SFC's Consultation on the (1) Proposed Guideline on Anti-Money Laundering and Counter-Terrorist Financing (the "Guideline") and (2) the Proposed Prevention of Money Laundering and Terrorist Financing Guideline Issued by the Securities and Futures Commission for Associated Entities

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CompliancePlus Consulting Limited provides comprehensive compliance support and solutions to hedge fund managers and mutual fund management companies. For enquiries on this submission, please contact **Josephine Chung** at jchung@complianceplus.hk. **CompliancePlus Consulting Limited** understands and agrees that our name and/or submission may be published by the SFC.

Introduction

Schedule 2 of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO"), coming into force on 1 April 2012, imposes obligations of customer due diligence, ongoing monitoring requirements and record keeping requirements upon Licensed Corporations ("LCs").

The SFC thus proposed and launched a consultation on the Proposed Guideline on Anti-Money Laundering and Counter-Terrorist Financing (the "Guideline") and (2) the Proposed Prevention of Money Laundering and Terrorist Financing Guideline Issued by the Securities and Futures Commission for Associated Entities ("AEs"), which will replace the existing Prevention of Money Laundering and Terrorist Financing Guidance Note (the "AML Guidance Note").

This submission is presented to the SFC in response to the Consultation Paper. We will discuss questions raised by the SFC.

Question 1: Purporting to Act for Customers

The proposed Guideline differs from the existing AML Guidance Note in different aspects. The first material difference is that the proposed Guideline imposes new obligation upon Licensed Corporations ("LCs") to verify the authority and identity of any person purporting to act for customers.

To this end, the Financial Action Task Force has issued the Interpretive Notes to FATF 40 Recommendations (October 2004). The Notes contain the following relevant provision:

> "When performing elements (a) and (b) of the Customer Due Diligence ("CDD") process in relation to legal persons or arrangements, financial institutions should:
> (a) Verify that any person purporting to act on behalf of the customer is so authorised, and identify that person."

The obligation is imposed upon LCs and other Financial Institutions ("FIs") by virtue of Section 2 of the Schedule 2 to the AMLO. The proposed Guideline clarifies that, as a general rule, FIs should verify the identity of those authorized persons to give instructions for the movement of funds or assets. We therefore agree that the proposed Guideline should, in principle, impose this new obligation upon LCs.

The key question then becomes the mode and the intensity of scrutiny required to verify the authority and identity of such persons. As to the latter, Section 3 of the Schedule 2 to the AMLO allows LCs to conduct simplified customer due diligence ("SDD") rather than undertaking the full CDD in some circumstances. The same provision has been inserted into the proposed Guideline, to which we agree.

As to the mode of inquiry, we agree with the proposed treatment enunciated in Appendix A to the proposed Guideline. In general, LCs should seek ID cards or other travel documents to verify the identity of the persons.

Question 2: Wire Transfer

We are of the opinion that the proposed treatment is effective in indicating that the relevant obligations usually do not apply to LCs.

Given that LCs are usually the originators or beneficiaries, it may be useful to provide examples to illustrate the exceptional case where LCs are the ordering or beneficiary institutions. Unless the LCs find the situation analogous to these examples, they need not consider the obligation under this Chapter.

Question 3: Companies Search

The proposed Guideline provides that, as a standard practice, a LC should perform a company registry search and obtain a full company search report in respect of all locally incorporated non-listed companies and companies incorporated in jurisdictions which have a public company registry. Alternatively, a LC can obtain a certified true copy of a search report from its clients.

The SFC acknowledged that this measure is indeed a mere "recommended" practice for customers within the high risk categories under the existing AML Guidance Note. The SFC also acknowledged that the additional obligation would increase compliance costs.

It is doubtful if an extension of this obligation is warranted. In The third Mutual Evaluation of Hong Kong on Anti-Money Laundering and Combating the Financing of Terrorism, the FATF commented on the existing approach:

> "While the guidelines issued by the respective regulators are generally quite comprehensive, there are several steps that the authorities will need to undertake in order to improve compliance with the standard."

The FATF did not identify the requirement relating to company search as an area requiring improvement. Presumably, the FATF did not find the existing approach unacceptable.

The FATF standard in relation to identity verification is contained in the Interpretive Notes to FATF 40 Recommendations (October 2004), which provides:

> "When performing elements (a) and (b) of the CDD process in relation to legal persons or arrangements, financial institutions should:
> (a) Verify that any person purporting to act on behalf of the customer is so authorised, and identify that person.
> (b) Identify the customer and verify its identity - the types of measures that would be normally needed to satisfactorily perform this function would require obtaining proof of incorporation or similar evidence of the legal status of the legal person or arrangement, as well as information concerning the customer's name, the names of trustees, legal form, address, directors, and provisions regulating the power to bind the legal person or arrangement.
> …

> The relevant information or data may be obtained from a public register, from the customer or from other reliable sources."

