

FATF



# Anti-money laundering and counter-terrorist financing measures

## Hong Kong, China

### Mutual Evaluation Report

September 2019





The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CTF) standard.

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## Executive Summary

1. This report summarises the AML/CFT measures in place in Hong Kong, China (HKC) as at the date of the on-site visit from 31 October to 15 November 2018. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of HKC's AML/CFT system, and provides recommendations on how the system could be strengthened.

### Key Findings

- a) HKC has a reasonably good level of understanding of its money laundering (ML) and terrorist financing (TF) risks. However, the level of understanding for some other higher risk ML areas (e.g. ML linked to foreign tax and corruption offences) should be further deepened. The Central Co-ordinating Committee on AML/CFT (CCC) provides a good platform for policy co-ordination, and the objectives and activities of competent authorities are generally consistent with areas of identified higher ML/TF risk, particularly fraud.
- b) Law enforcement agencies (LEAs) regularly use a broad range of information to pursue ML, TF and associated predicate offences, with the Joint Financial Intelligence Unit (JFIU) supporting operational needs to a large extent. LEAs identify and initiate a significant number of ML investigations (averaging 1 600 each year). The broad stand-alone ML offence helps promote parallel financial investigations and ML investigations. Fraud-related ML is extensively investigated as the highest risk but there is a marked drop in the investigation of other major ML risks such as foreign drugs, tax crimes and corruption.
- c) HKC demonstrates an ability to prosecute all forms of ML and has a high conviction rate. However, the number of prosecutions (averaging 120 per year) and convictions (averaging 95 a year) is much lower than the number of cases investigated, and the generally low sentences imposed indicate that many ML cases pursued are at the lower end of the scale. HKC has not yet prosecuted a legal person for ML.
- d) Confiscation is a high priority and there are clear procedures and systems in all agencies involved, as well as largely comprehensive legislation. Very significant amounts have been restrained and confiscated. However, minor legal gaps continue to exist and there is a need to enhance the volume of outgoing international requests. The effectiveness of the recently introduced cross-border movement of currency and bearer negotiable instruments (CBNI) disclosure/declaration system is yet to be demonstrated.

- e) The private sector's understanding of ML/TF risks and implementation of mitigating measures is mixed. Large financial institutions (FIs) and those belonging to large international groups, as well as large international designated non-financial businesses and professions (DNFBPs) tend to have a stronger approach. Core Principles supervisors – the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC) and the Insurance Authority (IA) – implement appropriate risk-sensitive supervision. Other supervisors and self-regulatory bodies (SRBs) need to strengthen their risk understanding and supervisory actions. Overall, limited sanctions have been applied against the private sector. Dealers in precious metals and stones (DPMS) and stand-alone financial leasing companies are not regulated for AML/CFT preventive measures.
- f) HKC has assessed the ML/TF risks and misuse of legal persons and arrangements, but the assessment should be more comprehensive. HKC authorities rely largely on AML/CFT requirements on FIs to ensure transparency. Recent measures from early 2018 to: (i) impose statutory AML/CFT requirements for trust and company service providers (TCSPs); and (ii) require companies to collect and maintain beneficial ownership information, will enhance transparency of beneficial ownership requirements over time. The effectiveness of these measures is however yet to be fully demonstrated due to their recent nature.
- g) HKC actively responds to formal international co-operation requests for mutual legal assistance (MLA) and extradition and has received positive feedback from counterparts concerning the high quality and timeliness of assistance received. Nevertheless, there remain legal impediments to formal international co-operation with Mainland and other parts of China and the low number of outgoing formal requests generally is not consistent with HKC's risk profile.
- h) HKC has a robust framework for identifying and investigating potential cases of TF. HKC is currently implementing TF and proliferation financing (PF) targeted financial sanctions (TFS) without delay, but these regimes have only been in place since May 2018, and there were previously delays in implementing TFS, particularly for PF TFS. This is mitigated to some extent as many large/international FIs and DNFBPs have demonstrated a good awareness and understanding of their TFS risks and obligations in practice, although awareness is lower with respect to PF TFS. HKC has a sound understanding of the TF risks and vulnerabilities within its non-profit sector, and has applied proportionate measures to mitigate the relatively higher risks faced by international non-profit organisations.
- i) HKC's status as an international financial centre (IFC), the relative ease of company formation, and its geographic location, expose it to potential PF activities, particularly through the misuse of legal persons, as well as financial channels. Gaps in understanding and implementation of the PF TFS obligations among smaller entities and newly regulated sectors, and in monitoring of compliance with the obligations in those sectors, impact HKC's ability to demonstrate effectiveness. There are residual concerns regarding whether it is reasonable that no PF TFS case has been substantiated by HKC so far given its exposure.

## Risks and General Situation

2. HKC has one of the world's most open and free economies, and is a systemically important financial centre. It has sizeable foreign exchange, securities, futures, and insurance markets and is one of the largest asset and wealth management centres in Asia. HKC also has an active DNFBP sector and large transactions in the real estate and DPMS sectors, and is a jurisdiction with significant company formation activities. HKC's economy is also closely linked to Mainland China.

3. HKC has a low and declining domestic crime rate but its status as a major global financial centre inevitably exposes it to potential misuse as a transit point for foreign proceeds of crime. It has identified its main ML threats as fraud, drugs-related crimes, and foreign corruption and tax evasion. The threat of financing domestic terrorism is low but given HKC's open financial system, and the cultural and economic links between certain segments of the community and regions affected by terrorism, the threat of financing terrorism abroad is relatively higher.

## Overall Level of Compliance and Effectiveness

4. HKC has a strong legal and institutional framework for combating ML and TF. HKC made a number of significant legislative amendments in 2018, including strengthening preventive measures for DNFBPs, introducing a cross-border declaration system, enhancing its legal regime for TF and TF TFS, and strengthening measures to enhance transparency of legal persons. The technical compliance framework is particularly strong regarding confiscation, law enforcement, preventive measures for, and the supervision of, FIs, and international co-operation but less so regarding transparency of legal arrangements, preventive measures for politically exposed persons (PEPs), and supervision of DNFBPs.

5. In terms of effectiveness, HKC achieves substantial results in risk identification and understanding, use of financial intelligence, confiscation of instrumentalities and proceeds of crime, investigation and prosecution of TF, implementation of TF TFS and protecting NPOs from TF abuse, and international co-operation. Only moderate improvements are needed in these areas. However, the recency of the legislative amendments has an impact on effectiveness, and more significant improvements are needed in other areas indicated below.

## *Assessment of risk, co-ordination and policy setting (Chapter 2; IO.1, R.1, 2, 33 & 34)*

6. HKC has a reasonably good level of understanding of its ML risks. Its risk understanding is largely informed by HKC's ML/TF Risk Assessment exercise (HRA) which was developed over several years and culminated in the HRA (published in April 2018). Some competent authorities (e.g. the Hong Kong Police Force (HKPF), the HKMA) have also conducted their own targeted assessments, which have a positive effect on HKC's risk understanding.

7. HKC largely recognises the range of ML threats it faces. It has an in-depth understanding of its main risks relating to fraud, deception, and drug trafficking, and the common typologies used to launder proceeds (e.g. through bank accounts, including stooze accounts, and shell companies). However, the level of understanding

for some other higher risk ML areas (e.g. ML linked to foreign tax evasion and corruption offences) should be further deepened, as should the level of activities to mitigate these and other major risks.

8. The risk ratings for FI and DNFBP sectors are generally reasonable, with the banking sector rightly identified as facing the highest risk. HKC has a good understanding of the common typologies related to misuse of companies, however the assessment would benefit from a more detailed discussion on legal arrangements and the full range of legal persons that can be established or are operating in HKC. The AML/CFT exemption for the DPMS sector is not based on proven low risk. HKC has not conducted a detailed risk assessment for stand-alone financial leasing companies to fully justify their exemptions.

9. HKC has a good understanding of its TF risk, which is informed by both the HRA exercise, and more importantly, additional analysis based on investigations of potential TF and intelligence from the Force Steering Group Committee on Counter Terrorism (FSCCT), which sits within the HKPF and assesses intelligence from all relevant LEAs.

10. The CCC provides a good platform for policy co-ordination on the key ML/TF risks identified. A number of working groups and inter-agency mechanisms support the work of the CCC. While there is good co-operation between the Core Principles supervisors, some co-operation and co-ordination challenges exist with regard to the other supervisors, including SRBs, and authorities should continue to monitor and ensure co-ordination and co-operation continues to work well between other authorities. Co-ordination of PF issues is generally adequate.

### ***Financial intelligence, ML investigations, prosecutions and confiscation (Chapter 3; IO.6, 7, 8; R.1, 3, 4, 29–32)***

#### *Use of financial intelligence (Immediate Outcome 6)*

11. LEAs regularly use a broad range of information to investigate and develop evidence related to ML, TF and associated predicate offences. A key strength is the interfaced online access across the main police and customs databases with the JFIU database, which allows automated data matching of suspicious transaction reports (STRs) against persons of interest to police and/or customs, sensitive criminal intelligence, and cross-border declarations.

12. Disseminations of STRs have continued to rise significantly since 2013, reflecting increased STR reporting due to an enhanced compliance culture of FIs and JFIU's efforts to improve STR quality. Under-reporting by many money service operators (MSOs) and most DNFBPs limits financial intelligence from some sectors assessed as medium-high risk (particularly TCSPs), although this is partly mitigated by STRs from banks and improved company information. The main legal and intelligence-sharing foundations of the CBNI system are newly in place and it is too early to assess the system's effectiveness.

13. The JFIU supports operational needs to a large extent, through analysing and disseminating an increasing number of STRs and the value-added operational financial intelligence it provides. The JFIU recently enhanced its strategic output beyond providing feedback to reporting entities on typologies and STR trends, and

has started to produce reports of value for operational targeting, supervision and policy, but the scope has been limited. Competent authorities generally co-operate and exchange financial intelligence to a good extent, but should continue to enhance inter-agency information sharing related to the major proceeds-generating crimes, particularly those linked to foreign predicates.

#### *ML offence (Immediate Outcome 7)*

14. HKC has a well-established legal and institutional framework to conduct ML investigations and prosecutions. An important tool in HKC's regime is the broad stand-alone ML offence provision that helps promote parallel financial investigations and ML investigations. LEAs identify and initiate a significant number of ML investigations (averaging 1 600 each year), with 60% progressing to full investigation. LEAs use a generally sound range of techniques to identify ML, although the largely foreign nature of many major ML threats poses challenges for LEAs to detect and in particular investigate. HKC authorities have sought to address this by increasing information sharing and joint operations with foreign counterparts, but the scale of the challenge suggests further efforts are required.

15. The authorities investigate and prosecute ML consistent to some extent with the risk profile. Fraud-related ML as the highest risk is extensively investigated (accounting for 70% of ML investigations for 2013-17), but there is an appreciable drop in the investigation of non-fraud ML cases assessed as medium-high risk. The non-fraud related risks (drugs, foreign tax crimes and corruption, goods smuggling, as well as stand-alone ML where the predicate is unable to be identified) account for **less than 30% of ML investigations. It appears that few of these foreign predicates** have been prosecuted for ML in HKC (although an undetermined number of such cases have been prosecuted overseas).

16. HKC demonstrates an ability to prosecute all forms of ML and has a high conviction rate. However, the number of prosecutions (averaging 120 per year) and convictions (averaging 95 a year) is much lower than the number of cases investigated, and the generally low sentences imposed indicate that many ML cases pursued are at the lower end of the scale. While sentences may be proportionate and dissuasive in individual cases, there is concern as to whether the sanctions being applied are effective, proportionate and dissuasive at a systemic level given the nature of ML risks in HKC. HKC has not prosecuted a legal person for ML.

#### *Confiscation (Immediate Outcome 8)*

17. HKC can be commended for increasing confiscation action since its last mutual evaluation. Confiscation is a high priority and there are clear procedures and systems observed in all agencies involved, as well as largely comprehensive legislation. In terms of results, a significant amount of proceeds of crime has been restrained and subsequently confiscated and recovered, reflecting strong action by LEAs and prosecutors. HKC also employs a number of additional tools to aid confiscation efforts such as the Letter of No Consent (LNC) Mechanism and more recently, the Anti-Deception Co-ordination Centre (ADCC) which have been largely successful in helping to restrain large amounts of proceeds involved in fraud and deception.

18. HKC actively responds to requests from foreign counterparts and partakes in asset sharing, but the volume of outgoing requests does not appear to be in line with

HKC's risk profile. Certain legal gaps continue to exist particularly under the Organized and Serious Crime Ordinance whereby only benefits above HKD 100 000 (USD 12 750) can be subject to formal restraint or confiscation procedures. HKC has only recently implemented its CBNI system, and effectiveness in this area is yet to be demonstrated.

### ***Terrorist and proliferation financing (Chapter 4; 10.9, 10, 11; R. 1, 4, 5-8, 30, 31 & 39.)***

#### *TF offence (Immediate Outcome 9)*

19. Despite inherent risks arising from its status as an IFC, its open nature and its geographical proximity and economic connectedness with a region affected by terrorism, to date there is no evidence of TF occurring within HKC. The absence of terrorism cases and prosecutions/convictions for TF is not inconsistent with HKC's medium-low TF risk. The systems in place to detect potential TF, arising both domestically and from overseas, are sound, and TF investigations are well integrated into HKC's counter-terrorism framework and investigations of potential terrorism cases. Authorities demonstrated that, even in the absence of prosecutions and convictions, they are actively investigating potential TF using sophisticated tools and intelligence. Sanctions for TF are proportionate and dissuasive.

#### *Preventing terrorists from raising, moving and using funds (Immediate Outcome 10)*

20. HKC amended its legal framework in May 2018 to implement TFS. Although this regime had only been in place for six months at the time of the onsite evaluation visit, in practice large FIs and DNFBPs with international exposure demonstrated a good awareness and understanding of their TFS risks and obligations, which mitigated some of the gaps in effective implementation of TF TFS that were observed prior to May 2018. Some smaller entities across all sectors (in particular, smaller MSOs and DPMS) struggled to articulate their TF and TFS risks and obligations.

21. HKC has a sound understanding of the TF risks and vulnerabilities within its NPO sector, and has applied proportionate measures to mitigate the relatively higher risks faced by international NPOs. Sufficient monitoring is in place, and NPOs demonstrated a strong understanding of the risks of their activities and the necessary preventive measures to minimise the risk of abuse.

22. While no TF assets or instrumentalities have been confiscated, this is not inconsistent with HKC's TF risk. Mechanisms are in place to deprive terrorists, terrorist associates, or terrorist financiers of assets and instrumentalities as and when identified, including preventive measures, mechanisms to freeze and forfeit terrorist property, and the framework for making domestic designations and implementing foreign designations.

#### *Proliferation financing (Immediate Outcome 11)*

23. Owing to its status as an IFC, the relative ease of company formation, and its geographic location, HKC is also exposed to potential PF activities, particularly through the misuse of legal persons, as well as financial channels. This is material in considering whether sustained effectiveness has been demonstrated. HKC is

currently implementing PF TFS without delay through a recently enhanced regime, but delays in implementing PF TFS (between 3 and 15 days for an average of 6.6 days) were observed prior to the enhanced regime.

24. Authorities demonstrated robust intelligence co-ordination mechanisms and the ability to conduct complex financial investigations, including developing leads to unveil deeper layers of financial activities involving networks and fund flows across multiple jurisdictions. However, the use of corporate structures and front companies is a typology for PF and the lack of regulation of the TCSP sector until recently may therefore have limited the availability of accurate and complete information with respect to legal persons. The recent commencement of the significant controllers register (SCR) and the TCSP regulatory regime would provide additional avenues for LEAs to obtain more accurate and complete beneficial ownership information.

25. No PF-related funds, assets or economic resources have been identified by HKC. Examination of case studies justified this to some extent, but there are residual concerns regarding whether the fact that no PF case has been substantiated so far is reasonable given HKC's exposure.

### *Preventive measures (Chapter 5; IO.4; R.9–23)*

26. Most FIs and DNFBPs are covered by AML/CFT obligations with the exception of DPMS and a small number of stand-alone financial leasing companies. For DNFBPs and moneylenders, these requirements are recent, which affects the overall implementation of preventive measures.

27. Large FIs and those belonging to international financial groups have a good understanding of their AML/CFT obligations and ML/TF risks. They also demonstrated a good level of the implementation of their customer due diligence (CDD) and beneficial ownership requirements. The understanding and appreciation of ML/TF risks and the implementation of AML/CFT measures needs improvements among the smaller FIs (particularly in the MSO and moneylender sectors), especially with regard to risks posed by non-resident customers, foreign PEPs and other higher risk areas.

28. DNFBPs, with the exception of large international TCSPs, accounting and law firms, do not take a risk-based approach to mitigate their ML/TF risks, mainly as a result of a poorer understanding of their ML/TF risks. They have implemented basic CDD and record-keeping measures but enhanced CDD (EDD) measures applied are not often commensurate with higher risk situations, particularly in relation to PEPs. Domestic TCSPs and estate agents do not yet have a good understanding of the concept of beneficial ownership and tend to understand it as legal ownership.

29. Most STRs are filed by large banks. The level of reporting in other sectors is low, particularly for MSOs, moneylenders and DNFBPs. There are also concerns about the quality of the STRs filed by MSOs and defensive filing by FIs.

