THE LAW SOCIETY OF HONG KONG 香港律師會

Law Society's Comments
Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill (Bill)

The Law Society's Company and Financial Law Committee and Securities Law Committee have reviewed the Bill and has the following comments:-

General Comments

As a matter of principle, the new legislation should not go beyond the requirements of Financial Action Task Force (FATF) in its 40 Recommendations and IX Special Recommendations, the implementation legislation of other comparable jurisdictions and other international standards, nor impose an excessive legal and regulatory burden on financial institutions, in order to maintain Hong Kong's competitiveness as a major international financial centre.

Clause	Comments
2(2)	The Secretary for Financial Services & the Treasury may amend Part 2 of Schedule 1 by notice published in the Gazette. Part 2 defines the regulated financial institutions (**FIs**) and the regulators. This is an important part of the legislation and basically sets out its scope. There is no apparent reason why the government should need such flexibility.
5(4)	The customer due diligence (**CDD**) and record-keeping requirements do not apply to the issue of multi-purpose cards with a stored value of not more than HK$3,000. There should be flexibility to alter such limit by notice to be published in the Gazette.
5(5), 5(6), 5(7), 5(8) and others	FATF 40 Recommendation 17 requires that effective, proportionate and dissuasive sanctions should be available to deal with natural or legal persons that fail to comply with anti-money laundering and terrorist financing requirements. However this Recommendation states that such sanctions may be criminal, civil or administrative. Here in Clause 5 and elsewhere in the Bill, criminal sanctions with prison terms are imposed on individual employees as well as the FIs themselves for contravention of the statutory requirements.

This is inconsistent with the position in a number of comparable jurisdictions, including Singapore and the UK. If an FI has committed a criminal offence under similar legislation, criminal sanctions can be applied to the officers of an FI as well as the FI, but only where it can be demonstrated that the offence is shown to have been committed with the consent or the connivance of a particular officer or can be attributed to any neglect on his part (e.g. Regulation 47 of the UK Money Laundering Regulations 2007). Therefore, criminal sanctions cannot generally be applied to "persons" in those jurisdictions for a breach of CDD or record keeping requirements.

Further, the CDD requirements of Schedule 2 are still expressed in loose and subjective terms, such as the definition of "politically exposed person", "adequate procedures", "effective procedures" and the like. It is wrong in principle to impose criminal sanctions on failure to comply with such loosely defined or vague standards.

The Administration has failed to provide in-depth reasoning or justification during the Second-round Consultation Conclusion for Hong Kong departing from the international approach in this regard. The imposition of a high mental threshold, i.e. committed "knowingly" or "with intent to defraud", fails to address our concerns.

If it is considered appropriate to introduce specific sanctions against individuals we invite the Bills Committee, to consider administrative or regulatory sanctions, for example, introducing additional licensing conditions, suspension of officers or revocation of the relevant licence or registration to be an adequate deterrent. The scope of such sanctions would then be consistent with the position in a number of comparable jurisdictions and would satisfy the relevant FATF requirement.

It should also be noted that the UK Money Laundering Regulations 2007 expressly provides that it is a defence to both civil and criminal sanctions if the person took all reasonable steps and exercised all due diligence to ensure that the requirement would be complied with. This defence has not been expressly stated in the Bill.

7 To ensure consistency and a level playing field among different FIs, the Administration should set up a Forum for all relevant authorities similar to the *Anti-Money Laundering Supervisors' Forum* in the UK. This Forum can then jointly develop one set of generic guidelines on the common principles in order to provide practical guidance on compliance with the legislation. To the extent that there are any sector specific concerns, we agree these would be best addressed in sectoral guidelines, which would supplement the generic guidelines.

Further, given a breach of the relevant guideline will be admissible in evidence under Clause 7(4) of the Bill, it is paramount that the relevant guidelines should be developed only after thorough consultation with relevant industry participants to ensure these are practically effective and

feasible. We recommend an amendment to this Clause to ensure consultation is included in the legislation; this is not new as an example can be found in Clause 60A of the Banking Ordinance.

7(5) This sub-clause should go further by stating that compliance by an FI of the published guidelines constitutes a good defence to a prosecution for non-compliance with requirements of Schedule 2 to which the guidelines relate.

9 – 15 The supervisory and investigation powers are modeled on those conferred upon the SFC under Part VIII of the SFO. The SFC is charged with the responsibility to protect market integrity and investigation may include the "investing public". By contrast, the purpose of any investigation launched under the Bill is limited to ascertaining whether an FI has complied with the statutory CDD and record-keeping requirements. We have serious concerns that the Bill seeks to apply the SFO's intrusive and extensive powers of investigation to non-compliance with the statutory CDD and record keeping requirements. It is important to note that the relevant FI may suffer a reputation loss or damage as a result of such an investigation particularly, when an FI has not breached the regulations.

Further, there is no requirement for the exercise of powers by the authorized person under Clauses 9(1) (a) and (b) and (c)(i) that it has to demonstrate it has reasonable cause to do so. The requirements set out regulation 38 of the UK Money Laundering Regulations, requires a higher degree of relevance and reasonable cause than in the Bill. There are no safeguards in the legislation against any abuse of the wide powers conferred under Clause 9 - especially the right of entry or complaint or appeal procedures, bearing in mind several relevant authorities may be involved and may interpret or apply such powers differently or inconsistently.

