CompliancePlus Consulting

Submission to Consultation Paper Issued by the Securities and Futures Commission on the Proposed Amendments to (1) the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and; (2) the Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities

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Introduction

The Securities and Futures Commission (The "SFC") issued a Consultation Paper in June 2020 on the Proposed Amendments to (1) the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and (2) the Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities. CompliancePlus is pleased to provide feedback on the SFC Consultation Paper as below:

Question 1

Do you agree that the institutional risk assessment should be subject to periodic review at least once every two years or more frequently upon the occurrence of trigger events? Please explain.

We agree that the institutional risk assessment ("IRA") review should be done regularly and at a more frequent intervals upon the occurrence of trigger events. Nevertheless, in an information boom century, the business environment is volatile and new market changes (i.e. Covid-19 outbreak, Cross-border risks, Third-party risks, New crypto and algo trend, etc.) arise. The weightings on different factors of the IRA will then be varied due to the changing regulatory environment. Therefore, we suggest that the IRA review should be conducted annually .

We also suggest that the SFC can formulate an IRA template, which can be just like the Anti-Money Laundering ("AML") self-assessment checklist, which acts as a piece of helpful reference information for the industry to follow and to ensure that the IRA assessment standard and assessing criteria can be consistent.

We believe that the SFC can provide more examples to further elaborate the definition of "trigger events". As stated in the proposed revised AML guideline, trigger events include "a significant breach of the Financial Institution's ("FI's") Anti-Money Laundering/Counter-Financing Terrorism ("AML/CFT") Systems, the acquisition of new customer segments or delivery channels, the launch of new products and services by the FI, or a significant change of the FI's operational processes".

More situational examples with illustration can be easily set out in a form of Frequently Asked Questions ("FAQs") that the SFC can issue to the industry as and when needed.

The SFC can on the other hand provide examples on how the IRA can be conducted and recorded which are accepted by the SFC in the SFC AML Guidelines or supplemented in the SFC FAQ, e.g. (1) the institutional AML risks can be assessed and discussed in the management meeting in which the senior management and Manager-In-Charge ("MIC") have attended, and the records of the discussion on the Licensed Corporation's ("LC's") institutional AML risks are recorded in the management meeting minutes and (2) the LC has created its own IRA template to analyse its institutional AML risks and it is documented in that template.

Question 2

Do you consider the expanded list of illustrative examples of risk indicators to be sufficiently comprehensive? Please state your views.

We generally agree that the proposed expanded list of illustrative examples of risk indicators is sufficiently comprehensive at the moment in assessing the Money Laundering/Terrorist Financing ("ML/TF") risks associated with a customer or proposed a business relationship. LCs will be pleased and appreciate if new examples will be added that more supplemental risk indicators can be added to the list as well.

The indication of Higher or Lower ML/TF risk according to the specified risk indicator examples under each type of risk factor provides a proper and clear guidance on risk profiling and assessment. As a result, LCs could determine ML/TF risk level associated with the client by mapping and comparison between the client's information and the expanded list. It could indeed simplify the procedure and alleviate LCs' workload in conducting customer risk assessment.

It is noted that in section 3(a) of Appendix A of the Proposed Revised Guideline, the SFC has already indicated that products or services that may inherently favour anonymity or obscure information about underlying customer transactions may present higher ML/TF risks. Nonetheless, the SFC may consider including further examples in section 3(a), such as the use of cryptocurrencies.

Furthermore, the exhaustiveness and usefulness of the list could be further expanded. It is suggested that SFC should include examples of risk indicators related to Fintech, robotics advisory, algorithmic trading, virtual asset and crypto assets trading, Over-the-counter ("OTC") derivative products and Environmental, Social, and Corporate Governance ("ESG") related products.

These investment products, underlying assets and business structures will be the trend of the coming years, more and more LCs will be engaging or planning to engage in these business activities, thereby we are fairly sure that LCs will be very concerned and welcome these risk indicators.