Paragraph 6.4.1 of the existing AML Guidance Note has already satisfied the FATF requirements. Notably, the Paragraph mentions the following documents:

> "(a) Certificate of Incorporation and, where applicable, Business Registration Certificate or any other documents proving the incorporation or similar evidence of the legal status of the corporation;
>
> (b) Board resolution evidencing the approval of the opening of the account and conferring authority on those who will operate it…"

We are of the view that the threshold in the current AML Guidance Note is sufficient to establish "proof of incorporation or similar evidence of the legal status of the legal person or arrangement, as well as information concerning the customer's name, the names of trustees, legal form, address, directors, and provisions regulating the power to bind the legal person or arrangement" required by the FATF.

The current threshold in the AML Guidance Note already addresses its necessity for higher risk customers or where there is any doubt as to the identity of the company's stakeholder. We believe that an increased compliance burden is unnecessary. It is doubtful whether the extension of the obligation in the proposed Guideline is justified. Hence, we believe that the threshold in the AML Guidance Note should be kept status quo for the proposed Guideline.

As an alternative to the option proposed by the SFC, it is submitted that LCs should be allowed to rely on company search previously conducted within 3 months from the date company search ought to be performed.

Question 4: Nominees Companies

It is common in the fund industry for fund distributors to open account in a fund on behalf of their (i.e. fund distributors') clients. The fund distributors thus serve as a nominee company and the question is whether simplified customer due diligence is available such that the fund needs not inquiry into the identity of the beneficial owners (i.e. the fund distributors' clients). The proposed Guideline allows such treatment provided that, ¬inter alia, the fund distributors have conducted due diligence.

We agree with the proposed treatment in principle.

We are of the view that on this area, Investment-Linked Assurance Scheme ("ILAS") also deserves closer attention. The SFC's Circular Clarifying the Licensing Requirements arising out of the Promotion, Offering or Sale of Investment-Linked Assurance Schemes to the Public issued on 13 August 2009 provided the following description of an ILAS arrangement:

> "The premium payments that are made by ILAS policyholders are first applied in respect of fees and commissions, with the balance being paid to the insurer and notionally invested in the underlying funds selected by the policyholders…Although it is the performance of these underlying funds that determines the value of an ILAS policy from time to time, the policyholder's premium payments are not invested in these underlying funds for or on behalf of the policyholder. If, as is normally the case, an insurer places a percentage of the premium payments received into such funds, these investments are for the account of the insurer itself. The policyholder has no interest in them whatsoever."

On the one hand, the policyholder normally has no interest in the underlying securities. On the other hand, the performance of those securities could affect the return of the policyholder. In addition, the insurer may have used the policyholder's premium payment to invest in those underlying securities. The SFC ought to clarify whether such arrangement falls within the "nominee company" arrangement described in the Consultation Paper.

Question 5: Training

Chapter 9 of the proposed Guideline outlines the training obligations imposed upon LCs.

It is noted that Section 11 of the existing AML Guidance Note contains similar provisions in relation to training. The obligations imposed under the new Guideline are similar to those outlined in the existing AML Guidance Note.

On the other hand, Paragraph 9.7 of the proposed Guideline deserves some special attention. It reads:

> "In addition, the following training modules may be appropriate for certain groups of staff:
> (a) all new staff, irrespective of seniority, should …
> (b) members of staff who are dealing directly with the public (e.g. front-line personnel, appointed insurance agents who act on behalf of authorized insurers) should ……"

This Paragraph is worth discussing for two reasons. Firstly, unlike the treatment in the AML Guidance Note, the proposed Guideline prescribes the content of the training that should be provided to different types of employees. Secondly, although the Paragraph starts by saying that LCs "may" provide certain training to their employees, it is then prescribed that different types of employees "should" be educated in a certain way.

In relation to the first aspect, we agree with the proposed treatment. This gives the Guideline more certainty and LCs could have a better understanding of the training that should be provided to their employees. To achieve this, the Guideline should classify employees into different categories with precision. Currently, the proposed Guideline classifies employees into (a) new staff, (b) members of staff who are dealing directly with the public, (c) back-office staff, (d) managerial staff and (e) compliance officers. We find this classification generally acceptable. It should be noted that the classification could overlap with each other. The SFC may consider adding this qualification to the proposed Guideline to prevent rigid "classification" of an employee.

With respect to the second aspect, it is unclear whether Paragraph 9.7 is mandatory or merely optional. The same can also be said of the Chinese version of the Guideline. In the interest of certainty the SFC ought to clarify this issue by using better terms in the proposed Guideline.

Conclusion

It is hoped that the proposed Guideline could be written with more certainty to give LCs more concrete guidance. It is also hoped that the SFC will review if the obligations mentioned should indeed be imposed upon LCs.

END