A financial institution incorporated in Hong Kong or in an equivalent jurisdiction subject to and supervised for AML/CTF compliance consistent with FATF standards

- A company listed on any stock exchange

An investment vehicle where CDD measures are carried out by a financial institution in Hong Kong or in an equivalent jurisdiction which is subject to and supervised for AML/CTF compliance consistent with FATF standards.

Simplified Due Diligence

- If CDD is applicable, then a legal firm need only :
 - a) identify the customer and verify the client's identity
 - b) obtain information on the nature and intended purpose of the business relationship unless this is obvious
 - c) if a person purports to act on behalf of the customer,
 - i. identify and verify the previous identify
 - ii. verify the person's authority to act on behalf of the client

Staff Training

Purpose

- To equip employees with sufficient knowledge to effectively recognise red flags and suspicious activity
 - To make employees aware of their legal obligations to recognise and report suspicious activity
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- Must be tailored to firm's areas of practice and risks associated with the services, type of clients and their transactions
 - Must include up-to-date trends and ML/TF techniques
 - Procedure for reporting STRs
 - Relevant legal provisions
 - Consequences of non-compliance
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□ Frequency

- At the commencement of employment for new employees
 - As often as required to keep employees well aware of the AML requirements, high risk indicators and suspicious activities
 - The attendance record and details of the training must be maintained by the firm
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Record Keeping

Records of a transaction which is subject to a Suspicious Transaction Report and investigation should be kept until the relevant authority has confirmed that the case has been closed.

In relation to a transaction (s20, Sch 2 of AMLO)

- The original or a copy of the documents, and a record of the data should be kept for **5 years** after the completion of the transaction

In relation to a client (s20, Sch 2 of AMLO)

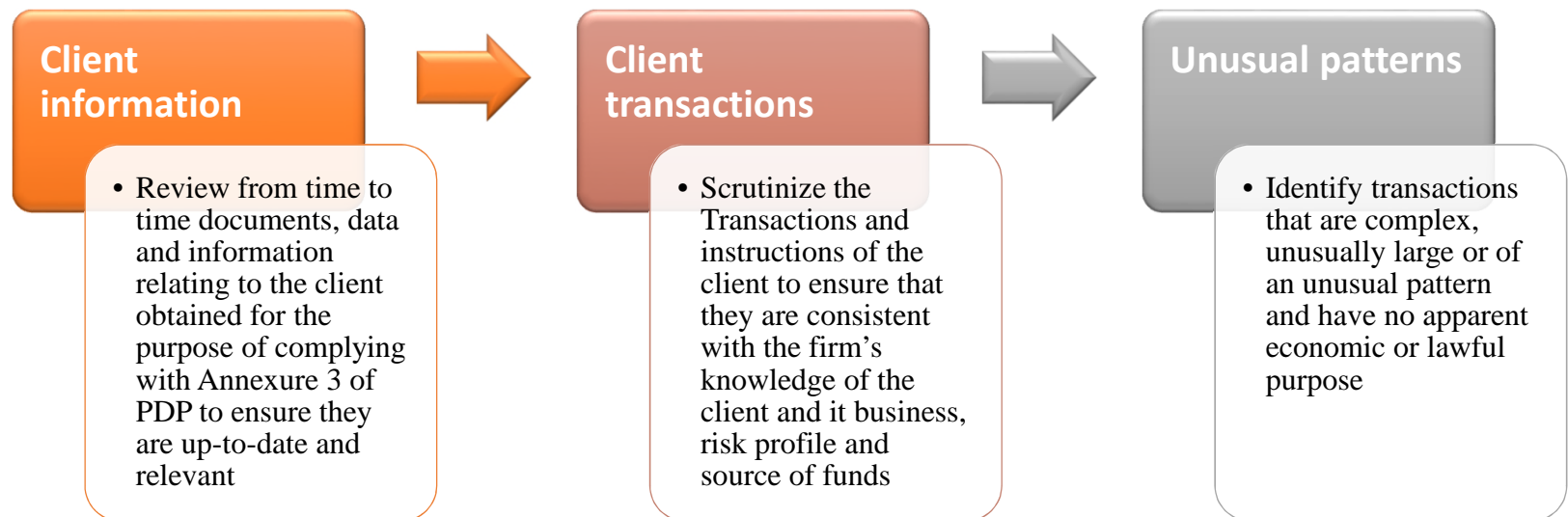
- The original or a copy of the CDD documents, records and client files including business correspondence with the client should be kept for **5 years** after the end of the business relationship

Specific requirements under PDP (s6, Table A)

- Files including CDD information should be kept for the period:
 - a) Conveyancing matters – **15 years**
 - b) Tenancy matters – **7 years**
 - c) Other matters, except criminal cases – **7 years**
 - d) Criminal cases – **5 years** from expiration of any appeal period

Ongoing monitoring

In terms of s.5, Schedule 2, AMLO and PDP, continuous monitoring and screening of clients is required to identify unusual or suspicious activities and to keep client risk assessments up-to-date.