In light of the above, to facilitate the expansion and revision of the list of examples of risk indicators in the coming future, we suggest the SFC to issue circulars from time to time or on a regular basis to add in new elements or supplemental risk indicators examples to the appendix. It is on one hand more convenient to the authority and the LCs. On the other hand, the SFC does not require to revise the AML/CFT Guideline frequently.

Question 3

Do you agree with the scope of application for the cross-border correspondent relationships provisions for the securities sector? Please explain.

We generally agree with this provision for the securities sector as the cross-border correspondent relationship has long been a blind-spot on the ML/TF system for the securities firms. The direct access of the respondent institution, which is qualified to carry out Simplified Due Diligence ("SDD"), to the local brokerage firms' account may possess ML/TF risks on the local securities firm.

Heightening and alerting risks (e.g. conflict of Interest, credit risks, data accuracy, third party risks) may arise to the correspondent securities firms as they may have no or limited information about the underlying customers and the nature or purpose of their transactions.

By applying additional due diligence measures, the ML/TF risks can be efficiently mitigated as the correspondent securities firm can obtain more fruitful information from the underlying clients from the overseas intermediaries.

Nevertheless, the specified exemption of which the provisions do not apply to business relationships between a domestic asset manager which acts as a delegated asset manager and provides services to an overseas delegating management company which is its customers is worth to be aware of. We would like to know the reason(s) for such exemption.

It is worth noticing that this relationship is similar to the relationship which a domestic securities firm provides services to an overseas asset management firm, especially when the domestic asset manager is allowed to hold client assets and will handle subscription and redemption by itself. It is suggested that the SFC should consider the exemption to be applicable only to domestic asset managers who are not responsible for handling client money.

It is indeed not unfair to the securities firm for conducting one more layer of firewall against potential ML/TF risks on cross-border correspondent relationships, reason being that the entire system is bounded by the Risk Based Approach ("RBA") to avoid unnecessary procedures that limit the transaction.

Question 4

Do you have any views on the additional due diligence and other risk mitigating measures applied to cross-border correspondent relationships in the securities sector? Please state your views.

We generally agree with the additional due diligence measures as it goes into details of what should be collected from the clients from the respondent institution. By having the RBA on those financial institutions who are entitled to be analysed by simplified customer due diligence only, more standard precautions can be taken to assess each respondent firm's AML standards and their potential ML/TF risks on the correspondent institution in Hong Kong.

It is mentioned in paragraph 36 of the SFC Consultation Paper that the extent of the aforesaid additional due diligence measure will depend on the assessed ML/TF risks posed by the respondent institution. We would like to clarify here whether any of the measures can be entirely exempted should the ML/TF risk posed by the respondent institution be convinced to be low.

For instance, in the scenario where the ML/TF risk of a respondent institution is assessed to be low, can a LC be exempted from some of the additional due diligence measures, such as skipping the collection of information of the respondent institution for understanding its nature of business? It is given that a LC is able to complete other additional due diligence measures and can be satisfied about the result.

We are of the view that while the additional due diligence measures give more guidance to the industry, the exemption can give flexibility to local intermediaries and welcome more collaboration or business opportunities with overseas intermediaries, especially when they are dealing with respondent institutions in heavily regulated regions such as Singapore or the United States.

It is noted that in paragraph 38 of the SFC Consultation Paper in relation to direct access to the correspondent account by the underlying customers of a respondent institution, nothing about "overseas" or "cross-border" relationship has been explicitly mentioned.

As such, we would like to seek clarification from the SFC that whether the provision in paragraph 39 of the SFC Consultation Paper is only applicable to a cross-border relationship and not applicable to a domestic relationship. We believe that if both the respondent institution and correspondent institution are domestic institutions, the current anti-money laundering regulations and guidelines are sufficient to govern the intermediaries and ensure that the ML/FT risks is at minimum and thus provision in paragraph 4.20.12 of the Proposed Revised Guideline are not necessary.

It is noted from paragraph 4.20.13 of the Proposed Revised Guideline that the LC should, on a regular basis or upon trigger events, undertake reviews of the information of the respondent institutions obtained when applying additional due diligence.

