



PUBLIC CONSULTATION ON

LEGISLATIVE PROPOSALS TO ENHANCE ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING REGULATION IN HONG KONG

The Law Society's Submissions

The Government of the HKSAR launched a public consultation on 3 November 2020 to gauge public views on legislative proposals to enhance anti-money laundering and counter-terrorist financing regulation in Hong Kong. A consultation paper was issued by the Financial Services and the Treasury Bureau in relation to the above ("Consultation Paper"). In response thereto, the Law Society provides the following submissions on the consultation questions posed.

- Q1.* Do you agree that Hong Kong should continue with efforts to strengthen the AML/CTF¹ system having regard to international standards, in keeping with our status as an international financial centre that is safe and clean for doing business?

Law Society's response:

We agree.

- Q2.* Do you agree that a balanced approach should be adopted for the current legislative exercise, complementing the need to have an effective system for tackling ML/TF² risks in the VASP³ and the DPMS⁴ sectors in accordance with the FATF⁵ Standards, while minimising regulatory burden and compliance costs on the businesses?

¹ Anti-money laundering and counter-terrorist financing

² Money laundering and terrorist financing

³ Virtual asset services providers

⁴ Dealers in precious metals and stones

⁵ Financial Action Task Force

Law Society's response:

We agree.

Q3. Do you agree with the proposed scope and coverage of the regulated activity of operating a VA⁶ exchange?

Law Society's response:

We agree with limiting the scope of the regulation to VA exchanges.

Q4. Do you agree with the proposed definition of VA? Other than closed-loop, limited purpose items, are there other digital items that should be excluded from the definition?

Law Society's response:

We agree with the proposed definition and its scope. We suggest expressly excluding "stored value" (as defined in the Payment Systems and Stored Value Facilities Ordinance (Cap 584)) from the definition of VA for the sake of certainty and to avoid overlap with the regulatory regime for stored value facilities.

Q5. Should peer-to-peer VA trading platforms be covered under the licensing regime?

Law Society's response:

As an initial starting position, we do not think peer-to-peer VA trading platforms (which do not hold VA or consideration in respect of a transaction) need to be regulated.

Q6. Do you agree that only locally incorporated companies may apply for a VASP licence?

Law Society's response:

We disagree. We believe the regime should be open to non-Hong Kong companies as defined in the Companies Ordinance (Cap 622) in line with the approach taken in other regulated sectors such as those regulated under the Securities and Futures Ordinance (Cap. 571).

⁶ Virtual assets

Q7. Should other criteria be added to the fit-and-proper test given the nature and risks of VASPs?

Law Society's response:

We are comfortable with the proposed criteria (noting that the proposed criteria for VASPs include experience and qualifications).

Q8. Should other regulatory requirements be added to mitigate the risks of VASPs?

Law Society's response:

We regard the existing list of regulatory requirements to be appropriate. We suggest clarification on 'reasonable due diligence on VAs' to ensure the threshold balances investor protection with the need to avoid being unduly burdensome on VA exchanges.

Q9. Do you agree that a VASP licence should be open-ended or should it be periodically renewed?

Law Society's response:

The VASP licence should be open-ended.

Q10. Do you agree with the exemption arrangement and the 180-day transitional period for application of a VASP licence?

Law Society's response:

A properly managed transition should be implemented. A period of 180 days from commencement of the regime may be too ambitious for existing VA exchanges to prepare applications submissions and for the SFC⁷ to process those applications. 365 days may be more realistic.

Q11. Do you agree that, for investor protection purpose, persons without a VASP licence should not be allowed to actively market a VA exchange business to the public of Hong Kong?

⁷ Securities and Futures Commission

Law Society's response:

We agree there should be a prohibition against active marketing for entities that are not appropriately regulated.

Q12. Do you agree that the penalty level for carrying out unlicensed VA activities should be sufficiently high to achieve the necessary deterrent effect?

Law Society's response:

We have no comments on the levels of proposed penalties as they are consistent with the penalty levels for existing regulatory penalties (see s.113(8) SFO, s. 383 SFO⁸, s.5 AMLO⁹).

Q13. Do you agree with the proposed sanctions, including that it shall be a criminal offence for a person to make a fraudulent or reckless misrepresentation to induce someone to acquire or dispose of a VA?

Law Society's response:

Notwithstanding that a VA is not a security, given the way in which a VA may be held for speculative purposes and may be subject to substantive value fluctuations, it is sensible to include such a sanction. We note that level of penalties are equivalent to or more lenient than those contained in s.107 SFO. We have no particular suggestions on the levels of proposed penalties,

Q14. Do you agree that the Tribunal¹⁰ be expanded to hear appeals from licensed VASPs against future decisions of the SFC?

Law Society's response:

We agree.

Q15. Do you agree generally with the proposed scope of "regulated activities" and related definitions for DPMS, which draw reference from the FATF requirement and overseas legislation?