### *Supervision (Chapter 6; IO.3; R.14, R.26–28, 34, 35)*

30. Financial supervisors generally apply robust screening measures to prevent criminals and their associates from abusing FIs. The implementation of screening measures for DNFBPs is however generally less robust. As noted, DPMS and stand-

alone financial leasing companies are not regulated or supervised for AML/CFT requirements.

31. The ML/TF risk understanding of the HKMA, the SFC and the IA at the sectoral and institutional level is good. However, the Custom & Excise Department (C&ED), the Registrar of Moneylenders (RML), SRBs and other DNFBP supervisors need important improvements in risk understanding at the institutional level. In particular, the quality of supervision of MSOs and TCSPs need improvements to better take into account the ML/TF risks, given the importance of these sectors in HKC's context.

32. The HKMA, the SFC and the IA have a reasonable supervisory framework to monitor AML/CFT compliance. Supervision in the banking sector is the most robust and risk-sensitive, which is commensurate with the sector's highest risk. The scope and depth of inspections by the C&ED and the RML are too limited. This is also a concern for SRBs and other DNFBP supervisors, whose supervisory activities are generally at a nascent stage or complaints driven.

33. Limited sanctions have been applied for most of the sectors and, therefore, their effectiveness could not be fully demonstrated. The C&ED, the RML and DNFBP supervisors have not applied remedial actions and sanctions effectively on a graduated basis.

34. Supervisors generally provide useful guidance to their sectors. However, there are important gaps in the understanding of AML/CFT obligations and ML/TF risks and particularly in the identification of suspicious transactions by MSOs, moneylenders and DNFBPs. This indicates that supervisory activities and outreach should be strengthened.

### ***Transparency and beneficial ownership (Chapter 7; IO.5; R.24, 25)***

35. The HRA analyses the ML/TF risks posed by the misuse of legal persons and arrangements, and finds that shell companies created in HKC have been used to facilitate predicate crimes and ML offences. Authorities also noted that trusts could be abused, although there is less information regarding their misuse.

36. Basic information on companies is publicly available on the Company Registry's (CR's) website, and legal ownership information is recorded on the register of members held by the company. Further steps could be considered to ensure that this information remains fully up-to-date and accurate, including legal ownership information available through the CR. Since March 2018, there have been statutory requirements for companies to collect beneficial ownership information by keeping a SCR. The CR has taken encouraging steps and commenced checks on a number of companies for their compliance with the SCR regime, but more time is needed to assess the effectiveness of the regime.

37. For trusts, HKC relies on both regulated entities, professional trustees and common law fiduciary duties on other trustees, to keep the relevant information. Where the trustees are regulated, there are requirements to maintain the required information, but other trusts set up under HKC's common law do not adequately ensure that non-professional trustees maintain adequate, accurate and up-to-date information on settlor/protectors/beneficial owners.

38. Competent authorities can also obtain basic and beneficial ownership information from other sources, particularly FIs, such as banks. Banks, especially large banks belonging to international financial groups, would generally have the required information, but for DNFBCPs (e.g. lawyers, accountants and TCSPs), uneven implementation means that it cannot be clearly demonstrated that accurate and up-to-date beneficial ownership information is always available.

39. HKC has taken some compliance action regarding beneficial ownership requirements, but as the measures are still new, there is insufficient information to conclude that compliance is proven and that sanctions are effective, dissuasive and proportionate.

### *International co-operation (Chapter 8; IO.2; R.36–40)*

40. HKC demonstrates many characteristics of an effective system for international co-operation and is able to render MLA, extradition, and intelligence/information (where available) in a constructive and timely manner. The feedback indicates that the quality of assistance is generally high, often supporting investigations and helping to secure convictions. HKC has also been effective in asset sharing with foreign jurisdictions.

41. Whilst HKC has effectively dealt with increasing numbers of incoming international requests, the low number of outgoing requests is not consistent with HKC's risk profile. In particular, HKC does not appear to be making enough proactive efforts to pursue proceeds of crime outside the jurisdiction and ML arising from foreign predicate offences through formal means.

42. Co-operation with other parts of China is administered through court-to-court letters of request, but is limited to the examination of witnesses and production of documents for the purposes of criminal proceedings and criminal investigations. Asset recovery with other parts of China may only be done within the Drug Trafficking (Recovery of Proceeds) Ordinance (DTRPO) regime and is confined to drug proceeds. These legal shortcomings are partly mitigated by HKCs robust informal co-operation.

43. In terms of other forms of co-operation, HKC actively uses agency-to-agency international co-operation for AML/CFT purposes, primarily for information exchange and informal liaison, and has undertaken a limited but gradually increasing number of joint operations with foreign counterparts. The HKMA, the SFC and the IA proactively seek and provide supervisory information with their foreign counterparts, while cross-border information exchange for other supervisors is limited to the C&ED. HKC shares basic and beneficial ownership information of legal persons and arrangements that is required and collected in HKC.

## Priority Actions

- a) HKC should continue its ongoing efforts to review and update its understanding of ML/TF risks and should take steps to more closely review the ML threats arising from foreign crimes such as corruption, and tax crimes.
- b) HKC should clearly prioritise investigating and prosecuting foreign non-fraud ML such as drugs, tax crimes and corruption.
- c) The C&ED, the RML, SRBs and other DNFBP supervisors should strengthen their understanding of ML/TF risks at the individual institution level to improve their understanding of sectoral risks and develop a robust risk-based supervisory approach.
- d) Supervisors/SRBs should apply effective, proportionate and dissuasive sanctions for non-compliance with AML/CFT requirements. HKC should take further actions to ensure that beneficial ownership information in relation to legal arrangements, especially for trusts that are not created through professional trustees, is more readily available and is accurate. It should closely monitor and ensure compliance with the implementation of the new SCR regime, and at an appropriate point assess its effectiveness.
- e) HKC should review and put in place the appropriate level of AML/CFT requirements for the DPMS sector having regard to ML/TF risks.
- f) HKC should close the technical gap in relation to the coverage of PEPs from other parts of China.
- g) HKC should take further actions to deepen FIs' and DNFBPs' understanding of ML/TF risks and to strengthen AML/CFT implementation by DNFBPs and the smaller FIs (especially in the MSO and moneylender sectors), particularly with regard to the risks posed by non-resident customers, beneficial ownership requirements, EDD requirements in relation to foreign PEPs, and TFS requirements.
- h) HKC should closely monitor and manage its exposure to PF by the Democratic People's Republic of Korea (DPRK) as a strategic priority. HKC should conduct targeted outreach to smaller entities in all sectors, and focus in particular on those sectors that demonstrated more systemic gaps in understanding of their TFS obligations, such as MSOs and DPMS. HKC should pursue the identification of PF-related funds, assets and economic resources and review whether there are impediments to the identification of such assets in HKC.
- i) HKC should follow and restrain assets that have moved to other jurisdictions and pursue the people involved, including through the use of more outgoing formal requests for MLA, extradition and asset recovery in line with its risk profile. HKC should also explore ways to improve its ability to co-operate with other parts of China through formal means.

## Effectiveness & Technical Compliance Ratings

### Effectiveness Ratings<sup>1</sup>

IO.1 - Risk, policy and coordination	IO.2 - International cooperation	IO.3 - Supervision	IO.4 - Preventive measures	IO.5 - Legal persons and arrangements	IO.6 - Financial intelligence
<b>Substantial</b>	<b>Substantial</b>	<b>Moderate</b>	<b>Moderate</b>	<b>Moderate</b>	<b>Substantial</b>
IO.7 - ML investigation & prosecution	IO.8 - Confiscation	IO.9 - TF investigation & prosecution	IO.10 - TF preventive measures & financial sanctions	IO.11 - PF financial sanctions	

**Moderate**      **Substantial**      **Substantial**      **Substantial**      **Moderate**

### Technical Compliance Ratings<sup>2</sup>

<b>R.1</b> - assessing risk & applying risk-based approach	<b>R.2</b> - national cooperation and coordination	<b>R.3</b> - money laundering offence	<b>R.4</b> - confiscation & provisional measures	<b>R.5</b> - terrorist financing offence	<b>R.6</b> - targeted financial sanctions – terrorism & terrorist financing
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>C</b>
<b>R.7</b> - targeted financial sanctions - proliferation	<b>R.8</b> - non-profit organisations	<b>R.9</b> – financial institution secrecy laws	<b>R.10</b> – Customer due diligence	<b>R.11</b> – Record keeping	<b>R.12</b> – Politically exposed persons
<b>C</b>	<b>C</b>	<b>C</b>	<b>LC</b>	<b>LC</b>	<b>PC</b>
<b>R.13</b> – Correspondent banking	<b>R.14</b> – Money or value transfer services	<b>R.15</b> –New technologies	<b>R.16</b> –Wire transfers	<b>R.17</b> – Reliance on third parties	<b>R.18</b> – Internal controls and foreign branches and subsidiaries
<b>C</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>
<b>R.19</b> – Higher-risk countries	<b>R.20</b> – Reporting of suspicious transactions	<b>R.21</b> – Tipping-off and confidentiality	<b>R.22</b> - DNFBPs: Customer due diligence	<b>R.23</b> – DNFBPs: Other measures	<b>R.24</b> – Transparency & BO of legal persons
<b>LC</b>	<b>LC</b>	<b>C</b>	<b>PC</b>	<b>LC</b>	<b>LC</b>
<b>R.25</b> - Transparency & BO of legal arrangements	<b>R.26</b> – Regulation and supervision of financial institutions	<b>R.27</b> – Powers of supervision	<b>R.28</b> – Regulation and supervision of DNFBPs	<b>R.29</b> – Financial intelligence units	<b>R.30</b> – Responsibilities of law enforcement and investigative authorities
<b>PC</b>	<b>LC</b>	<b>LC</b>	<b>PC</b>	<b>C</b>	<b>C</b>
<b>R.31</b> – Powers of law enforcement and investigative authorities	<b>R.32</b> – Cash couriers	<b>R.33</b> – Statistics	<b>R.34</b> – Guidance and feedback	<b>R.35</b> – Sanctions	<b>R.36</b> – International instruments
<b>C</b>	<b>C</b>	<b>C</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>
<b>R.37</b> – Mutual legal assistance	<b>R.38</b> – Mutual legal assistance: freezing and confiscation	<b>R.39</b> – Extradition	<b>R.40</b> – Other forms of international cooperation		
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>		

<sup>1</sup> Effectiveness ratings can be either a High- HE, Substantial- SE, Moderate- ME, or Low – LE, level of effectiveness.

<sup>2</sup> Technical compliance ratings can be either a C – compliant, LC – largely compliant, PC – partially compliant or NC – non compliant.



## MUTUAL EVALUATION REPORT

### Preface

This report summarises the AML/CFT measures in place as at the date of the on-site visit. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of the AML/CFT system, and recommends how the system could be strengthened.

This evaluation was based on the 2012 FATF Recommendations, and was prepared using the 2013 Methodology. The evaluation was based on information provided by HKC, and information obtained by the evaluation team during its on-site visit to HKC from 31 October to 15 November 2018.

The evaluation was conducted by an assessment team consisting of:

- Mr. Ali Anakhrouch, Supervisor Specialist, De Nederlandsche Bank N.V, Netherlands (financial expert)
- Mr. Alistair Sands, Director International TA&T, AUSTRAC, Australia (law enforcement expert)
- Mr. Alvin Koh, Deputy Director & Specialist Leader, Monetary Authority of Singapore, Singapore (financial expert)
- Mr. Christopher Ng, Deputy Senior Counsel and Deputy Public Prosecutor, Attorney General's Chambers, Brunei Darussalam (legal expert)
- Mrs. Erin Lubowicz, Chief Adviser, Ministry of Justice, New Zealand (legal expert)
- Mr. Kota Sekiya, Deputy Director for AML/CFT, Financial Services Agency, Japan (financial expert)

The team was supported by Mr. John Carlson (Senior Policy Analyst, FATF Secretariat), Ms. Ailsa Hart and Mr Alexandre Rodriguez-Vigouroux (Policy Analysts, FATF Secretariat), and Mr. Eliot Kennedy (Deputy Executive Secretary, APG Secretariat.)

The report was reviewed by Mr. Ben Aldersey, FCA, United Kingdom (UK); Mr. Matthew Shannon, Department of Finance, Canada; and Mr. Fabio Teramo, Ministry of Economy and Finance, Italy.

HKC previously underwent a FATF Mutual Evaluation in 2008, conducted according to the 2004 FATF Methodology. The 2008 evaluation has been published and is available at: [www.fatf-gafi.org/countries/#Hong Kong \(China\)](http://www.fatf-gafi.org/countries/#Hong Kong (China)).

HKC's 2008 Mutual Evaluation concluded that it was compliant with 10 Recommendations; largely compliant with 20; partially compliant with 15; and non-compliant with four. HKC was rated compliant or largely compliant with 10 of the 16 Core and Key Recommendations. HKC was placed in regular follow-up, and reported

back in June 2010 (first follow-up report) and June 2011 (second follow-up report). In October 2012 (third follow-up report), the FATF recognised that HKC had reached a satisfactory level of compliance with all of the Core Recommendations; and two of the three Key Recommendations. It had not yet definitely reached a satisfactory level of compliance with former SR. III. On this basis, HKC was moved to biennial updates.

## Chapter 1. ML/TF RISKS AND CONTEXT

44. HKC is a Special Administrative Region of the People's Republic of China (PRC). Following British rule from 1841 to 1997, China resumed the exercise of sovereignty over HKC on 1 July 1997 under the "One Country, Two Systems" principle.

45. Situated on the south-eastern coast of China, HKC has an area of about 1,106 square kilometres, covering Hong Kong Island, Kowloon, the New Territories and 262 outlying islands, and has a population of approximately 7.41 million. In 2016, locally born residents made up about 60.6% of the population; 31% were born in other parts of China, and the remaining 8.4% originated from elsewhere. Of the last group, there were approximately 184 000 Filipinos and 153 000 Indonesians, the majority of both groups being women employed as foreign domestic helpers (FDH).

46. The Basic Law is a national law of the PRC and a constitutional document for HKC. It provides, *inter alia*, that HKC is authorised to exercise a high degree of autonomy and enjoys executive, legislative and independent judicial power, including that of final adjudication. Foreign affairs relating to HKC and defence are the responsibilities of the Central People's Government of the PRC.

47. HKC has an executive-led political structure headed by the Chief Executive, who is advised on major policy decisions by the Executive Council. The Administration, the executive arm of the Government, is organised into the Government Secretariat and departments. Bureaux in the Government Secretariat, led by Principal Officials with ministerial responsibilities, formulate policies and initiate legislative proposals. HKC has a two-tier system of representative government. At the central level the Legislative Council (LegCo) legislates, approves public expenditure and monitors the performance of the Administration. At the district level, 18 District Councils advise on the implementation of policies in their respective districts.

48. Under the "One Country, Two Systems" principle, HKC has its own legal system (which is founded on English common law) and local legislation codified in the Laws of HKC. Laws in force in HKC include: (a) the Basic Law; (b) PRC national laws listed in Annex III to the Basic Law as applied to HKC; (c) the laws previously in force in HKC before 1 July 1997, including the common law, rules of equity, ordinances, subordinate legislation and customary law, except for any that contravene the Basic Law, and subject to any amendment by LegCo; and (d) laws enacted by LegCo. The Court of Final Appeal (CFA) is the final appellate court within the court system with the power of final adjudication. The CFA may invite judges from other common law jurisdictions to sit on the court.

## ML/TF Risks and Scoping of Higher Risk Issues

### Overview of ML/TF Risks

49. While HKC has a low and declining domestic crime rate<sup>3</sup>, its status as a major IFC inevitably exposes it to potential misuse as a transit point for foreign proceeds of crime. The bulk of HKC's exposure to ML risks arises from offences committed overseas.

50. There is no specific intelligence suggesting that HKC is a likely target of terrorism, or evidence indicating that there are foreign terrorist associates with a nexus to it. The threat of financing domestic terrorism is, therefore, low. Externally, there have been some suspected cases of funds or other assets of designated persons or entities (or those acting on their behalf) being in or passing through HKC. Given HKC's open financial system, and the cultural and economic links between certain segments of the community and regions affected by terrorism, the threat of financing terrorism abroad is relatively higher.

### Jurisdiction's Risk Assessment & Scoping of Higher Risk Issues

51. In April 2018, HKC published its first assessment on territory-wide ML/TF risks. The HKC ML/TF Risk Assessment Report (HRA) was developed under the high-level CCC and overseen by a dedicated Steering Committee of ML/TF Risk Assessment under the CCC. All competent authorities with AML/CFT responsibilities and relevant key stakeholders participated in the exercise, including policy bureaux, law enforcement agencies (LEAs), regulatory authorities, government departments and private sector stakeholders. HKC adopted the World Bank National Risk Assessment Tool (WBT) as the methodology for conducting the HRA, and made close reference to the 2013 FATF Guidance on National Money Laundering and Terrorist Financing Risk Assessment during the process.

52. The HRA focuses on the territory-wide ML and TF risks as well as the sectoral risks facing six financial and five non-financial sectors. The HRA gives an account of the TF risk of NPOs and the ML/TF risk of emerging technologies (such as virtual commodities), companies (as the predominant type of legal person in HKC), and trusts.