You should monitor changes to Sanctions, PEP, FATF and Terrorist lists, and screen your clients subject to the client's risk level associated with money laundering and terrorist financing.

The Financial Action Taskforce (“FATF”)

- Inter-governmental body founded in 1989 by G7 in Paris
- 39 full members including Hong Kong since 1991
- Objectives: “to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system...; promote the adoption and implementation of the FATF Recommendations globally”
- FATF 40 Recommendations (most recently revised in March 2022): recognized as the global anti-money laundering and counter-terrorist financing standards
- Recommendations divided into 7 chapters – A – AML/CTF Policies and Coordination; B – Money Laundering and Confiscation; C – Terrorist Financing and Financing of Proliferation; D – Preventative Measures; E – Transparency and Beneficial Ownership of Legal Persons; F – Powers and Responsibilities of Authorities; G – International Cooperation



FATF's evaluations of Hong Kong

- FATF conducts reviews on each of its members to assess levels of implementation of FATF Recommendations – these Mutual Evaluation Reports (“MERs”) provide in-depth descriptions and analysis of members’ systems for preventing criminal abuse of the financial system
- FATF MER July 2008: Generally, only “partially compliant”
- FATF 4th Follow Up Report in October 2012: followed the enactment of the Anti-Money Laundering and Counter Terrorist Financing (Financial Institutions) Ordinance and an amendment to the United Nations (Anti-Terrorism Measures) Ordinance. Conclusion: a “satisfactory level of compliance” in most but not all areas; specifically, non-compliant in implementing UN asset freezing orders and in cross-border movement of currency
- FATF MER September 2019 : “Hong Kong has a sound regime to fight money laundering and terrorist financing that is delivering good results. However, it must enhance prosecution of money laundering involving crimes committed abroad and strengthen supervision of certain non-financial businesses.” One of the key findings: Hong Kong has a reasonably good level of understanding of its money laundering and terrorist financing risks



Some of FATF's concerns about Hong Kong's AML/CTF Regime

- Designated Non-Financial Businesses and Professions (DNFBPs)
 - supervisors (including the Law Society of Hong Kong) should strengthen their understanding of ML/TF risks at grass roots level and develop a “robust risk-based supervisory approach”
 - supervisory activities are too limited, at beginner stage or complaints driven
 - supervisors should apply proportionate and dissuasive sanctions for non-compliance with AML/CTF requirements
 - supervisors should strengthen AML/CTF implementation for non-resident customers, enhanced due diligence on foreign politically exposed persons, targeted financial sanctions
- Hong Kong should monitor and manage its exposure to proliferation financing by North Korea as a strategic priority

Follow-up to FATF's MER

- Hong Kong Government will provide FATF with a progress report regarding FATF's recommendations for Hong Kong contained in the 2019 MER
- Hong Kong Government will also publish its second money laundering and terrorist financing risk assessment report in 2022
- The Law Society is sharpening its AML/CTF supervisory focus on law firms (see in Hong Kong Lawyer - President's Message, 'Anti-Money Laundering Effort', February 2022 and 'From the Secretariat', June 2022)
- In May 2022, the Law Society completed Phase I of the AML Review involving an initial sample of 50 member firms. The aim of the AML review is to :
 - develop a financial crime risk assessment specific to the Hong Kong legal profession, through identifying general and specific ML and TF risks in the sector

Follow-up to FATF's MER (cont.)

- understand ML and TF risks applicable to individual member firms
 - perform an initial assessment of firms' efforts to comply with the AML/CTF regulatory requirements under PDP and the AMLO
 - identify gaps and challenges facing law firms in meeting such requirements
 - proactively assist law firms with guidance and support effectively to combat ML and TF
- Phase II of the AML Review will be launched later this year
 - Further guidance on Phase II will be provided via a webinar planned for the next month or so
 - Tools including FAQs on PDP, templates of an AML Policy, CDD Forms and guidance on alternative processes to verify clients' identities are being considered for use by legal professionals and, if approved, will be made available via the Law Society website, Circulars and social media

Disclaimer

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