Law Society's response:

⁸ Securities and Futures Ordinance (Cap. 571)

⁹ Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615)

¹⁰ Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal

We agree with the proposed scope and related definitions.

Q16. Are there any other business activities in respect of precious metals, precious stones, precious products, and precious-asset-backed instruments that should be covered under the registration regime?

Law Society's response:

We regard the current business activities to be appropriate.

Q17. Do you agree with the proposal to have a two-tier registration regime, such that registrants who do not engage in large cash transactions can be separated from those who do, with the former being subject to simple and mere registration requirements and the latter to standard AML/CTF requirements currently applicable to other DNFBPs¹¹?

Law Society's response:

We agree with the proposal to have a two-tier registration regime.

Q18. Do you agree generally with the respective requirements for Category A and Category B¹² registrations, including that Category B registration should be renewed every three years?

Law Society's response:

We have no comments on the registration requirements.

Noting that a money service operators licence renews every two years, we have no particular comment on the proposal that Category B registration should be renewed every three years.

We note that a DPMS business that is refused Category B registration may amend its processes to prohibit receipt of payments in cash for amounts equal to or exceeding HKD120,000 and then operate under a Category A registration. Refusal of a Category B registration renewal should not have the consequence of forcing such businesses to cease trading.

¹¹ Designated non-financial businesses and professions

¹² For Category A and Category B, please refer to page 26 of the Consultation Paper

Q19. Do you agree that financial institutions which are already regulated under the AMLO should be exempted from the registration regime when carrying on a DPMS business that is ancillary to their principal business?

Law Society's response:

We agree with the proposed exemption for ancillary activities.

Q20. Do you agree that non-domestic dealers who visit Hong Kong only occasionally should be exempted from the registration regime, subject instead to the requirement of filing cash transaction reports with possible sanctions for failure to do so?

Law Society's response:

We agree with the exemption and the reporting. We note that the reporting applies only to a specified cash transaction (and so would not apply where payments are made via the banking system, for example using credit or debit cards or account transfers).

Q21. Do you agree with a 180-day transitional period and the deemed registration arrangement for incumbent dealers to facilitate their migration to the registration regime?

Law Society's response:

We agree with the 180 day transitional period and the deemed registration arrangement for the interim period.

Q22. Do you think the proposed sanction is adequate in deterring the operation of a DPMS business without registration?

Law Society's response:

We believe the proposed sanctions provide an adequate deterrence.

We note that the sanction for making a false, deceptive or misleading statement in a material particular is lower than that set out in s.383 SFO (being \$1,000,000 and imprisonment for 2 years) but regard a lower level as appropriate for this newly-regulated sector.

Q23. Do you agree that Category B registrants should be subject to the same administrative sanctions as other DNFBPs, and not to criminal sanctions, for non-compliance with the AML/CTF requirements in the AMLO?

Law Society's response:

We agree that Category B registrants should be treated similar to other DNFBPs.

Q24. Do you agree that the Tribunal be expanded to hear appeals from registrants against future decisions of the Registrar?

Law Society's response:

We agree.

Q25. Do you agree with the miscellaneous amendments proposed by the Government to address some technical issues identified in the Mutual Evaluation Report¹³ and other FATF contexts?

Law Society's response:

Politically Exposed Persons:

We agree to the amendment to the definition of PEP.

Beneficial Ownership of Trust:

While we have no objection to ensuring that beneficial ownership of a trust should extend to persons who hold ultimate ownership or control, we disagree to amending the definition of "beneficial owners" of a trust under AMLO with that of "controlling person" of a trust under the Inland Revenue Ordinance. In particular, 'controlling person' catches settlors, protectors and enforcers who may not exercise ultimate ownership or control. We recommend conducting further consultation on the draft language to be used.

Non-Face-to-Face Situations

We agree with the proposal to amend section 9 of Schedule 2 to the AMLO to add the use of independent and reliable digital identification systems for customer identification and verification purposes where a customer is not physically present.

Unlicensed Money Service Operation

¹³ The Mutual Evaluation Report on Hong Kong, published by the FATF in September 2019

We are not convinced that increasing the level of penalty will significantly act as a further deterrence for the offence of carrying out an unlicensed money service operation. We suggest further publicity to educate the sector, together possibly with increased monitoring and enforcement for breaches, before considering increasing the penalties.

We regard it as anomalous to have different penalties for unlicensed money service operators (under section 29) compared to unlicensed trust or company service providers (under section 53F). We regard the current penalties for unlicensed trust or company service providers to be appropriate.

Our view is therefore that the penalty for unlicensed money service operators should remain unchanged at this time.

Exchange of Supervisory Information:

We agree that the parameters for exchange of information should be standardised and expanded to cover those who are subject to an investigation under the AMLO.

**The Law Society of Hong Kong
22 December 2020**