53. The HRA takes into account both quantitative and qualitative information, including:

- key ML/TF threats of cases investigated and convictions obtained, information from the JFIU (e.g. STRs), assets restrained in relation to specific crimes, numbers of international requests for assistance, as well as references to international typologies reports, intelligence, interviews and news monitoring;
- key ML/TF vulnerabilities (e.g. average transaction, size of product, client base profile of the product, frequency of international transaction of product) of products/activities from the covered sectors, including the level of AML/CFT controls (e.g. availability and enforcement of criminal sanctions,

<sup>3</sup> [www.info.gov.hk/gia/general/201801/23/P2018012301086.htm](http://www.info.gov.hk/gia/general/201801/23/P2018012301086.htm)

effectiveness of supervision procedures and practices, effectiveness of suspicious activity monitoring and reporting etc.), where available; and

- experts' views as well as feedback from public and private sector stakeholders.

54. The HRA assesses that HKC's status as an international finance, trade, and transport hub with strong links to other jurisdictions in the Asia/Pacific region and beyond makes it susceptible to becoming a transit point for illicit funds generated from across the border and other parts of the world. Internally, fraud and drugs-related crimes pose high and medium-high ML threats respectively to HKC. Externally, fraud poses a high ML threat while drugs, corruption and tax evasion pose medium-high threats. Other foreign predicate offences, such as human trafficking and wildlife trafficking, are noted in the HRA as emerging threats to the Asia/Pacific region as a whole, though the HRA noted that there is no evidence to suggest that they pose a material ML threat to HKC.

55. The HRA identifies HKC as having a low level of internal TF risk, given that there has been no specific intelligence, or actual case, to suggest that HKC is likely to be a target of terrorist attacks. The threat of financing terrorism abroad (including for foreign terrorist fighters) is assessed to be relatively higher, given HKC's open financial system as well as the cultural and economic ties between certain segments of the community and regions affected by terrorism. That said, TF investigations conducted by the competent authorities have not led to confirmation of any TF activity in HKC or discovery of high-risk patterns, which is consistent with the city's medium-low TF risk. The vast majority of NPOs in HKC focus on domestic services, and HKC assesses that the risk of them being abused is low.

56. In addition to the HRA, some competent authorities (e.g. HKPF, the HKMA) have conducted other threat and vulnerability assessments over the years during the normal course of their work. These sector-specific threat and vulnerability assessments are broadly consistent with the conclusions of the HRA.

57. In deciding what issues to prioritise, the assessment team reviewed materials provided by HKC (including on its territory-wide ML/TF risks) and information from third-party sources. The assessors identified the following priority issues:

- *HKC as a major IFC and mitigation of risks posed by foreign predicate crimes*: how effectively HKC (including the private sector) understands and mitigates these risks, with a particular focus on the coverage of foreign predicates, and the measures in place to mitigate such threats;
- *Misuse of legal persons and legal arrangements for ML/TF purposes and availability of beneficial ownership information*: the extent to which efforts put in place by HKC to reduce the abuse of corporate structures are successful in preventing the abuse of corporate vehicles for criminal purposes and the ease with which competent authorities can get timely access to accurate and up-to-date beneficial ownership information;
- *Co-operation, co-ordination and other interaction with other parts of China*: the extent to which HKC engages with other parts of China to mitigate potential ML/TF risks stemming from its status as an important gateway to the

Mainland's economy and financial system, the use of remittance services between HKC and the Mainland, and corruption in other parts of China, etc.;

- *International co-operation and cross-border issues*: to consider international co-operation between HKC and other jurisdictions in pursuing ML cases involving foreign predicate offences or cross-border components, with particular attention on the newly implemented declaration/disclosure system for cross-border movement of currency and bearer negotiable instruments (CBNIs) and the supervision of MSOs;
  - *Trade Based Money Laundering (TBML)*: the extent to which authorities are addressing the risks associated with TBML, given HKC status as a trading centre and the volume of financial and commercial transactions between HKC and its trading partners;
  - *Tax crimes*: how authorities are addressing tax crimes, including the identification of suspicious activity relating to foreign tax crimes, the strategies adopted by LEAs and tax authorities on this issue and the results of recent ML cases, especially in the context of the new automatic exchange of information;
  - *PF*: the extent to which funds or other assets of designated persons and entities are being identified and such persons and entities are being prevented from operating or executing financial transactions related to PF;
  - *TF*: the extent to which TF risks are understood and measures are applied in HKC to mitigate the TF risks, including the implementation of targeted financial sanctions (TFS), and the extent to which authorities are investigating TF cases; and
  - *DNFBPs*: the level of implementation and enforcement of AML/CFT requirements, including outreach to DNFBPs, and AML/CFT control on DPMS.
58. Two areas were identified for reduced focus:
- *Casinos*: The Gambling Ordinance makes it illegal to operate or manage a gambling establishment in HKC. There are no licensed casinos in HKC; and
  - *Insurance sector*: The insurance sector accounts for around 4% of GDP, with 93% of market share concentrated among 15 insurers. HKC assesses the ML risk in the insurance sector to be medium-low, noting that the detected cases of misuse are relatively negligible.

## Materiality

59. HKC has one of the world's most open and free economies, and is highly dependent on international trade and finance. HKC has a highly developed, services-oriented economy, with services sectors accounting for more than 90% of GDP<sup>4</sup>.

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4

[Hong Kong: The Facts](#)

HKC's GDP was USD 341 billion<sup>5</sup> in 2017, with a per capita GDP of US 46 000; financial services accounted for 18% of total output<sup>6</sup>. HKC is the world's seventh largest trading entity, with total trade amounting to USD 1 140 billion in value, of which USD 550 billion are from exports<sup>7</sup>. HKC's top five trading partners are Mainland China, the United States, Chinese Taipei, Japan, and Singapore.

60. HKC is a major IFC and was identified by the IMF as one of the 29 systematically important financial centres. It has a sizeable foreign exchange as well as securities, futures, and insurance markets. HKC is one of the largest asset and wealth management centres in Asia, with the combined fund management business amounting to over USD 3.1 trillion as at end 2017. HKC is also the world's largest offshore Renminbi (RMB) hub, with RMB deposits and outstanding RMB certificates of deposits totalling RMB 600 billion as at end September 2018.

61. Of note, HKC's economy is also closely linked to the Mainland; it is China's third largest trading partner and accounts for 31% of China's offshore investments, and 20% of HKC's private banking accounts are from China.

## Structural Elements

62. HKC has all of the key structural elements required for an effective AML/CFT system. There is high political and institutional stability, with well-established accountability, integrity and transparency mechanisms for all institutions and an independent judiciary. HKC has a dedicated anti-corruption agency, and has consistently been ranked as one of the least corrupt places in the world, ranking 13<sup>th</sup> least corrupt overall and 2<sup>nd</sup> least corrupt in the Asia/Pacific region in the 2017 Corruption Perceptions Index. Due process and the rule of law are entrenched in the constitutional and legal frameworks.

## Background and Other Contextual Factors

### AML/CFT strategy

63. HKC's AML/CFT Policy is articulated in the HRA published in April 2018. HKC's AML/CFT policies and key initiatives are co-ordinated by the high-level CCC overseen by the Financial Secretary. The CCC provides a good platform for high-level policy co-ordination.

64. HKC's AML/CFT policy objectives are to uphold a robust AML/CFT regime that: (a) fulfils the international AML/CFT standards; (b) deters and detects illicit fund flows in and out of the territory, through the financial system or otherwise; (c) combats ML/TF and restrains and confiscates illicit proceeds effectively; (d) reduces ML/TF vulnerabilities of both financial and non-financial sectors in HKC; (e) adopts a RBA in applying compliance obligations to businesses and individuals; (f) fosters strong external and international collaboration to disrupt global ML/TF threats; and

<sup>5</sup> [www.censtatd.gov.hk/hkstat/sub/sp250.jsp?tableID=030&ID=0&productType=8](http://www.censtatd.gov.hk/hkstat/sub/sp250.jsp?tableID=030&ID=0&productType=8)

<sup>6</sup> [www.fstb.gov.hk/fsb/ppr/report/doc/booklet\\_hong\\_kong\\_leading\\_international\\_financial\\_centre\\_e.pdf](http://www.fstb.gov.hk/fsb/ppr/report/doc/booklet_hong_kong_leading_international_financial_centre_e.pdf)

<sup>7</sup> [www.tid.gov.hk/english/aboutus/publications/tradestat/tradestat\\_maincontent.html](http://www.tid.gov.hk/english/aboutus/publications/tradestat/tradestat_maincontent.html)

(g) promotes the awareness and builds the capacity of private sector stakeholders in combating ML/TF risks through engagements in AML/CFT efforts.

65. To achieve these objectives, HKC authorities have focused efforts in five areas: (a) enhancing the AML/CFT legal framework to address gaps in legislation in accordance with international standards and applying an RBA; (b) strengthening risk-based supervision to ensure targeted regulation of the riskier areas faced by the financial and non-financial sectors; (c) sustaining outreach and capacity-building to promote awareness and understanding of ML/TF risks by various sectors and the wider community on a continuous basis; (d) monitoring new and emerging risks to respond promptly to evolving patterns of predicate offences or terrorism, and modes of ML/TF; and (e) strengthening law enforcement efforts and intelligence capability to tackle domestic and international ML/TF, and enhance restraint and confiscation of the proceeds of crime, including through multi-agency co-operation/ partnership.

### *Legal & institutional framework*

66. Preventive AML/CFT measures are stipulated mainly in the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO), and are supplemented by other Ordinances relating to financial regulation including the Banking Ordinance (BO), the Securities and Futures Ordinance (SFO), the Insurance Ordinance (IO), the Payment Systems and Stored Value Facilities Ordinance (PSSVFO), the Moneylenders Ordinance (MLO), the Legal Practitioners Ordinance (LPO), the Professional Accountants Ordinance (PAO), and the Estate Agent Ordinance (EAO). The company formation and beneficial ownership regime is implemented through the Companies Ordinance (CO).

67. Criminal justice measures are stipulated mainly in the OSCO, the DTROP, the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO), and the United Nations Sanctions Ordinance (UNSO) and its underpinning subsidiary legislation. International co-operation is rendered and sought under the mutual legal assistance in criminal matters (MLA) regime implemented through the Mutual Legal Assistance in Criminal Matters Ordinance (MLAO) and the DTROP; the court-to-court letters of request (LOR) regime under the Evidence Ordinance; and the surrender of fugitive offenders regime through the Fugitive Offenders Ordinance (FOO).

68. Guided by the AML/CFT Policy and having regard to the findings of the HRA, HKC has made recent progress in enhancing its legal framework, including:

- amending the AMLO to introduce a licensing regime for TCSPs and imposing AML/CFT requirements on DNFBPs including legal professionals, accounting professionals, estate agents and TCSPs;
- amending the CO to require all locally incorporated companies to maintain beneficial ownership information by way of keeping a “significant controllers register” (SCR);
- enacting the Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance to introduce a declaration / disclosure system for cross-border movement of large quantities of CBNIs;

- amending the PSSVFO<sup>8</sup> to regulate matters relating to the operation of stored value facilities (SVFs) and retail payment systems, including the introduction of a licensing regime with investigatory and sanctioning powers;
- amending the UNATMO to implement the United Nations Security Council (UNSC) Resolution 2178 in respect of mandatory measures on foreign terrorist fighters;
- imposing enforceable AML/CFT requirements on all moneylenders as part of their licensing requirements; and
- updating the enforceable AML/CFT Guidelines issued by the regulators to provide further guidance on compliance with the AMLO.

69. The following are the main ministries and authorities responsible for formulating and implementing HKC's AML/CFT and counter- PF policies:

i. ministries and co-ordinating committees:

- As mentioned above, the CCC oversees and co-ordinates HKC's AML/CFT policies and key initiatives;
- The Financial Services and the Treasury Bureau (FSTB) provides secretarial support to the CCC; co-ordinates HKC's efforts to deliver AML/CFT policies, strategies, and legislative initiatives endorsed by the CCC; oversees the supervision of the financial sectors; and monitors the effectiveness of HKC's AML/CFT regime and compliance with the FATF Standards;
- The Security Bureau (SB) is responsible for security-related policies; maintenance of law and order; and overall counter-terrorism (CT) strategy, including steering the Inter-departmental Counter Terrorism Unit. It also supports the FSTB in a number of AML/CFT policy areas such as preventive AML/CFT measures for DNFBNs and the declaration/disclosure system for CBNIs. In addition, the Commissioner for Narcotics under the SB is responsible for co-ordinating policy and enforcement work against drug trafficking and related AML efforts;
- The Commerce and Economic Development Bureau (CEDB) oversees the implementation of United Nations Security Council (UNSC) sanctions, including those about counter-proliferation and PF;
- The Inter-departmental Counter-terrorism Unit (ICTU), a cross-departmental platform set up by the SB for co-operation and co-ordination on CT and CFT, promotes intelligence sharing and focuses investigative efforts on important cases requiring joint efforts of LEAs;
- The Inter-Agency Meeting on Implementation of UNSC sanctions related to Proliferation, chaired by the CEDB, co-ordinates territory-wide efforts in relation to counter-proliferation and PF;

<sup>8</sup> Formerly the Clearing and Settlement Systems Ordinance.

- The Steering Committee of ML/TF Risk Assessment under the CCC, chaired by the FSTB, oversees and co-ordinates territory-wide, sectoral, and thematic risk assessment initiatives;
  - The Anti-Money Laundering Regulation and Supervision Co-ordination Group (AMLRSCG) under the CCC, chaired by the FSTB, enables regulators to discuss overarching supervisory issues relating to the implementation of the AML/CFT regime; and
  - The Anti-Money Laundering Regulatory Enforcement Co-ordination Group (AMLRECG) under the CCC enables regulators to discuss operational issues relating to the enforcement of the AML/CFT requirements.
- ii. criminal justice and operational agencies:
- *The Hong Kong Police Force (HKPF)* has the general power for investigating all offences in HKC, including ML and predicate offences. It is also responsible for investigating terrorism, TF, and TFS violations relating to the DPRK and Iran, etc.;
  - *The Customs and Excise Department (C&ED)* is responsible for investigating customs-related offences (e.g. goods smuggling, intellectual property rights infringement, customs fraud, drugs trafficking, etc.) and related ML, and the implementation of the declaration / disclosure system for CBNIs;
  - *The Independent Commission Against Corruption (ICAC)* is responsible for investigating corruption and related ML;
  - *The Inland Revenue Department (IRD)* assesses tax and combats domestic tax evasion, and provides assistance to overseas tax authorities;
  - *The Joint Financial Intelligence Unit (JFIU)* is an independent FIU established and operated jointly by the HKPF and the C&ED for receiving, analysing, and disseminating STRs. It also produces financial intelligence products and conducts operational and strategic analysis; and
  - *The Department of Justice (DOJ)* provides legal advice to LEAs during investigation, prosecutes ML/TF offences, handles restraint and confiscation of crime proceeds and instrumentalities, as well as provides and seeks international co-operation under the MLA, the Letter of Request, and the surrender of fugitive offenders' regimes.
- iii. Financial and non-financial supervisors:
- *The Hong Kong Monetary Authority (the HKMA)* supervises authorised institutions (AIs)<sup>9</sup> and SVF licensees;
  - *The Securities and Futures Commission (the SFC)* supervises licensed corporations (LCs) and other licensees participating in the securities and futures markets;

<sup>9</sup> In this report, the term “bank” is used interchangeably with “authorized institution”.

- *The Insurance Authority* (IA) supervises insurance institutions (IIs) (i.e. authorised insurers, appointed insurance agents and authorised insurance brokers carrying on or advising on long term business);
- *The Money Service Supervision Bureau* (MSSB) under the C&ED supervises MSOs (i.e. money changers and remittance agents);
- *The Companies Registry* (CR) house-keeps the Companies Register and enforces legal and beneficial ownership requirements in respect of companies, and the Registrars of Moneylenders which is part of the CR, supervises moneylenders and TCSPs;
- *The Estate Agents Authority* (EAA) supervises estate agents;
- *The Hong Kong Institute of Certified Public Accountants* (HKICPA) supervises accounting professionals (i.e. certified public accountants, firms of practising certified public accountants and corporate practices); and
- *The Law Society of Hong Kong* (LSHK) supervises legal professionals (i.e. solicitors and registered foreign lawyers).

70. On the operational co-ordination side, there are various platforms including an MOU between the SFC and the HKPF on combating securities-related financial crimes, annual liaison meetings between the HKPF and the HKMA, the ICAC's respective Operational Liaison Group meetings with the HKPF and C&ED, the Inter-departmental Task Force on Wildlife Crime, the ICAC – Banking Sector Operational Liaison Network, liaison meetings between the ICAC and the HKMA and the SFC respectively, and the C&ED's Marine Joint Task Force for combating smuggling activities, etc. Aside from these platforms, LEAs have established procedures for conducting joint operations with other LEAs both locally and overseas, and there have been a number of successful cases. There are also various regular and ad-hoc channels that facilitate collaboration between agencies.

### **Financial sector and DNFBPs**

71. As at end-June 2018, there were 7 599 FIs in HKC. In 2017, financial services accounted for 18% of HKC's GDP and 7% of total employment in the economy.