We would like to seek further guidance on the timeframe of the review. It would be informative for LCs to understand the SFC's expected frequency for conducting such review, for example: the minimum frequency for this review or the appropriate frequency should the ML/FT risk be assessed to be high.

We suggest that the SFC can provide some guidance or templates on how a due diligence questionnaire should be so as to keep the AML standard aligned among the industry.

For the additional due diligence, other than checking on the respondent institutions with publicly available information for their reputation, using a global searching database (i.e. LexisNexis or Thomson Reuters) may also be added as one of the additional measures as these databases are more credible to use.

Question 5

Do you have any views on the expanded list of illustrative examples of possible simplified and enhanced measures under a risk-based approach? Please state your views.

We agree with the expansion of list of examples in simplified and enhanced measures under the risk-based approach could provide a more concrete and explanatory description on the actual measures that LCs could adopt for their customer due diligence and ongoing monitoring according to clients' risk level.

LCs could better understand the degree, frequency and extent of the CDD and ongoing monitoring that they should put in place on individual client LC based on the risk-based approach.

Nevertheless, it is noted that in paragraph 4.1.2 of the Proposed Revised Guideline that the LC should has the authority to should determine the extent of CDD measures using an RBA, taking into account the higher or lower ML/TF risks identified in the customer risk assessment conducted by the FIs.

We suggest SFC providing better guidance or suggestion on any systematic approach and structure that could help FIs to determine the extent of measures appropriate to a particular customer. For example, the SFC should design and conceive a reference table or a scale of measurement which could possibly categorize or quantify the extent of CDD measures. FIs then could take reference from the table or scale, matching them with the ML/TF risk rating they have concluded, eventually adopt the corresponding CDD measures and on-going monitoring.

Moreover, in paragraph 2.18 of the Proposed Revised Guideline, it is suggested that FI should keep records and relevant documents of the customer risk assessment so that it can demonstrate to the extent of CDD measures and ongoing monitoring is appropriate based on that customer's ML/TF risks.

In light of that, we suggest the SFC should provide examples on the demonstration of the appropriateness of the extent of CDD and ongoing monitoring. It would be informative that documentation, reporting or any record-keeping requirement could be present. Provision of documentation samples or templates will be even better.

Question 6

Do you have any views on the list of illustrative red-flag indicators of suspicious transactions and activities set out in Appendix B to the Proposed Revised Guideline? Please state your views.

We agree that the list of illustrative red-flag indicators is sufficient to indicate suspicious transactions and activities. However, we suggest the SFC could extend the scope of the indicators in order to give practical scenarios to the industry for reference. Compared to the current AML guideline, the indicators are further broken down into 6 categories (Customer-related, trading-related, Selected indicators of market manipulation and insider dealing, related to deposits of securities, Related to settlement and movement of funds and securities and Employee-related).

We believe that these red flags are useful as to enhance transaction monitoring in systems and control. Yet, we would like to suggest the scope of the categories can be broadened to fit the market needs on the new products, services and transaction methods.

For instance, gifts and benefits received by the senior management should add into the employee related category. The amount employees received as gifts may lead to involuntary favour in actions of the employee to the client.

Apart from the indicators mentioned above, we would also like to recommend the SFC to add risk indicators on regulating virtual assets. Since the SFC has been issuing further codes and guidelines on electronic uncommon products, therefore, it is appreciated if the SFC could further develop in this area.

Question 7

Do you have any views on the facilitative guidance permitting delayed third-party deposit due diligence? Please state your views.

We agree and appreciate on the facilitative guidance permitting delayed third-party deposit due diligence. As there might be difficulties to trace the source of funds and source of wealth of the payment, it is reasonable to give a longer time frame for FI to investigate the suspicious transactions.

In order to be fair to all parties, it is important for the SFC to set out criteria on what circumstances should be reasonable when FI accept third party payments. Further guidelines should also be given on the appropriate delayed third-party due diligence, risk management policies for the industry to comply with the requirements.

Apart from determining the source of funds and the source of wealth, we recommend that third-party relationships such as family relationships, trust deeds and employer-employee relationships should also be considered as acceptable areas for permitting delayed third-party deposit due diligence.

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