It is imperative to maintain a high degree of transparency and consistency in the exercise of powers among the relevant authorities under Clauses 9 to 14. Guiding principles and considerations should be set out in the joint guidelines to be issued by the relevant authorities aforementioned. We also note that large financial groups, which may have businesses regulated by the HKMA, SFC and Insurance Authority, should be provided with guidelines or a separate Memorandum of Understanding among the relevant authorities which clearly sets out how such powers can be exercised so as avoid unnecessary duplication of the regulatory powers.

The power to call on persons unconnected with the FI (Clauses 9(1)(c)(ii) and 9(3)(b)) and removal of a person's right to remain silent (Clauses 13(11) and 9(9) etc) are draconian, unnecessary and disproportionate to the offences in the Bill.

It is submitted that the Bills Committee should narrow the exercise of

powers under Clause 9 to "connected persons only" by adopting the provisions as set out in Regulation 37 of the UK Money Laundering Regulations.

21(2)(c)(ii)

The pecuniary penalty proposed in the Bill appear to have been taken from the SFO. However, a penalty at 3 times the amount of the profit gained or costs avoided by the FI bears little relevance to the offence of failing to comply with the CDD and record-keeping requirements. We recommend the Administration to consuct a benchmark exercise of legislation in comparable jurisdictions to set such penalty at an appropriate level.

30(10) and 31(12)

It is unclear why an initial licence is valid for 2 years or such other period as the Commissioner considers appropriate (s.30(10)), but a subsequent licence is valid for 2 years or such other shorter period as the Commissioner considers appropriate (s.31(10)). We recommend clarification of the 2 provisions.

40(2)

If a licensee ceases business, it must return its licence to the Commissioner (s.40(1)). Under s.40(2), the Commissioner must, once it has received the licence, either cancel or amend the licence. If, as we assume, each licence is granted to a particular licensee, there is little reason for giving the Commissioner the power to amend a licence where the licensee has ceased business. We suggest deleting the reference to "amend".

Schedule 2, Part 1, definition of "beneficial owner"

In relation to a customer that is a trust, it should not be necessary to catch the beneficiaries given the administrative difficulties in identifying them. It should be enough that CDD information is collected and maintained on the settler, protector or trustee of a trust; with such information, law enforcement agencies should be able to track down the settler, protector or trustee and seek further information from them.

Limb (iv) refers to *"an individual who has ultimate control over the trust"*. The expression "trustee" or other more clearly defined terms should be used.

Schedule 2, Part 1, definition of "politically exposed person"

A "politically exposed person" includes, among others, the senior executive of a state-owned corporation. The term "state-owned corporation" must be clearly defined. There are many corporations that are owned or in which a sovereign fund has an interest.

The definition also covers a *"close associate of an individual falling under paragraph (a)"*, which is defined in sub-paragraph 3 to include *"a person who has close business relations with the first-mentioned individual"*. This is too broad and creates uncertainty.

Schedule 2 Part 1 Clause 1(1) "equivalent

Sub-paragraph (b) refers to a jurisdiction that imposes requirements similar to those imposed under this Schedule. Since an FI cannot be presumed to be experts on CDD legislation in all jurisdictions, it is

jurisdiction"	unlikely that foreign lawyers will be instructed to provide legal opinions for every jurisdiction, in order to determine whether simplified CDD can be applied. In practice, therefore, this limb would be of little use to financial institutions, given the criminal penalties for contravention as set out in Part 2. We recommend that either another criterion be substituted or this limb be removed altogether.
Schedule 2 Part 1 Clause 1(1) "beneficial owner"	Since 25% is the standard generally applied under the CDD and record keeping regimes in other comparable jurisdictions, for example in Singapore and the UK, we recommend the 10% threshold in the Bill should be replaced by 25%. This lower threshold may result in higher costs of compliance and render the FIs in Hong Kong at a competitive disadvantage.
Schedule 2 Part 2 Division 1	The Bill should make clear that the application of a risk-based approach is a core principle that should be observed in relation to all aspects of the CDD process and is not restricted to the specific examples set out in, for example, Clause 4 and Clause 9 of Schedule 2. As enforcement can involve more than one relevant authority in order to ensure consistency of application by the relevant authorities, the requirement to apply a *'risk based approach'* should be placed in the legislation itself and be set out in a standalone provision at the beginning of the legislation or at least in the same manner as the Money Laundering Regulations 2007 in the United Kingdom.
Schedule 2 Part 2 Division 1 Clause 3 (1)(d)	This provides that when an FI suspects that the customer is involved in money laundering or terrorist financing, it must carry out CDD measures. The current practice in Hong Kong is that under these circumstances, banks may choose to file a suspicious transaction report (STR) in the first instance, for example, where the customer is seeking to transfer out a significant amount. Attempting to carry out CDD at that point may not be realistic, and may even tip off the customer. It is submitted that for this case, the more appropriate requirement should be either to carry out CDD or to file an STR.
Schedule 2 Part 2 Division 2 Clause 9(b)	We recommend guidance be provided as to who are "appropriate persons" for certifying customer information.
Schedule 2 Part 2 Division 4 Clause 18 (3)(a)(ii)	We recommend that the word "(practising)", which appears to be a duplication, should be deleted.