72. HKC's financial sector is dominated by banks. As at end-June 2018, there were 154 licensed banks, 19 restricted licence banks, and 17 deposit-taking companies in HKC, as well as 47 local representative offices of overseas banking institutions<sup>10</sup>. Together they operate a comprehensive network of over 1 300 branches (or over one branch per square km). Total banking assets amounted to USD 3.05 trillion as at end June 2018<sup>11</sup>. The banking institutions vary widely in terms of size. The 30 higher risk banks (according to the HKMA's categorisation) account

<sup>10</sup> [HKMA Register of Authorized Institutions and Local Representative Offices](#)

<sup>11</sup> [HKMA's Monthly Statistical Bulletin](#)

for over 98% of the total customer base<sup>12</sup> and 84% of total deposits<sup>13</sup>. The banking sector is weighted most heavily throughout this assessment.

73. HKC is also the leading asset and wealth management centre in Asia, with an asset worth of over USD 3.1 trillion under management as at end-2017. While overseas investors account for the majority of the business, their share has been declining from 72% at the end of 2013 to 66% at the end of 2017<sup>14</sup>. Private banking and private wealth management business accounted for around USD 1 trillion at the end of 2017<sup>15</sup>, with customers originating both locally and from a wide range of jurisdictions. The securities sector is weighted as heavily important.

74. There are more than 1 300 MSOs active in HKC handling over USD 1 billion in transactions, with the US, Singapore, the UK, and Mainland China accounting for 74% of outgoing remittances<sup>16</sup>. The cash-intensive nature of this business and the frequent cross-border and one-off transactions make it exposed to ML/TF risk. This sector is weighted as heavily important.

75. SVF licensees represent a growing sector in HKC, with over USD 1 billion in SVF float and deposit in 2018. However, the sector is quite concentrated with 16 licensees in 2018 and one major player (i.e. Octopus card)<sup>17</sup>. This sector is weighted as moderately important.

76. The insurance sector in HKC accounts for around 4% of GDP and the long-term insurance market is concentrated with 15 insurers accounting for 93% of the market.<sup>18</sup> In 2017, total long-term premiums reached USD 56.60 billion and 80% of new premiums from offshore clients were from Mainland China. However, there were no detected cases of misuse of insurance for ML/TF and the sector is weighted as less important.

77. In the context of HKC, moneylenders do not take deposits from customers, and customer loans are the most important type of business. Some moneylenders provide commercial, mortgage, and vehicle loans and the vast majority of the loans are made to the local population. There were over 2,000 moneylender institutions and the total asset size for the sector was around USD 9 billion in 2018. Given its limited scope, the sector is weighted as less important.

78. An overview of the FIs in HKC is tabulated as follows.

<sup>12</sup> At the end of 2016

<sup>13</sup> In September 2018

<sup>14</sup> The SFC's Asset and Wealth Management Activities Survey 2017

<sup>15</sup> The figure covered licensed corporations and banks, as stated in the SFC's Asset and Wealth Management Activities Survey 2017.

<sup>16</sup> No other jurisdiction accounts for more than 1.5% of the remittance value.

<sup>17</sup> It is predominantly used for transport and low-value retail payments with a maximum stored value of HKD 1 000 (approx. USD 130).

<sup>18</sup> HRA 2018

Table 1.1. Overview of Financial Sector

Sector	Institutions	Number	Asset size as at June 2018, unless otherwise specified (USD billion)
Als*	Licensed banks	154	3 047
	Restricted licence banks	19	
	Deposit-taking companies	17	
	Local representative offices of foreign banks in HKC	47	
LCs		2 775	212
IIs	Insurers	67	2017 total long term inforce premiums: 56.60
	Insurance brokers	696	
	Insurance agencies	407	
	Appointed individual agents	62 247	
MSOs	1 309	1 309	1.22 (as at end 2017)
Moneylenders	2 095	2 095	9.1
SVF licensees	13 SVF licensees; and 3 licensed banks currently issuing or facilitating the issue of SVF		1.1 (total SVF float and deposits)

\* Hong Kong has a three-tier banking system. Licensed bank can undertake the full range of banking services. Restricted licence banks can take deposits of at least HKD 500 000 (approx. USD 64 000) of any maturity, while deposit taking companies can take deposits of at least HKD 100 000 (approx. USD 12 750) with a tenor of not less than 3 months. All of these entities are referred to as Authorized Institutions (AI) under the Banking Ordinance.

79. DNFBPs present in HKC are subject to statutory AML/CFT preventive measures such as CDD and record-keeping, except for DPMS. HKC does not have any licensed casinos. Barristers are prohibited under their Code of Conduct from engaging in financial activities or transactions that would bring them under the scope of the FATF Standards, but other legal professionals are subject to AML/CFT requirements. Notaries public are legal professionals and do not in such capacity engage in financial activities or transactions that would bring them under the scope of the FATF Standards.

80. The DNFBP sectors are much smaller in terms of turnover of business as compared with the financial sectors. However, HKC is known to be a jurisdiction with efficient company formation activities and its TCSP sector comprises over 6 000 entities. There is a strong demand for trust or company services given HKC's open economy and status as an IFC and it is an active market for forming and operating companies. In 2017, 160 229 new companies were registered in the jurisdiction, and 118 073 companies were dissolved (i.e., liquidated, de-registered, or struck-off). This sector is weighted heavily. Legal professionals and accountants also operate in this business but less intensively and are therefore weighted as moderately important.

81. The DPMS sector is also important. In 2017, the retail sales of jewellery and precious metals accounted for approximately USD 9 billion while the total export accounted for approximately USD 60 billion, in which around USD 47 billion were re-exported. Gold and specie dominate the export value (90% or USD 53 billion), and 53% (or USD 28 billion) thereof were exported to Mainland China. Given that this sector does not fall within the HKC's AML/CFT framework (except for STR and TFS obligations), it is weighted as moderately important.

82. Real estate transactions in HKC amounted to more than USD 92 billion in 2017, with a significant proportion being residential property. HKC's property

market is open to non-resident investors but they represent a very low proportion, especially with the various rounds of demand side management measures introduced to suppress external demand. Estate agents would typically only process the initial deposits (around 3-5% of the total transaction value), usually as cheques. However, given the high average value of real property in HKC, estate agents may still handle significant funds on behalf of clients. This sector is weighted as moderately important.

**Table 1.2. Overview of DNFBPs**

Sector	Size and distribution	
Legal professionals	Solicitors	10 957
	Registered foreign lawyers	1 505
	Hong Kong law firms	903
	Registered foreign law firms	83
Accounting professionals	Certified public accountants (CPA) with practising certificates	4 769
	CPA firms	1 286
	Corporate practices	575
Estate agents	Licensed estate agents (company)	3 709
	Licensed estate agents (individual)	39 298
TCSPs	Licensed TCSPs	6 106
DPMS	Retail	1 970
	Import/Export	3 330
	Manufacturer/Wholesale	810

### Preventive measures

83. HKC's preventive measures are primarily set out in the AMLO and enforceable AML/CFT Guidelines promulgated by regulators under the AMLO, which cover AIs, LCs, IIs, MSOs, SVF licensees, legal professionals, accounting professionals, estate agents, and TCSPs. Moneylenders are subject to the AML/CFT Guideline issued by the CR (which mirrors the AML/CFT Guidelines issued by other regulators) and enforced as part of their licensing conditions.

84. In terms of exemptions, HKC has applied an exemption threshold for SVFs – currently, it divides SVFs into device-based (CDD is not required where maximum stored value is HKD3 000 or under (approx. USD 380) and network based products. These exemptions were given taking into account FATF Guidance, benchmarking against other jurisdictions and their use in HKC. However they were not fully documented. DPMS and stand-alone financial leasing companies are not included in the AML/CFT framework (except for STR and TFS obligations), but not on the basis of proven low risk.

### Legal persons and arrangements

85. In 2017, private limited companies accounted for around 99% of all corporate body types registered with the CR. As at 31 December 2017, there were 1 369 600 private limited companies in HKC. In 2017, the CR registered 160 229 new companies, while 118 073 companies were dissolved, including 64 128 companies which had been struck off. All HKC companies are required to maintain beneficial ownership information by keeping an SCR as required under the CO. HKC listed

corporations are required to comply with even more stringent disclosure requirements under the SFO<sup>19</sup>.

86. While there are other types of legal persons, they are formed only under specific circumstances for a specific purpose. Investments of open-ended fund companies (OFC) must be managed by a person licensed or registered with the SFC (who are subject to the statutory AML/CFT requirements). Other types of legal persons are typically non-commercial entities which must be democratically controlled and operated. They would normally have highly restrictive use and membership admission/transfer criteria. The number of various types of legal person in HKC as at 31 December 2017 is tabulated below.

**Table 1.3. Type of Legal Persons in HKC**

Description	Number	Description
Private company limited by shares	1 369	A private company limited by shares has a share capital. The liability of its members is limited to any amount unpaid on the shares held by the members. The number of members and members' right to transfer shares are restricted for private company, and invitation to the public to subscribe for any shares of the company is also prohibited. It is the most common type of company for conducting business and trade.
Private unlimited company	600	
Public company limited by shares	14	A private company with a share capital but with no limit on the liability of its members.
Public unlimited company	725	A public company limited by shares is one where there is no restriction on the number of members and on the members' right to transfer shares. Its shares are allowed to be offered to the public.
Company limited by guarantee	0	A public unlimited company is a public company with a share capital but with no limit on the liability of its members.
OFC	13 607	A company limited by guarantee has no share capital. It has members, rather than shareholders, whose liability is limited to the amount that the members undertake to contribute to the assets of the company in the event of a winding-up. The structure is mostly used by NPOs.
Co-operative societies	0	An OFC is a collective investment scheme which is structured in corporate form with limited liability and variable share capital that must be registered with the SFC and holds a certificate of incorporation issued by the CR. It must be managed by an investment manager who is a licensed person subject to statutory AML/CFT requirements. The legal regime for OFC came into force on 30 July 2018. Yet no OFC has been established so far.
Trade unions	175*	A co-operative society is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically- controlled enterprise.
Registered trustee incorporation	888**	A trade union is an entity whose principal object is the regulating of relations between employees, employers and/or employees and employers. Its members must come from the trade, industry or occupation to which the trade union is directly concerned.
Owners' corporations	96	A registered trustee incorporation is a community of persons bound together by custom, religion, kinship, nationality or regional or local interests, or any body or association of persons established for any charitable purpose, to which the Chief Executive of the HKC Government has granted a certificate of incorporation.
Credit unions	10	An owners' corporation is established for the management and maintenance of the common parts of a building or an estate. Its members comprise only the owners of the building or the estate.
	711***	
	44*	A credit union is an organisation the object of which is to promote thrift among its members, to receive the savings of its members, and to make loans to its members exclusively for provident or productive purposes. Its members must share a common bond of occupation, association or neighbourhood.

<sup>19</sup> The SFO requires individuals and corporations who are interested in 5% or more of any class of voting shares in a HKC listed corporation to disclose their interests, and short positions, in voting shares of the HKC listed corporation. The SFO also requires all HKC listed corporations to keep a register of interests in shares and short positions.

Description	Number	Description
Statutory bodies	264****	Statutory bodies are public organisations established by way of a dedicated statute, such as the Hospital Authority.

\*Agriculture, Fisheries and Conservation Department Annual Report 2016-2017

\*\* Annual Statistical report of Trade Unions in Hong Kong 2017

\*\*\* Land Registry Annual Report 2017-18

\*\*\*\* [www.hab.gov.hk/en/policy\\_responsibilities/District\\_Community\\_and\\_Public\\_Relations/advisory.htm](http://www.hab.gov.hk/en/policy_responsibilities/District_Community_and_Public_Relations/advisory.htm)

87. Like other common law jurisdictions, general partnerships in HKC do not have a separate legal personality. In HKC, limited partnerships and limited liability partnerships (LLPs) are forms of general partnerships without a separate legal personality. Only law firms may form LLPs.

88. The common law concept of trust exists in HKC. HKC's trust industry can be divided into four main sectors, comprising corporate trusts, pension schemes, "private" trusts (i.e. trusts set up by individuals), and charitable trusts<sup>20</sup>. While there are no specific statistics on the breakdown, trusts are predominantly managed by professional trustees (i.e., FIs, legal professionals, accounting professionals, or TCSPs) regulated under the AMLO. HKC authorities indicate that pension schemes and corporate trusts are more prevalent, but "private" trusts are also being used for a range of wealth management purposes.

### Supervisory arrangements

89. Part 2 of Schedule 1 to the AMLO designates relevant regulatory authorities (RAs) to supervise respective FIs subject to AML/CFT requirements – the HKMA for AIs and SVF licensees, the SFC for LCs, the IA for authorised insurers, appointed insurance agents and authorised insurance brokers carrying on or advising on long term business (collectively insurance institutions ('IIs')), and the C&ED for licensed MSOs and the Postmaster General<sup>21</sup>.

90. The RAs are the competent authorities under the AMLO for regulating and supervising FIs for AML/CFT purposes. The RAs are empowered under Parts 3 and 4 of the AMLO to supervise and monitor regulated entities' compliance with AML/CFT requirements, including the power to conduct inspections and investigations of FIs, and the power to take disciplinary actions against FIs for non-compliance with the AML/CFT requirements.

91. In addition to the supervisory powers provided in the AMLO which are applicable to all types of FIs and DNFBPs, the HKMA, the SFC, the IA, the RML, the LSHK, the HKICPA, and the EAA are also empowered under their respective regulatory Ordinances to impose a range of supervisory requirements and sanctions to ensure compliance by FIs and DNFBPs with AML/CFT requirements.

<sup>20</sup> Hong Kong Trust Industry Spotlight: Enhancing its competitive edge by KPMG and the Hong Kong Trustees' Association.

<sup>21</sup> This refers to any premises at which the Postmaster General operates a remittance service and any premises at which the remittance service operated by the Postmaster General is managed.

### *International co-operation*

92. HKC has a comprehensive framework for international co-operation, with incoming and outgoing MLA and extradition requests coming from / going to a wide range of jurisdictions. The Mutual Legal Assistance Unit (MLAU) of the DOJ is the central authority for processing all incoming and outgoing MLA and extradition requests. There is also the Letter of Request mechanism for assistance to be sought from and provided to courts in other jurisdictions (including other parts of China) by way of letters of request issued by courts. LEAs and other agencies such as the IRD are also active in providing assistance to their international counterparts through established channels and mechanisms.



### Key Findings and Recommended Actions

#### *Key Findings*

- a) HKC has a reasonably good level of understanding of its ML/TF risks. HKC's risk understanding is largely reflected in its 2018 National Risk Assessment (HRA). Some competent authorities (e.g. the HKPF, the HKMA) have conducted their own targeted assessments which have a positive effect on HKC's overall risk understanding.
- b) HKC largely recognises the range of ML threats it faces but the level of understanding could be stronger. It has an in-depth understanding of its main risks relating to fraud and drug trafficking, and the common typologies used to launder proceeds (e.g. through bank accounts, including stooge accounts). This understanding is based to some extent on ML investigations, including requests for assistance, as a barometer of the level of risk associated with different ML threats. In regard to other higher ML threats such as foreign corruption and tax crimes, the lack of ML cases has an impact on the authorities' appreciation of the full extent of risks, although they have sought to mitigate this by taking into account international typologies and other qualitative information. The authorities assess ML related to cash smuggling to pose a limited threat but the issue would benefit from regular review, having regard to developments in neighbouring jurisdictions. TBML is another key area where regular reviews are important.
- c) The banking sector is identified as facing higher risk consistent with HKC's status as an international financial and trading centre. The medium-high risk assessments for TCSPs and MSOs, as well as medium risk assessments for the securities, legal, accounting and real estate sectors, appear reasonable. The DPMS sector was assessed to be medium-low/medium risk; however, the exemption of the sector from AML/CFT requirements was not made on the basis of a proven low ML/TF risk. There are a small number of stand-alone financial leasing companies and FI credit card companies<sup>22</sup> which are exempted from AML/CFT requirements, but not on a clearly proven low risk. The exemption thresholds used for SVFs, while not unreasonable, were not adequately documented.
- d) HKC has considered the ML/TF risk of abuse of legal persons and legal arrangements. However, the assessment would benefit from a more detailed discussion of the full range of legal persons that can be established or are operating in HKC.
- e) HKC has a good understanding of its TF risk, which is informed by both the HRA exercise and more importantly, additional analysis based on investigations of potential TF cases

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<sup>22</sup>. At the time of the assessment, the said company is subject to AML/CFT requirements for its MSO activities.

and intelligence from the Force Steering Group Committee on Counter Terrorism (FSCCT), which sits within the HKPF and assesses intelligence from all relevant LEAs.

- f) The 2018 HRA articulates a high level AML/CFT policy which has a strong focus on complying with international AML/CFT standards and implementing regulatory measures. It sets out a five-pronged approach to address the risks, and was supported by an action plan and with specific leads and agencies identified. Progress was monitored by CCC and tracked using a reporting system, although in some cases, the timelines were not always clear, mainly as a consequence of external factors relating to the legislative and consultation process.
- g) The objectives and activities of competent authorities are generally consistent with the areas of identified higher ML/TF risk, particularly fraud and deception cases which are identified by authorities as higher risk for ML, but less so for other higher risk ML areas (e.g. ML linked to foreign tax and corruption).
- h) Aside from the CCC, there are other inter-agency mechanisms and operational groups, relating to the analysis and sharing of STR trends, AML/CFT supervisory information and operational liaison meetings (e.g. between the HKPF and the ICAC). Informal co-operation is dependent on the authorities having developed a good working relationship, and in most cases they have, but this can be enhanced further, particularly for the SRBs.
- i) The Commerce and Economic Development Bureau (CEDB) is the co-ordinating bureau on PF, and convenes an adequate inter-agency platform which include key agencies to discuss PF issues.
- j) Where appropriate, agencies have worked with the Privacy Commission.

### *Recommended Actions*

- a) HKC should continue its ongoing efforts to review and update its ML/TF risk assessment and take steps such as to: (i) more closely review the ML threats arising from corruption and tax evasion; (ii) update its understanding of cross-border cash smuggling risk, potentially in collaboration with neighbouring jurisdictions as appropriate, (iii) fully document and complete its update of the ML/TF risk assessment and the exemptions applied for SVFs; (iv) review vulnerabilities relating to the few stand-alone financial leasing companies (to support their exemption from AML/CFT requirements, as appropriate); and (v) undertake a more comprehensive assessment of the ML/TF risks of different types of legal persons and of trusts.
- b) HKC should review and put in place the appropriate level of AML/CFT requirements for the DPMS sector having regard to the ML/TF risks.
- c) Authorities should take further steps to monitor and ensure that information sharing, objectives and activities of competent authorities are consistent with the other higher ML risks identified in the HRA (e.g. ML threat posed by foreign corruption, tax evasion).
- d) The authorities should take additional steps to disseminate and communicate its ML/TF risk assessment to better ensure that the private sector, particularly DNFBPs, are aware of their ML/TF risks.

93. The relevant Immediate Outcome considered and assessed in this chapter is IO.1. The Recommendations relevant for the assessment of effectiveness under this section are R.1, 2, 33 and 34.

## Immediate Outcome 1 (Risk, Policy and Co-ordination)

### *Jurisdiction's understanding of its ML/TF risks*

94. HKC has a reasonably good level of understanding of its ML/TF risks. This understanding is largely informed by the territory-wide risk assessment exercise which was developed over several years and culminated in the HRA (published in April 2018).<sup>23</sup> The HRA was supported by the Risk Assessment Unit (RAU) staffed by the HKPF, and overseen by the Steering Committee of Risk Assessment (led by the FSTB) and comprised a range of law enforcement, supervisory and policy agencies. The HRA was mainly based on the World Bank National Risk Assessment Tools (WBT) and considered a range of quantitative and qualitative information.

#### *ML Risk Understanding*

95. HKC has considered and recognises the range of ML risks it faces, but the level of understanding can be stronger. It has an in-depth understanding of its main risks, such as fraud and drug-trafficking, and the common typologies used to launder proceeds (e.g. through bank accounts including stooage accounts<sup>24</sup> and shell companies). Its understanding of the other major threats could be more developed. This is partly a result of its reliance on ML investigations, including requests for assistance, as a barometer of the level of risk associated with different ML threats – this appears to lead to stronger focus on fraud.

96. As regard other risks such as those relating to foreign corruption and tax crimes, the lack of ML cases has an impact on the authorities' appreciation of the full extent of risks, although they have sought to mitigate this by using additional indicators and qualitative information, such as through news surveillance, international typologies review and general literature review. For instance, aside from ML investigations and requests for assistance, the authorities have considered adverse news from neighbouring jurisdictions which highlights corruption and tax evasion as key threats<sup>25</sup> for the Asia/Pacific region.

97. While organised crime and triad activities were not assessed separately, HKC authorities noted that such groups are frequently associated with crimes such as fraud, drug trafficking, gambling, vice and blackmail, rather than constituting a separate crime type. Statistical analysis of ML cases by HKC suggests that most foreign predicate offences originate from the US and Mainland China, and aside from fraud, the highest number of MLA requests relate to tax crimes and corruption.

98. The authorities assess ML related to physical cross-boundary cash movement ("cash smuggling") to pose a limited threat, relative to the misuse of the financial system, but this assessment would benefit from further review. While there have

<sup>23</sup> Please see: [www.fstb.gov.hk/fsb/am/en/risk-assessment.htm](http://www.fstb.gov.hk/fsb/am/en/risk-assessment.htm)

<sup>24</sup> This include online business fraud, email scam and social media scam

<sup>25</sup> Taken from APG Typology Reports

been only two cases of ML involving cross-border cash movements since 2011 and minimal STRs or interception of mailed CBNIs, since the implementation of the declaration regime for incoming CBNIs, there has been a large number and high value of movements, including from neighbouring jurisdictions, which should be further analysed (see IO.8 for further details). As at October 2018, the majority of declarations (77% of those made by arriving travellers and 97% of those concerning cargoes) were bulk cash movements for banks. Mainland China's CBNI limit of RMB 20 000 (USD 5 000) is seen as mitigating cash movement across HKC's main border. Nevertheless, there are potential residual risks that could involve attempts to circumvent Mainland CBNI and ATM restrictions, a view which was supported by some of the feedback provided during the on-site visit. CBNI reporting combined with other intelligence and potential collaboration with neighbouring jurisdictions could be used to update HKC's understanding of its cash smuggling risk.

99. The banking sector was rightly assessed to have high ML risks. Apart from fraud risks in relation to money mules (including individuals of various nationalities and corporates domiciled in different jurisdictions), other predicate offences to which the banking sector is vulnerable include: foreign tax evasion and foreign corruption, particularly in the wealth management segment. TBML is also another area of vulnerability.

100. MSOs and TCSPs were assessed to face medium-high risks, which appears reasonable. Typology studies show that MSOs have been misused as conduits for foreign predicates and about 4% of the major cross-border ML cases involved MSOs. Other risks relate mainly to the cash-intensive nature of money-changing, and frequent walk-in and one-off transactions. For TCSPs, the main risks relate to the abuse of shell companies and use of their bank accounts as repositories of crime proceeds, particularly where there is a cross-border element involved (e.g. fraud schemes, drug trafficking and corruption). HKC noted that cases of complicit involvement of professionals in ML are infrequent, e.g. 16 out of 97, and 10 out of 85, ML cases leading to convictions involved the use of TCSP services in 2015 and 2016 respectively.

101. The securities, legal, accounting and real estate sectors were assessed to be facing medium risks which is generally reasonable. HKC's initial risk assessment on SVFs was medium risks and while not unreasonable, would benefit from an update and with fuller supporting documentation (see para. 115, Exemptions below). The DPMS sector was also assessed to be medium-low/medium risk. Recognising virtual assets as an emerging globally risk, HKC included an initial assessment, assessing it as medium-low risk.

102. HKC has also considered the ML/TF risk of potential abuse of legal persons and legal arrangements (i.e. trusts) in the context of the HRA exercise. HKC acknowledged that ML syndicates may abuse the efficient and open business environment which allows easy formation of shell companies to launder proceeds of crime, and common typologies include the use of shell companies formed by stooges to layer funds, hide beneficial ownership and commingle legitimate and illegitimate activities, etc. HKC authorities explained that LLPs can only be formed by law firms and the risks, covered as part of the ML/TF risk assessments for lawyers. The assessment would benefit from a more detailed consideration of the range of legal

persons (e.g. partnerships) that could be established or are operating in HKC, and of trusts.

103. While HKC demonstrates a reasonably good understanding of its ML/TF risks, the HRA would benefit from additional information such as the customer and jurisdictional profile from the recently regulated DNFBPs, as well as further consideration of feedback from the private sector.

104. To elaborate, supervisors in sectors that have been regulated for some time (e.g. the HKMA) are able to have an accurate assessment of the inherent risks and controls in their sector; particularly where they had considered inputs from experts in the private sector. However, this was more challenging for DNFBPs as there were no designated AML/CFT supervisors in some of the sectors until recently. For DPMS, there is still no designated AML/CFT supervisor.

#### *TF Risk Understanding*

105. HKC has separately assessed its TF threats and vulnerabilities and has a good understanding of its TF risk. This was informed by both the HRA exercise and more importantly, additional analysis based on investigations of potential TF and intelligence from the FSCCT, which sits within the HKPF and assesses intelligence from all relevant LEAs.

106. HKC noted that as an IFC, it may be susceptible to the potential threat (as was also supported from their TF investigations) of financing of terrorism activities abroad or TF activity conducted outside and routed through HKC. Relevant threat factors include terrorist groups that may be operating in parts of Mainland China (e.g. the East Turkestan Islamic Movement), foreign minority groups within HKC that may be sympathetic to foreign terrorist groups, and NPOs supporting services in conflict zones.

107. Overall, HKC has identified its TF risks to be medium-low, with banks and MSOs identified to be more susceptible to TF risk, particularly in relation to potential risks arising from minority groups that may be sympathetic to foreign terrorist groups. Banks were also noted to have a higher level of awareness of their TF risks and tend to have better controls in place; but MSOs have a lower understanding of TF risks and uneven level of controls, with the larger MSOs having better controls. While HKC is aware of the risks of NPOs being potentially misused to move funds to support terrorism overseas, the overall TF risk has been assessed to be low as there were no reports, STRs, intelligence or investigations suggesting that NPOs are being abused in HKC, or found to sympathise with or encourage terrorism.

108. Authorities provided case studies indicating the potential use of cash, remittance (both licensed and unlicensed) and precious stones and metals in HKC to finance terrorism activities outside of HKC. While those investigations did not find TF activity in HKC per se, this is an area of risk HKC has identified for heightened monitoring, and authorities are encouraged to pay additional attention to the threat from abroad.

#### ***National policies to address identified ML/TF risks***

109. HKC recently published its AML/CFT policy in its HRA. It addresses the identified key ML/TF risks at a high level and includes:

- a) *Commitment to address ML/TF risks and comply with international AML/CFT standards.* HKC has enacted the AMLO in 2012 and recently introduced new AML/CFT requirements for a number of DNFBPs and other legislative amendments such as the cross-border CBNI declaration/disclosure regime and the SCR regime.
- b) *Deterring and detecting illicit fund flows through HKC.* HKC seeks to achieve this by adopting a RBA, and there are positive results from the HKMA and the SFC. For the other sectors that were only recently regulated for AML/CFT, more time is needed to gauge whether the measures are sufficient.
- c) *Combat ML/TF and restrain and confiscates illicit proceeds.* There is a strong focus in terms of policy and operations to seize and restrain proceeds of crime. The HKPF has identified ten major proceeds-generating crimes that investigation units are required to examine financial aspects with a view to identifying ML activities and assets for confiscation. The HKPF's initiative to set up the Fraud and Money Laundering Intelligence Task Force (FMLIT) and the Anti-Deception Co-ordination Centre (ADCC) has also contributed positively to the outcomes.
- d) *Foster strong international collaboration to disrupt global ML/TF threats.* This can be seen in HKC's ability to provide generally good co-operation with its foreign counterparts and contribution to key AML/CFT forums such as the FATF and the APG.
- e) *Promote the awareness and build the capacity of private sector stakeholders.* The publication of the HRA and engagement of the industry is one example of such ongoing efforts, and with the respective authorities recognising that more can be done, especially for the DNFBPs.

110. The high-level CCC provides a good platform for policy co-ordination on the key ML/TF risks identified. A number of working groups and inter-agency mechanisms (see para. 69) support the work of the CCC. The work of the CCC was also supported through an Action Plan, and with specific leads and agencies identified. Progress was monitored by CCC and tracked using a reporting system, with specific updates on key milestones. However, in some cases, the timelines were not always clear, mainly as a consequence of external factors relating to the legislative and consultation process.

### *Exemptions, enhanced and simplified measures*

111. In general, FIs and DNFBPs regulated for AML/CFT are required to adopt enhanced measures for higher risk situations and simplified measures may only be adopted for lower risks situations. The simplified measures allow the possibility of not having to identify and verify the beneficial owner of an investment vehicle which is supervised for AML/CFT compliance in a jurisdiction considered as having equivalent AML/CFT framework, including all FATF members. In so far as there is good co-operation, this should not be an issue.

112. HKC has reviewed and updated its previous assessment of low ML/TF risk to exempt credit unions from AML/CFT requirements. HKC has also applied exemption thresholds for SVFs; it divides SVFs into device-based (CDD is not required where maximum stored value is HKD 3 000 or under (approx. USD 380) and network-based

products. Network-based products are further divided into reloadable (CDD is not required where the maximum stored value is HKD 3 000 or under and annual transaction amount does not exceed HKD 25 000 (approx. USD 3 200)) and non-reloadable (CDD is not required where the maximum stored value is HKD 8 000 or under (approx. USD 1 000)) facilities. While HKC has considered FATF Guidance, benchmarked against other jurisdictions and the use of SVF products in HKC, the assessment were not fully documented. Hence, while the results do not appear unreasonable, HKC should take appropriate steps and document that the exemptions were fully justified.

113. HKC should take additional steps to confirm the low ML/TF risks from the small number of stand-alone financial leasing companies, and credit card companies operating independently of FIs, to clearly justify their exemption from AML/CFT requirements. While HKC authorities explained that there are only about 20 stand-alone financial leasing companies (i.e. not affiliated to banks and/or money-lenders) with approximately 140 staff, and indicated in an undated document of the threat assessment done, it was not clear that the ML/TF risk was low or had been approved by the CCC. For credit card companies, while it was noted that most of them are linked to banks, and accounted for the vast majority of transactions, it was not clear that there was an independent assessment of the low ML/TF risk to exempt non-bank credit card companies or that it was endorsed by the CCC – nonetheless, it is noted that thus far, there is only one non-bank credit card company operating in HKC, and it is regulated as an MSO in HKC, hence this is only a minor issue.

114. HKC has exempted DPMS from AML/CFT requirements and supervision. Given HKC's assessment that the sector is medium/medium-low risk, cases (including seizure and confiscation statistics) and feedback received during the on-site, the risks in the DPMS sector do not justify its exemption from AML/CFT requirements.

### *Objectives and activities of competent authorities*

115. Guided by the CCC, agencies have taken steps, particularly in terms of legislation, to address most of the ML/TF risks identified in the HRA. This includes amendments in 2018 to the UNATMO and the AMLO, the Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance (R.32 Ordinance) as well as to the Companies Ordinance in relation to beneficial ownership of legal persons.

116. Respective agencies have taken steps to address some key threats and vulnerabilities identified in the HRA. From the enforcement perspective, HKPF's operational priorities in 2018 include a focus on: (i) violent crime; (ii) triads, syndicated and organised crime; (iii) drug trafficking; (iv) quick cash crimes (including those arising from fraud); (v) cyber security and technology crime; (vi) public safety; and (vii) counter terrorism. As noted above, the HKPF has also identified ten major proceeds-generating crimes that investigation units are required to examine with a view to identifying ML activities and assets for confiscation. The HKPF has formed the FMLIT and the ADCC to tackle the highest threat area identified in the HRA (fraud/deception), and has a dedicated bureau (the Narcotics Bureau) to combat drug-trafficking and related crimes. The C&ED and the ICAC have also stepped up relevant training, with the C&ED having a dedicated Financial Investigation Group to investigate related ML, and the ICAC setting up a dedicated

international & Mainland (operational) liaison section. Statistically, international co-operation is consistent with the HRA; ML investigations and prosecutions are consistent with the HRA to some extent, as fraud-related<sup>26</sup> and stand-alone ML investigations (especially mules type) dominate LEA actions. Other crime types account for markedly lower numbers of ML investigations, 24% of prosecutions and convictions, and more for confiscations (see IO.7 and IO.8).

117. Supervisory authorities, particularly the HKMA, the SFC and IA, have taken steps to refine their RBA and focus on key thematic areas (e.g. TBML for the HKMA, risks from Mainland China clients for the IA), and other supervisors such as the CR have begun taking steps (since March 2018) to supervise TCSPs. Some of these measures are also at a relatively nascent stage, and supervision relating to MSOs, estate agents as well as the legal and accounting profession could be further strengthened, with a particular focus on the risk awareness, especially cross-border risks. With the exception of some AML/CFT outreach, limited activities, have occurred to address the risks emanating from the DPMS sector.

### *National co-ordination and co-operation*

118. The CCC provides a good platform for high-level policy co-ordination and it was instrumental in overseeing the implementation of various new AML/CFT legislations and resourcing increases. The CCC meets on a need to basis (approximately once a year, though it met five times between 2017 and 2018) and has put in place mechanisms to monitor how the policy objectives are achieved by discussing key policy papers, approve the key HRA findings, and tracks updates on AML/CFT enforcement statistics. As noted, the CCC's monitoring is supported by an Action Plan, as well as follow-up progress reports to the CCC with clear delineation of responsibilities for each action item. Once the CCC provides the overall policy steer, individual policy bureaux are responsible for the ensuring and co-ordinating the formulation and implementation of relevant policies, in collaboration with relevant departments, supervisors, and other stakeholders.

119. The RAU and the Steering Committee on Risk Assessment provided co-ordination for the HRA exercise, and meets about twice a year and with key operational issues left to agencies to implement, monitor and co-ordinate independently.

120. There are a number of other working groups which facilitate inter-agency co-ordination relating to AML/CFT. For instance, the JFIU leads the Suspicious Transactions Reporting Working Group and provides high-level STR information and trends to LEAs and supervisors, though the sharing of certain case-specific information, particularly for AML/CFT supervisors, could be further enhanced. Although this is already being done to some extent through initiatives such as the FMLIT, more can be done to enhance the level of operational co-operation and co-ordination, particularly on the sharing of information in relation to the detection and investigation of cross-border and complex ML.

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<sup>26</sup> This would include TBML cases where there is a fraud element. However, they form only a small proportion of the cases.

121. While there is good co-operation between the HKMA, the SFC and the IA, some co-operation and co-ordination challenges exist with regard to the other supervisors, including SRBs. For instance, SRBs are not included in the AMLRSCG, and thus do not benefit from the more experienced AML/CFT supervisors. In practice, co-ordination and co-operation works reasonably well, although in some areas, it can be further enhanced (e.g. while the HKMA had various initiatives with the banking sector, the relevant findings could be shared with LEAs in a more timely manner; the FMLIT does not yet include the ICAC/ the C&ED). Authorities should thus continue to monitor and ensure co-ordination and co-operation continues to work well and is strengthened as required.

#### *Co-ordination and Co-operation for Proliferation Financing*

122. Co-ordination of PF issues is generally adequate. The CEDB is the co-ordinating bureau for PF and convenes an inter-agency platform which includes key agencies such as the FSTB, the HKPF, the C&ED, CR, and the HKMA. Most of these agencies are also members of the CCC and there is a level of synergy between the two bodies.

123. Updates on TFS on the DPRK and Iran, as well as intelligence, are shared through this platform, and it is generally adequate. For instance, the HKPF has shared information of companies of concern to the CR which has taken initial steps to review and consider if regulatory actions (e.g. subject companies to check, prosecution or striking off) could be taken.

#### *Data Protection and Privacy*

124. Where appropriate, AML/CFT competent authorities have worked with the Privacy Commission. The Privacy Commission is also aware of the need to strike the right balance between privacy and combating ML/TF (including the need to meet HKC's international obligations in this aspect), and in practice, the Privacy Commission takes an active interest and provide a range of feedback (e.g. through public consultation or bilaterally) on key AML/CFT measures proposed.

#### *Private sector's awareness of risks*

125. As part of the HRA exercise, authorities consulted industry and sought their input through the use of industry focus groups, consultations and questionnaires. Since the publication of the HRA, supervisory authorities such as the HKMA, the SFC, the IA, the C&ED and the CR etc. have taken steps to share and communicate the key findings (e.g. through circulars) and to raise awareness of the HRA to entities regulated by them. The SB has also taken steps to disseminate the HRA findings to the DPMS sector.

126. Many private sector representatives indicated that they found the HRA useful and there was a generally good level of awareness of the publication of the HRA. FIs were largely familiar with the contents specific to their sector, and most of the private sector also indicated broad agreement with the key threats (e.g. in relation to fraud) and vulnerabilities (e.g. banking, MSO and TCSPs as higher risk) identified.

127. Some feedback from the private sector indicated that the HRA could better take into account the level of threats and vulnerabilities facing HKC, and the

authorities should consider how it could better take them into account in its next iteration.

2

128. The private sector's understanding of TF risks is uneven, and appears largely correlated to how long those sectors have been supervised. Some sectors, particularly the DNFBPs, are mainly focused on designated entities or only focused purely on the domestic aspect.

### *Overall conclusions on IO.1*

129. **HKC has achieved a substantial level of effectiveness for IO.1.**

### Key Findings and Recommended Actions

#### *Key Findings*

##### *Immediate Outcome 6*

- a) LEAs regularly use a broad range of information to investigate and develop evidence related to ML, TF and associated predicate offences. Key HKPF and C&ED investigative units extensively use their direct online access to the JFIU database to quickly access and tailor financial intelligence to meet operational needs. JFIU access to a wide range of information, particularly online criminal and customs data, supports generally effective data matching to corroborate leads and produce actionable intelligence.
- b) Disseminations of STRs have continued to rise significantly since 2013, reflecting increased STR reporting and the JFIU's efforts, with other regulators and the banking sector (which files most STRs), to improve STR quality. Under-reporting by most MSOs and DNFBPs (particularly TCSPs which, like MSOs, which are assessed as medium-high risk), limits financial intelligence, although this is partly mitigated by STRs from banks and improved company information.
- c) The main legal and intelligence-sharing foundations of the CBNI system are newly in place and it is too early to assess the system's effectiveness in terms of supporting operational needs.
- d) The JFIU supports operational needs to a large extent, notably through analysing and disseminating an increasing number of STRs and the value-added operational financial intelligence it provides. The JFIU recently enhanced its strategic output beyond providing feedback to Reporting Entities (REs) on typologies and STR trends, and has started to produce reports of value for operational targeting, supervision and policy, but the scope has been fairly limited. The JFIU's online database and strategic input support HKC's recently established fraud and ML public/private partnership mechanism (FMLIT).
- e) The JFIU's practice of manually analysing all STRs helps identify intelligence to support LEAs and monitor STR quality to provide feedback to REs. Scope exists however to complement or modify this approach with less-resource intensive methods that would allow resources to be shifted to produce more enriched intelligence reports and strategic analysis.

##### *Immediate Outcome 7*

- a) LEAs identify and initiate financial investigations in a significant number of ML cases each year (approximately 1 600), with about 60% progressing to full investigations. The

majority of ML investigations (70%) relate to fraud/deception cases (both domestic and foreign), which the authorities say are more identifiable than other major threats.

- b) While LEAs use a generally sound range of avenues to identify ML, the largely foreign nature of many major ML threats poses difficulties for LEAs to detect and in particular investigate ML. LEAs have increased information sharing and conducted a number of joint operations with foreign counterparts to address these difficulties, but the lower number of foreign non-fraud cases in part highlights the hurdles authorities face and that the current significant effort on international co-operation needs to expand.
- c) The authorities investigate and prosecute ML consistent to some extent with the risk profile. The disparity between fraud and non-fraud ML cases appears wider than the difference expected between high and medium-high risks. While the robust approach to combating domestic and foreign fraud is generally in line as it is the highest assessed threat, additional efforts are needed to effectively combat large-scale/complex fraud, ML syndicates and foreign predicate ML in line with HKC's risk profile. The major non-fraud related risks (drugs, foreign tax evasion and corruption, goods smuggling, as well as stand-alone ML where the predicate is unable to identified) account for less than 30% of ML investigations. It appears that few of these foreign predicates have been prosecuted for ML (although an unknown number of such cases are handed over to foreign jurisdictions to investigate and prosecute both the foreign predicate and ML offences).
- d) HKC has made significant efforts to pursue and investigate ML and has demonstrated an ability to prosecute all forms of ML. The number of prosecutions (averaging 120 per year) and convictions (averaging 95 per year) are however at a much lower level than the number of investigations (as many of them do not proceed beyond preliminary stages). This appears to be due to a combination of factors such as the lack of referrals to prosecute by LEAs as well as a cautious approach by the Prosecution Division (PD) of DOJ. While some successes have been observed, the excellent stand-alone ML provision has not led to a commensurate number of prosecutions which may suggest some potential gaps in practice.
- e) The large majority of sentences imposed are at the lower end of the sanctioning scale, with fewer than 10% of sentences imposed for four years or more. While sentences may be appropriate and proportionate in individual lower end cases, there are concerns as to whether the sanctions being applied are effective and dissuasive at a systemic level given the nature of ML/TF risks in HKC. HKC has not yet prosecuted a legal person for ML.

#### *Immediate Outcome 8*

- a) HKC has increased confiscation action since its last mutual evaluation. Confiscation is a high priority and there are clear procedures and systems observed in all agencies involved, as well as largely comprehensive legislation.
- b) HKC also employs a number of additional tools to aid confiscation efforts such as the Letter of No Consent (LNC) Mechanism and more recently, the Anti-Deception Co-ordination Centre (ADCC) which have been largely successful in helping to restrain large amounts of proceeds involved in fraud and deception.

- c) HKC actively responds to requests from foreign counterparts and partakes in asset sharing but the volume of outgoing requests does not appear to be fully in line with HKC's risk profile.
- d) HKC has only recently implemented its system to combat falsely declared or undeclared cross-border movements of currency and bearer negotiable instruments. There has not yet been confiscation of crime proceeds or terrorist property arising from enforcement of the system. Effectiveness in this area is yet to be demonstrated.

### *Recommended Actions*

#### *Immediate Outcome 6*

- a) Further increase the JFIU's outreach to MSOs and DNFBP sectors (particularly TCSPs) to improve STR quantity and quality, including through promoting the use of the updated standardised STR template.
- b) The JFIU should build closer ties with the Immigration Department to promote timely access to immigration information.
- c) The JFIU, the HKPF and the IRD should explore ways to enhance intelligence on foreign tax crime proceeds consistent with international obligations.
- d) The JFIU should continue its efforts to increase output of value-added operational financial intelligence reports and strategic intelligence, while exploring alternative ways to refine STR triage and complement the practice of analysing all STRs.
- e) The JFIU and LEAs should consider: (i) enhancements to the JFIU IT system to harness advanced technologies such as big data analysis; (ii) the intelligence value and feasibility of obtaining additional information sources, such as international wire transfer reports, for strategic purposes; and (iii) whether forming a separate specialist financial intelligence and investigations bureau within the HKPF would strengthen capability.
- f) Continue to develop information-sharing with the private sector to enhance financial intelligence and understanding of typologies, particularly related to the major proceeds-generating foreign predicates.

#### *Immediate Outcome 7*

- a) Clearly prioritise investigating and prosecuting non-fraud ML, particularly in relation to foreign predicates such as corruption and tax crimes. Ensure that LEAs do more to target complex, large-scale ML, including cases involving foreign proceeds of crime, and consider adopting a high-end ML investigation and disruption strategy to help achieve this objective.
- b) LEAs should continue to prioritise the detection and investigation of the financial component of predicate offence, as well as explore how to improve understanding of typologies related to major risks.
- c) Consider expanding the FMLIT's membership and remit to include key agencies and private sector partners involved in combating major ML risks.

- d) LEAs should continue to engage foreign counterparts, particularly major overseas partners, to explore opportunities to increase joint operations to combat key cross-border threats.
- e) HKC should consider enhancing its statistics on the number of investigations by LEAs to the Prosecution Division (PD) of DOJ, and predicate prosecutions undertaken, to provide a clearer picture of the extent to which ML is prosecuted, and the reasons why it is not.
- f) Given HKC's position as an IFC and the ease of setting up corporate entities within the jurisdiction, HKC should be more proactive in prosecuting legal persons involved in ML.

#### *Immediate Outcome 8*

- a) HKC should enhance efforts to follow assets abroad to better combat the high-risk crimes identified in its risk profile.
- b) HKC should amend its legal framework to ensure that the HKD 100 000 threshold (approx. USD 12 750) in OSCO is removed.
- c) HKC should take steps to ensure adequate co-ordination with foreign counterparts regarding cross-border movement of CBNI, including the detection and confiscation of undeclared CBNI.

130. The relevant Immediate Outcomes considered and assessed in this chapter are IO.6-8. The Recommendations relevant for the assessment of effectiveness under this section are R.1, 3, R.4 and R.29-32.

### **Immediate Outcome 6 (Financial Intelligence ML/TF)**

#### *Use of financial intelligence and other information*

131. HKC authorities regularly use a broad range of information to develop evidence on and investigate ML, TF and associated predicate offences. The JFIU, the HKPF and other LEAs obtain, cross-match and analyse data that extends across financial, criminal and customs intelligence to regulatory, company, land ownership, housing and other information (see table 3.1). The JFIU can directly access a large body of information online or obtain it indirectly.

**Table 3.1. JFIU access to extrinsic data**

Department/Agency	Details of Information	Access
Immigration Department	Registration of persons / Hong Kong Identity Cards and travel documents / marriage, births and deaths register / travel movement records	By letter/memo
Transport Department	Vehicle and driver licensing information	Direct online
Land Registry	Ownership of properties and related records	Direct online
CR	Basic and legal ownership information and related records of companies	Direct online
Hong Kong Jockey Club	Betting records	By letter/memo
Hong Kong Confederation of Insurance Brokers and Professional Insurance Brokers Association	Authorised insurance brokers	Direct website
Hong Kong Housing Authority	Public tenancy information	By letter/memo
HKMA	Licensed banks, restricted license banks and deposit-taking companies	Direct website
SFC	Securities, futures and leveraged foreign exchange intermediaries which are licensed or registered by the SFC to carry on business in Hong Kong	Direct website
IA	Registered appointed insurance agents	Direct website
IRD	Records of ownership of sole proprietorship, and partnership businesses with business registrations, list of charitable institutions and trusts of a public character which are exempt from tax under section 88 of the Inland Revenue Ordinance (Cap. 112)	Direct online or website
MSSB	Licensed MSO information	Direct website
Social Welfare Department	Social security record	By letter/memo
Hong Kong Stock Exchange	Shareholding information and disclosed interests of listed companies	Direct online
Telephone and internet service providers	Telephone and internet subscriber information	Indirect electronic via designated HKPF unit

132. A key strength is the interfaced online access across the main police and customs databases with the JFIU database (known as STREAMS – STR and Management System). The interface automates data-matching of STRs against persons of interest to police and customs, sensitive criminal intelligence, conviction records and since July 2018 CBNIs. This helps to integrate a variety of intelligence and automate data cross-matching to identify high-risk STRs and develop intelligence value. Two-hundred and seventy users across the crime/vice units of the HKPF at the headquarters, regional and district levels, and the four C&ED officers posted to JFIU, have direct access to JFIU data. The very large number of online searches of JFIU data – now averaging over 120 000 a year – demonstrates the extensive use and value of LEAs’ direct access to STRs.

133. LEAs make substantial use of JFIU information and employ a wide range of other intelligence and data for investigations. With a law enforcement-type FIU set-up, use of financial intelligence for investigations is high among HKPF units. As table 3.2 below shows, STRs have triggered nearly 700 ML and TF investigations and contributed to over 3000 ML and TF investigations between 2013 and 2017. Housing JFIU alongside the Financial Investigations Division (FID) in the Narcotics Bureau (NB) helps support interaction and feedback between intelligence producers and operational consumers. Likewise, the joint HKPF-C&ED model also enables information sharing between the JFIU and the C&ED.

134. The assessment team’s discussions with different HKPF units and case studies indicate that police without online STREAMS access, at the regional and district levels, also consider financial intelligence when exploring the financial elements of predicate crimes. Online or written requests for JFIU information from units/agencies without

direct access to STREAMS have increased to over 3,000<sup>27</sup> a year since 2016. Additional staffing and IT enhancements have helped the JFIU manage the growing number of online and written requests.

135. Dedicated financial investigation units in the HKPF (FID) and the C&ED (the Financial Investigation Group (FIG)) also support the use and fusion of financial intelligence with other information. The FID and the FIG are well resourced and have procedures for evaluating, selecting and developing information for intelligence analysis and investigation. This includes examining STRs and considering the prospect they offer for ML and/or predicate investigations. Sharing access to interfaced databases also increases the likelihood that the HKPF and the C&ED intelligence work and investigations will incorporate financial intelligence.

**Table 3.2. Use of JFIU information in ML, TF and other investigations<sup>28</sup> 2013 to 2017**

	HKPF	C&ED	ICAC	IRD <sup>29</sup>	THE SFC
Investigations triggered by JFIU information	698 <sup>30</sup>	369	3	159	5
Investigations using JFIU information	3 049	120 <sup>31</sup>	30	8	194

136. LEAs regularly use other non-FIU information to open ML files or parallel financial investigations when predicate investigations indicate a financial link. Depending on the nature of the case, asset scanning of bank, property, company and business, ownership structures, personal records and travel information routinely occurs in parallel financial investigations. The JFIU and LEAs may also place targets on the Immigration watch-list to receive immediate alerts on their cross-border movements (or the stop-list for their interception). Case studies show the JFIU's indirect access to immigration data appears adequate for developing financial intelligence for operational needs, but on occasion delays have occurred in receiving information. In view of the importance in HKC's context of tracing the whereabouts and cross-border movements of suspects (particularly foreign mules), the JFIU should explore closer collaboration with the Immigration Department (ImmD) to ensure it has timely access to immigration information.

137. Reflecting HKC's exposure to higher external than internal ML threats, foreign information and requests are a crucial channel for developing evidence and tracing proceeds, particularly related to fraud, corruption and tax crime. As outlined in IO.2,

<sup>27</sup> This number includes requests for JFIU information from all HKC authorities.

<sup>28</sup> Other Investigations" refers but is not limited to the following categories of investigation: bookmaking, loansharking and other predicate offences from HKPF's cases; customs offences or other offences under the purview of money service supervision; corruption-related investigation/ enquiry; tax-related investigation/ enquiry; investigation/ enquiry on suspected insider dealings.

<sup>29</sup> Figures covering only 2016 and 2017 as the IRD started maintaining such statistics in 2016.

<sup>30</sup> Including 628 ML investigations and 70 TF investigations originated from STRs between 2013 and 2017.

<sup>31</sup> The figure represents investigations involving the use of JFIU information but excluding those investigations triggered by JFIU information.

the JFIU's and LEAs' exchange of information with foreign counterparts has steadily increased in recent years.

138. Case studies involving the JFIU and LEAs show the capacity to use multi-source data to analyse some complex ML, TF and proceeds-generating predicate crimes (see case study below). This includes developing leads to unveil deeper layers of financial activity involving networks and funds flows across several jurisdictions. The authorities pay special attention to the misuse of company structures and bank accounts, as 'stooge' or front company accounts with foreign links are common typologies in HKC.

139. Suspected TF cases also show the authorities access and analyse a range of information, including from foreign counterparts, to trace funds and investigate matters. The FID's role in assessing and investigating the financial elements in suspected terrorism or TF cases helps promote the use of financial intelligence. The JFIU appropriately triages TF-related STRs for urgent dissemination to specialised units to investigate. As discussed in IO.9, 70 of the 166 TF investigations undertaken between 2013 and 2017 arose from STRs relating to suspected TF or CT. However, a large portion of these cases were found to involve false positives or STRs filed only on the basis that fund flows involved high-risk jurisdictions (perhaps reflecting defensive reporting which is discussed below). While urgent dissemination of TF-related STRs is warranted, if the number of these STRs were to increase substantially in future, the JFIU may need to consider measures to filter TF/CT-related STRs at an early stage, to enable investigations to focus on more substantive cases.

### Box 3.1. C&ED - Use of Financial Intelligence for Drug Trafficking & ML case

#### Brief summary

In March 2017, the C&ED mounted an anti-narcotics operation. A couple was arrested and 4.6 kg of cannabis buds and USD 127,450 of suspected drug proceeds were seized. A parallel financial investigation was conducted to identify possible ML/TF activities. Evidence showed that the couple laundered suspected crime proceeds amounting to USD 688 000. In March 2018, USD 471 000 worth of realisable properties was restrained by way of court order.

#### Effectiveness

**Financial investigations:** Upon parallel investigation into the drug trafficking ML case, a large amount of crime proceeds was found to be deposited into the man's bank account with ML patterns observed. Upon the couple's arrest, the C&ED retrieved relevant STRs which identified further bank or securities accounts with suspicious transactions. The STRs provided useful leads for the investigation. Upon production of documents by the banks pursuant to the court order, FIG investigators analysed the funds flow and successfully identified the hallmarks of ML.

**Prosecution & Conviction:** In February 2018, the man was charged with a drug trafficking offence and the couple was charged with a ML offence. In November 2018, the man was convicted of ML and drug trafficking and sentenced to four years and two months imprisonment. His wife was discharged.

**Restraint and Confiscation of assets:** In March 2018, the Court granted a Restraint Order to restrain USD 471 000 worth of assets held by the man. Court proceedings are in progress.

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### Reports received and requested by competent authorities

140. The HKPF regularly receives, accesses or requests STRs and other information from the JFIU that assists them with their investigations (see table 3.3. below). Other LEAs receive fewer disseminations but this is largely in line with their more targeted areas of focus. As the large number of searches and growing number of requests demonstrate, LEAs are also regularly accessing or receiving JFIU information either directly online through the STREAMS database or via JFIU disseminations. The JFIU disseminates STRs as well as value-added Financial Intelligence Reports (FIRs). FIRs comprise a number of STRs classified as high-risk for deeper analysis and intelligence cultivation, based on ML/TF risk, their intelligence value and the prospect of investigation or further action (see tables 3.4 and 3.5 below).

141. For regulators, the JFIU provides products customised from STRs to support their risk profiling, onsite supervision and understanding of compliance behaviour and illicit activity in their sectors. The JFIU may disseminate STRs to regulators for enforcement against AML/CFT non-compliance (which is a crime under the AMLO) or unlicensed activities, or to the SFC for the purpose of conducting financial investigations into predicate offences (e.g. securities crimes). Regulators have used JFIU information to identify and examine suspected malpractice in the insurance, money lending and MSO sectors, in some cases leading to convictions or licensing action.

**Table 3.3. STR disseminations to authorities from 2013 to 2018 (end of Oct)**

		2013	2014	2015	2016	2017	2018 (end of Oct)
Local LEAs	HKPF	4 961	5 366	7 773	9 417	9 543	10 210
	C&ED	2 749	1 897	1 858	2 309	2 852	1 661
	ICAC	52	61	143	235	207	133
	Immigration Department (ImmD)	0	2	2	8	11	5
	Inland Revenue Department (IRD)	18	57	172	127	107	73
Local Regulators	HKMA	1	0	6	3	1	0
	SFC	44	65	97	124	207	251
	IA	9	7	1	1	1	25
Others	3	1	16	3	2	2	
Worldwide FIUs and LEAs		200	206	386	404	635	383
<b>Total No of STRs received</b>		<b>32 907</b>	<b>37 188</b>	<b>42 555</b>	<b>76 590</b>	<b>92 115</b>	<b>64 846</b>
<b>Total STRs disseminated (as a percentage of total STRs)</b>		<b>8 037 (24.4%)</b>	<b>7 662 (20.6%)</b>	<b>10 454 (24.6%)</b>	<b>12 631 (16.49%)</b>	<b>13 566 (14.73%)</b>	<b>12 743 (19.65%)</b>

142. STRs (92% of which are received electronically) are stored in STREAMS, and the JFIU has access to cross-border declarations via the C&ED's recently established CBNI database (see below).

143. Between 2013 and 2017, STRs almost tripled in volume, peaking at over 92 000 in 2017. During the first ten months of 2018, STRs dropped to about 64 000 due largely to banks filing fewer but, according to the JFIU, higher quality reports. FIs accounted for 98% of all of STRs filed in 2018, while DNFBPs accounted for less than 1%.

144. The increased quantity of financial information has seen total STR disseminations increase from about 8 000 STRs in 2013 to almost 13 000 during the first ten months of 2018. Disseminations as a percentage of total STRs have fluctuated, indicating STR quality and defensive reporting issues. The continued increase in disseminations despite the drop in STRs filed in 2018 encouragingly, appears to support the JFIU's view that overall quality has improved (see table 3.3 above). Case studies, the JFIU's quarterly reporting on STR trends and LEA feedback support JFIU's assessment that overall STRs are of reasonably good quality and regularly provide actionable intelligence to support investigations.

145. However, a number of factors limit the intelligence value of some STRs. The JFIU attributes the fall in STRs disseminated as a percentage of the total received (from over 24 percent in 2013 to just under 15 percent in 2017) mainly to defensive reporting. Low-level alert settings and rushed reporting by some REs contribute to this shortcoming.

146. Competent authorities also reported that inconsistent reporting formats and missing information can hamper the JFIU's ability to process some STRs efficiently. Approximately eight percent of STRs (about 140 a week) are received non-electronically and need to be uploaded manually to the database. The volume of STRs filed by most MSOs and some DNFBPs appears low (particularly TCSPs given the prevalent misuse of company structures and accounts), but is partly mitigated by STRs from other sectors and improved company information.

147. The JFIU has taken steps to address a number of these limitations. The JFIU and the main FI regulators, particularly the HKMA, have worked to improve the quality of STR reporting. The JFIU quarterly STR analysis reports inform REs on ways to improve STR quality, as well as ML/TF typologies and trends. The JFIU engages with the private sector directly or through a number of working groups involving regulators, LEAs and industry (such as banks, MSOs and SVFs) to provide feedback on STRs and its expectations. The JFIU attributes the drop in STR filing and increase in dissemination rate in 2018 partly to its efforts to improve quality. While RE's views on the adequacy of STR feedback vary, some praised the JFIU for its open informal channels of contact that enable questions about STRs to be discussed with analysts and addressed quickly before reports are submitted.

148. The JFIU has continued to refine the standard STR template, working with regulators and professional bodies to promote common use of it among REs. A recently piloted modification aims to improve reporting consistency, data uniformity and automated intelligence searches. The JFIU has rolled out the new template following positive responses to the pilot.

149. As a leading global financial and business centre exposed to major foreign ML risk, collecting additional strategic information such as international wire transfer reports would enhance the intelligence available to the JFIU, LEAs and other authorities. While collecting such information is not required under the FATF

standards for technical compliance, in HKC's context it would provide the authorities with access to valuable intelligence not necessarily available in STRs, foreign financial intelligence and other information.

### *Cross-border Currency and Bearer Negotiable Instruments (CBNIs)*

150. In July 2018 HKC implemented a cross-border currency and bearer negotiable instruments (CBNI) regime for all CBNIs over HKD 120 000 (USD 15 000) (see R.32.) The new regime: (a) requires individual travellers entering HKC at control points to make a declaration and allows LEA to seek disclosures from travellers for exported CBNIs, and (b) requires for cargo entering or leaving HKC that a declaration is made. At the end of October 2018, nearly 6 000 traveller and over 3 100 cargo declarations had been made, worth HKD 66.3 billion (USD 8.5 billion) and HKD 392 billion (USD 50.4 billion) respectively. Based on total declared value, 77% of traveller declarations and 97% of cargo declarations related to CBNIs moved for banks. According to the authorities, this is a common practice for repatriating HKC bank notes from Macao, China.

151. While it is too early to assess effectiveness, the main foundations to use CBNIs for intelligence and to detect suspicious activity are in place. CBNI reports are stored in a C&ED database that the JFIU crosschecks against STRs daily. The FIG screens CBNIs against a range of databases to select higher-risk leads for investigation, as well as suspected unlicensed MSOs for compliance attention. At the end of October 2018, two persons and one company had been selected for follow-up investigation related to ML or TF. See IO.8 for further analysis of the CBNI regime.

### *Operational needs supported by FIU analysis and dissemination*

152. The JFIU's financial analysis and dissemination supports law enforcement's operational needs to a large extent, with scope to increase operational and strategic analysis linked to complex ML. The JFIU has increased the volume of high-risk STRs disseminated to LEAs from over 8 000 in 2013 to almost 13 000 in the first ten months of 2018, while at the same time doubling the number of value-added operational intelligence reports (FIRs) it disseminates. The JFIU's efforts to increase disseminations is particularly notable as this occurred during a period of growing pressure where STR reporting tripled in volume. LEAs generally spoke positively of the JFIU's operational support and the intelligence value of its disseminations.

153. To deal with the recent growth of STRs, the JFIU increased its staff from 48 in April 2014 to 65 in August 2018. Close to half the establishment are assigned to STR analysis. The JFIU has been funded to take on 15 additional staff in 2019 with recruitment under way. The JFIU considers this staffing increase should be sufficient to meet its growing workload but it should continue to monitor its resources against operational requirements which are likely to continue to grow.

### *Operational analysis*

154. The JFIU uses an effective automated data matching system for STRs to support operational intelligence needs. All STRs are initially screened to determine urgency and checked for missing information. The JFIU officers assess urgent STRs immediately and disseminate them as required, or contact REs to provide missing

information. Further automated checks and manual screening categorise STRs into low and high risk.

155. The JFIU directly disseminates high-risk STRs to partners and indexes the low-risk STRs in STREAMS. Automated data-matching of STRs against police and customs databases, coupled with manual analysis of other information (see section on *Use of Financial Intelligence and other information* above), enables the JFIU to disseminate STRs in a timely way to operational partners. However, the initial classification of STRs into only two categories – low and high priority – could benefit from a more gradated approach for better targeting and resource management (as discussed below).

156. As noted above, direct online STR access for a large number of HKPF units and the C&ED officers posted to the JFIU is a strong element of HKC's financial intelligence model. It is particularly valuable for tailoring searches to operational needs and early-on in cases when investigators consider the potential for parallel financial investigations into predicate crimes. The extensive use of online STR searches highlights the value operational consumers of financial intelligence place on the system.

157. The JFIU also supports operations through disseminating an increasing number of value-added FIRs. STRs contained in FIRs average about 40% of STRs disseminated directly to LEAs (see table 3.4 below). The JFIU's criteria and skills for developing FIRs appear sound and more refined than the standard high/low risk rating system for STRs. Analysts conduct wider searches of databases and collect additional information from REs or foreign FIUs where required. Network analysis and mapping tools are used to enhance the intelligence picture of targets, entities and syndicates.

**Table 3.4. Financial Intelligence Reports Disseminated**

	2013	2014	2015	2016	2017	2018 (end of Oct)
No. of STRs further analysed by JFIU into financial intelligence reports	2 031	2 515	3 625	3 633	3 392	4 119
No. of financial intelligence reports disseminated by JFIU (and % of all STRs disseminated)	814 (40%)	884 (35.1%)	1 373 (37.9%)	1 278 (35.2%)	1 619 (47.7%)	1 625 (39.5%)

Table 3.5. Financial intelligence reports disseminated by agency

Agencies receiving financial intelligence reports	2013	2014	2015	2016	2017	2018 (end of Oct)
HKPF	712	734	1 055	833	1 240	1 245
C&ED	5	1	3	19	57	46
ICAC	40	42	112	211	107	56
ImmD	0	2	1	4	9	1
IRD	10	44	114	107	94	112
HKMA	1	0	0	0	0	0
SFC	38	58	83	99	109	84
IA	4	2	0	0	1	35
Others	4	1	5	5	2	46
<b>No. of financial intelligence reports disseminated by JFIU</b>	<b>814</b>	<b>884</b>	<b>1373</b>	<b>1278</b>	<b>1619</b>	<b>1 625</b>

158. Case studies show the JFIU has developed a growing capacity to uncover complex company structures and trace ownership to controlling interests abroad. This includes identifying funds flows through third countries (see case study below). This type of financial intelligence analysis is important in view of HKC's risk profile and the ML typologies prevalent in the jurisdiction.

159. The JFIU also analyses STRs to identify opportunities to issue Letters of No Consent (LNCs) to support LEAs' intelligence and operational objectives. The JFIU's role in alerting REs to put funds on temporary hold provides opportunities for LEAs and JFIU to trace funds flows and detect crime networks, and has led to significant confiscation and disruption results (see IO.8).

160. Nevertheless, there are some areas for improvement. The surge in STRs received in 2016-2017 saw processing delays increase, requiring injections of extra staff and analysts to work more overtime. While the JFIU has managed to increase STR disseminations and its value-added FIR output (see table 3.5 above), it should review its triaging system to enhance the targeting of priority STRs for analysis and dissemination, as well as allocating resources accordingly.

161. The JFIU's practice of manually assessing all low-priority STRs supports feedback on quality to REs and identifying operational leads. However, this needs to be weighed against the benefits that could be achieved through allocating resources to produce higher-value operational intelligence and the fact that the main LEAs access STRs online or request them regularly. The JFIU is encouraged to explore other less resource-intensive approaches (e.g. random sampling for quality control) to complement or modify its current manual practice. Given their enriched intelligence value, the JFIU should examine opportunities to increase its FIR output.

162. The JFIU has made a number of upgrades to its IT system to handle larger STR volumes and enhance online access to its database. The database has spare capacity to manage both STR volumes many times over the 2017 peak, as well as support additional online users. It would however benefit from further enhancements to enable large-scale data mining to support advanced strategic analysis. The JFIU is consulting foreign FIU counterparts among others as it considers solutions for its IT requirements. The experience of HKC banks that employ big data analytics to identify hidden networks would also provide lessons for the JFIU to consider.

**Box 3.2. JFIU value-added analysis triggered by STRs**

Between June and October 2018, the JFIU received 45 STRs against corporate accounts which had received fraudulent payments mainly related to business email compromise scams. The accounts were held by HK-incorporated companies that had recently had all company directorships changed to Mr. A (passport holder of Jurisdiction-X). Mr A was one of a number of subjects under JFIU analysis.

(1) Company registry – showed that Mr. A was the director of 193 companies (as at June 2018), and that directorship changed between November 2017 and March 2018. Mr A's signatures on the change of directorship documents for the various companies differed. The previous directors of companies were all from Jurisdiction Y. The companies shared common appointed secretarial companies with no TCSP licenses.

2) STR database – 43 STRs were filed between June and September 2018 against 45 of the 193 companies under Mr. A's directorship, with fraudulent payments totalling HKD 60 million (USD 7.6 million). Searches also showed that 29 accounts were under police investigation.

(3) Other LEA databases – showed that Mr A. had not entered HKC in the last 10 years.

(4) Account & transaction analysis – Fraudulent payments were received within one month of directorship changes, with accounts dormant before the change.

(5) Liaison with banks – revealed that Mr. A did not have personal accounts in HKC.

(6) Internet search – revealed many of the appointed secretarial companies had websites providing secretarial services in Jurisdiction Y where the previous directors resided.

**Outcome:** Information provided to the HKPF investigation units. Particulars of Mr. A and the relevant secretarial companies were passed to the Companies Registry. Details of ex-directors and the secretarial companies suspected of providing company services in HKC were passed to the FIU in Jurisdiction Y.

*Strategic analysis*

163. Previously, the JFIU's strategic output focused on quarterly reports on STR trends. These include succinct strategic analyses of risks and typologies (e.g. ML related to corporate accounts and real estate, NPOs), new technologies (digital wallet risks) and emerging threats (business email compromise, suspicious use of new accounts to shift funds overseas). In addition to feedback to REs on STR quality issues, these reports provide useful guidance on typologies and red flags.

164. In 2017, the JFIU established a small strategic team of three analysts, and is now adding five more analysts to the unit. It has produced reports on email scams and SVFs that display deeper and richer analysis than the guidance on STR trends. Co-operation with JFIU operational analysts on these products and, for SVFs, with the RAU demonstrates good practice in integrating strategic analysis into the intelligence cycle. Producing these types of strategic analysis reports is a positive development. Additional IT enhancements (as suggested above), combined with extra staff, should support JFIU's effort to expand the scope and output of its strategic analysis. Increasing co-operation between the strategic analysts and the RAU (which sits in the same crime bureau as the JFIU) would also help both functions enhance higher-level intelligence and risk assessment quality and output.

### *Co-operation and exchange of information/financial intelligence*

3

165. The joint HKPF-C&ED model of the JFIU provides a sound foundation for sharing and integrating intelligence. It not only helps with cross-matching financial, police and customs intelligence but also overcomes security restrictions that otherwise might constrain quick online access across different agencies databases. It should prove particularly important for deriving intelligence value from the new CBNI system. Posting officers from the FIG into the JFIU also provides a direct channel for intelligence exchange and liaison with the C&ED's principal financial investigation unit.

166. Basing the JFIU in the NB has worked reasonably well but it is largely historic. Since its establishment, the JFIU has expanded its staffing, disseminations and range of financial intelligence output. The RAU has been established, as have a number of co-ordination mechanisms (see FMLIT below) for which financial intelligence is central. It may be timely for the authorities to explore whether consolidating the JFIU and these related functions (including the FID) into a specialist stand-alone bureau would strengthen the harnessing of financial intelligence and investigations.

167. The IRD refers suspected proceeds and terrorist asset information to the JFIU but the extent to which it co-operates on ML with LEAs is limited. While the domestic threat of tax crime is low, there is scope for the JFIU, LEAs and the IRD to work more closely on ways to improve detection of foreign tax crime proceeds.

168. The JFIU engages with regulators mainly to support AML/CFT supervision as well as support ML/TF investigations. This involves examining STR trends and typologies and addressing STR quality through jointly developed guidance. The JFIU hosts the STR Working Group involving LEAs, regulators and the major STR reporters as well as other consultation forums with specific regulators and their sectors. It is a member of the AMLRSCG and a number of other information-sharing mechanisms (outlined in IO.1) with other regulators. The JFIU shares information derived from STRs to assist regulators with compliance and enforcement activity. For instance, it has assisted the MSSB to identify and take action against unlicensed MSOs.

169. HKPF's lead unit for combating fraud, the Commercial Crime Bureau (CCB), set up the FMLIT in May 2017 with the support of the NB (including the JFIU and the FID), the HKMA, the Hong Kong Association of Banks (HKAB) and the jurisdiction's ten major banks. The FMLIT's potential to harness private and public sector data capability and expertise is evident in the good quality alerts it has issued on illegal bookmaking and types of fraud and TBML (see IO.7 for more on expanding FMLIT's membership and remit). The JFIU is a member of the FMLIT's strategic working group that meets monthly to examine the ML/TF environment and set priorities. Online access to STREAMS supports the FMLIT's operational case work.

170. The informal co-operation that characterises HKC's general style of government operations works reasonably effectively in supporting co-ordination and information sharing. However, the authorities should consider developing strategies and plans to enhance financial intelligence and understanding of typologies related to the major proceed-generating crimes, particularly linked to foreign predicates (see IO.7). The FMLIT provides a sound platform to support this work as well as cross-fertilise expertise between the authorities and private sector.

171. Appropriate measures are in place to protect the confidentiality and security of JFIU information. In addition to government and HKPF security requirements, the JFIU enforces its own security order for STREAMS. Access to STREAMS is limited to authorised officers and compartmentalised by the security level and sensitivity of information. The JFIU audits user access monthly.

### *Overall conclusions on IO.6*

172. **HKC has achieved a substantial level of effectiveness for IO.6.**

### **Immediate Outcome 7 (ML investigation and prosecution)**

#### *ML identification and investigation*

173. LEAs identify and initiate financial investigations in a significant number of ML cases each year, although a large portion does not for various reasons progress beyond preliminary stages. The majority of ML investigations (70%) relate to fraud/deception cases (both domestic and foreign) that the authorities say are more identifiable than other major threats. While LEAs use a generally sound range of avenues to identify ML, the largely foreign nature of many major ML threats poses challenges for LEAs to detect and in particular investigate ML. LEAs have increased information sharing and conducted a number of joint operations with foreign counterparts to address this challenge, but the lower number of foreign non-fraud cases shows difficulties persist.

174. HKC has a well-established legal and institutional framework to conduct ML investigations and prosecutions. Four competent authorities are responsible for investigating ML:

- The HKPF is the primary LEA for ML;
- The C&ED focuses on customs-related crimes including related ML threats such as drug trafficking and goods smuggling. The FIG specialises in financial investigation and asset recovery, receiving referrals of detected or suspected ML or crime proceeds from C&ED officers;
- The ICAC investigates corruption offences and related crimes, including ML. ML cases linked to foreign corruption that have no corruption element in HKC are handled by the HKPF;
- The SFC can also conduct financial investigations when investigating predicate offences such as insider trading; and
- The IRD has a limited ML investigative role domestically but is able to use its extensive information gathering powers to support other agencies or in response to foreign requests (see IO.2). It refers any suspicions of proceeds of crime or terrorist property to the JFIU to examine.

175. Dedicated financial investigation units in the HKPF (i.e. the FID) and the C&ED (i.e. the FIG) provide specialist capability for identifying and combating ML. LEA officers receive financial investigation training both locally and abroad. The joint police/customs FIU structure serves as a financial intelligence hub for LEAs and other authorities, while the interface of financial, criminal and customs intelligence enables a range of information to be integrated to help detect ML and follow money trails.

Special investigative techniques are employed in parallel investigations against drug trafficking, triad, syndicated and organised crime to gather financial intelligence, alongside intelligence-based operations against predicates.

176. LEAs use a generally sound range of avenues to identify ML: stand-alone ML investigations, parallel financial investigations of local predicate offences, referrals from other authorities, STRs (that the JFIU disseminates or LEAs access from the STREAMS database in the course of investigations), and foreign intelligence or requests. Parallel investigations account for almost 13% of ML cases. As seen in IO.6, STRs and JFIU information contribute to a significant number of investigations and trigger a reasonable number of cases. The recently established co-ordination mechanisms, the FMLIT and the ADCC also provide information-sharing hubs with the private sector and support LEA co-operation for identifying and developing intelligence on ML. Co-operation with foreign LEA liaison officers has also at times provided a valuable channel for information exchange and co-ordinating actions.

### Box 3.3. FMLIT's role in combating an email scam

The HKPF identified a cross-jurisdictional email scam syndicate, involving two females (Ms. A and Ms. B) from Jurisdiction T and a male (Mr. C) from Jurisdiction U. The syndicate recruited individuals from Jurisdiction V to open company accounts in HKC. The company accounts stayed dormant for a period of time and the company directorship was later changed to Ms. A, Ms. B and Mr. C. It was found that shortly after the change of company directorship, the company accounts were used to receive proceeds.

This case was circulated to the FMLIT and resulted in a member bank alerting the FMLIT secretariat of two pending remittances of USD 4.05 million into company accounts belonging to Ms A. HKPF action led to suspending the accounts and tracing the victims – two firms which were unaware of the fraud – in Jurisdiction W.

The HKPF identified two more suspected syndicate members in Jurisdiction V. It also uncovered a common IP address linking the fraudulent transactions to Jurisdiction Z. The HKPF has sought assistance from LEAs in Jurisdiction Z.

177. LEAs vigorously undertake financial investigations to pursue ML matters, as the large number of cases initiated (averaging 1 600 each year) reflect. About 60% of cases progress to full investigation, of which about one-third entail the use of LNCs to prevent dissipation of assets (such as funds in accounts). The 40% of cases that do not progress beyond preliminary stages (e.g. asset scans, background checks) show, in part, that LEAs actively examine leads and are particularly responsive to foreign requests. In some instances, LEAs have followed up with foreign counterparts (including third countries) to see if further information exists that could warrant a parallel financial or ML investigation.

178. An important tool in HKC's regime is the broad stand-alone ML offence provision that helps promote parallel financial investigations and ML investigations. The provision enables ML investigations and prosecutions to proceed without the need to identify or prove the predicate offence. Stand-alone ML investigations average about 370 a year and account for almost a quarter of all ML investigations in 2013-2017. The stand-alone offence is a valuable measure particularly for an IFC

exposed to higher external ML threats. It allows LEAs to pursue foreign ML cases in circumstances where detecting and following money trails related to foreign proceeds, as well as domestic proceeds moved abroad, tend to be more challenging.

179. Despite engendering a vigorous approach to opening financial investigations, the stand-alone ML provision may partly account for some of the 40% of cases that do not proceed beyond preliminary enquiries. LEAs also explained that while it is not necessary to prove the predicate offence, investigators still need to show substantial illicit money flows (among other evidence) to establish reasonable grounds to take a case to court. It can take time to collate and verify such evidence, as well as follow money trails to trace masterminds or identify networks, particularly when foreign elements are involved.

180. Fraud is the most heavily investigated predicate for ML. Averaging about 1 100 cases opened a year, it accounts for 70% of all ML investigations for 2013-2017. About 60% of fraud cases progress beyond preliminary stages. The authorities say that, as a victim-based crime, fraud is relatively more easily identifiable than other serious predicates. Victim reporting to LEAs directly or to banks produces STRs and investigative leads. Fraud also features prominently in foreign requests, for instance, dominating incoming spontaneous disclosures to the JFIU.

181. ML related to foreign predicates (such as foreign fraud, drug crimes, tax crimes and corruption), tends to be more opaque and challenging to detect and investigate. With 60% of the JFIU's outgoing requests or spontaneous dissemination relating to non-fraud ML, the authorities have developed the capacity to identify a range of foreign cases. This may support HKC's view that the main barriers they face relate more to investigating than detecting foreign ML, although the significantly lower number of non-fraud cases opened suggests detection is not without its challenges. LEAs say following the money trail in foreign cases is not straightforward as it relies largely on foreign co-operation. This is particularly so where funds shuttle through HKC to other jurisdictions. The quality and timeliness of co-operation from foreign counterparts and response times vary, depending on the jurisdiction. Incomplete information, delays or a lack of response from foreign counterparts can prolong or stymie investigations.

**Table 3.6. Number of ML investigations**

Year	2013	2014	2015	2016	2017
HKPF	1 652	1 349	1 462	1 603	1 786
ICAC	21	13	19	13	17
C&ED*	19	14	19	34	28
<b>Total</b>	<b>1 680</b>	<b>1 367</b>	<b>1 491</b>	<b>1 641</b>	<b>1 823</b>
<b>No. of ML convictions (individuals)</b>	<b>137</b>	<b>154</b>	<b>132</b>	<b>103</b>	<b>94</b>

\* Figures represent extensive local investigations filtered from the larger number financial investigations

182. **HKPF:** As the lead ML agency, the HKPF undertakes over 95% of all ML investigations (see table 3.6 above). The annual Commissioner of Police's Operational Priorities recognise the importance of combating ML and mandate ten proceeds generating predicates (including the major threats identified in the HRA) that must

be examined to identify ML and assets for confiscation.<sup>32</sup> The HKPF demonstrated that units at different levels (headquarters, regional and district) are capable of conducting ML/financial investigations. It has strengthened its effort to identify and respond to ML, including with the FMLIT and also the ADCC. Significant effort has been devoted to combating fraud as the highest rated domestic and external risk. Fraud cases include some complex, large-scale foreign matters but the majority appear to relate to frauds against individuals or simpler cases. While the HKPF is very responsive to foreign requests in general (as the large number of preliminary scans and background checks show), its approach could be more proactive for some foreign predicates, particularly foreign tax crimes and foreign corruption.

183. **C&ED:** The C&ED has built its capacity to investigate ML related to customs offences, with sound procedures to consider cases for parallel investigations, the well-resourced FIG (67 staff) and access to multi-source intelligence. ML investigations are initiated from suspicious entities identified in predicate offences or local or foreign intelligence. The FIG conducts a large number of financial investigations but it considers only a relatively low number involve sufficient ML criminality to progress to extensive investigations (see table 3.6). The C&ED may need to consider refining its case selection criteria or information collection to increase the number of cases that progress into extensive investigations, although it reported that investigating customs-related ML – that by nature involves a cross-border element and accounts for 60% of its ML cases – can, like other foreign ML offences, be complicated. Cases show the C&ED’s capacity to pursue more complex and high-end ML matters, including jointly with foreign counterparts (notably on TBML, drug-proceeds and value-added tax fraud).

184. **ICAC:** The ICAC investigated 83 domestic corruption cases related to ML from 2013-2017 (The HKPF conducted 32 foreign corruption-related ML cases in the same period). The authorities consider the number of ICAC cases to be consistent with the HRA assessing ML related to domestic corruption as low risk. The ICAC explained that corruption cases rarely involve ML charges unless they involve self-laundering. In its view, the private sector is more exposed to corruption risk from neighbouring jurisdictions (mainly their private sectors) and beyond. The ICAC has been reasonably effective in detecting potential predicate crime/ML activity in parts of the private sector. Recently it has focused particularly on corruption identified in cartel and price-rigging behaviour in the large property renovation market in HKC.

<sup>32</sup> Including trafficking in / manufacturing of dangerous drugs; bookmaking; operating / managing / controlling gambling establishment; lending money at an excessive interest rate; keeping or managing a vice establishment; trafficking-in-persons to or from Hong Kong; causing prostitution of person or living on earnings of prostitution; ML; theft / robbery / burglary; fraud / obtaining property by deception; and any other type of proceeds-generating crime(s) as deemed appropriate by regions.

### *Consistency of ML investigations and prosecutions with threats and risk profile, and national AML policies*

185. The authorities are investigating and prosecuting ML consistent to some extent with the overall risk profile. The predominant effort devoted to combating fraud/deception appears largely in line with its highest assessed risk, but the picture is less clear when it comes to investigating or prosecuting non-fraud predicates assessed as medium-high risks (such as ML linked to drug crimes, foreign corruption and foreign tax crimes). The disparity between fraud and non-fraud cases (70% and between 5%-30%)<sup>33</sup> appears wider than the difference expected between high and medium-high risks, even when qualitative factors (relative complexity, scale and magnitude of proceeds) are taken into account.

186. In very broad terms, HKC's overall ML investigations reflect the level of assessed lower internal and higher external threat to some extent. Based on case numbers, the ratio of domestic to foreign predicate investigations the HKPF and the C&ED undertake varies between 40% and 60% yearly, in total averaging to roughly a 50:50 split over 2013-2017 (see table 3.7 below).

187. There are, however, some challenges in interpreting the statistics on ML cases based on types of risk. The number of full investigations into the major risks other than fraud is unknown. The statistics only show the breakdown based on all investigations opened including those that do not progress beyond preliminary stages. The substantial number of stand-alone ML cases, where the underlying predicate has not been identified or confirmed, are not easily categorised against assessed risks. The authorities also say they encounter cases that involve commingled or 'mixed proceeds' from a number of predicates that may be categorised as fraud or stand-alone ML. Due to these issues, a range of 5% to 30% is used as an approximate for the number of non-fraud ML cases HKC has investigated and prosecuted over 2013-2017.

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<sup>33</sup> Non-fraud cases where the predicate is identified account for about 5% of all ML investigations. Stand-alone ML cases account for 24% of ML investigations. The situation is reversed for prosecutions. Non-fraud cases account for about 25% and stand-alone for 6% of all ML prosecutions.

**Table 3.7. Number of ML Investigations, Prosecutions and Convictions from 2013-2017  
(broken down by foreign/domestic)**

	2013	2014	2015	2016	2017	Total
<b>ML Cases Investigated by HKPF</b>	<b>1 652</b>	<b>1 349</b>	<b>1 462</b>	<b>1 603</b>	<b>1 786</b>	<b>7 852</b>
<i>Foreign Predicate Offences</i>	929	763	897	608	711	3 908
<i>Domestic Predicate offences</i>	723	586	565	995	1 075	3 944
<b>ML Cases Investigated by C&amp;ED</b>	<b>19</b>	<b>14</b>	<b>19</b>	<b>34</b>	<b>28</b>	<b>114</b>
<i>Foreign Predicate Offences</i>	15	7	13	19	17	71
<i>Domestic Predicate Offences</i>	4	7	6	15	11	43
<b>No. of Cases ML Prosecuted by HKPF</b>	<b>133</b>	<b>164</b>	<b>111</b>	<b>88</b>	<b>102</b>	<b>598</b>
<i>Foreign Predicate Offences</i>	66	51	41	36	42	236
<i>Domestic Predicate offences</i>	67	113	70	52	60	362
<b>Number of individuals prosecuted for ML by C&amp;ED</b>	<b>0</b>	<b>0</b>	<b>13</b>	<b>8</b>	<b>1</b>	<b>22</b>
<i>Foreign Predicate Offences</i>	0	0	3	0	0	3
<i>Domestic Predicate Offences</i>	0	0	10	8	1	19
<b>No. of Cases Convicted by HKPF</b>	<b>112</b>	<b>120</b>	<b>98</b>	<b>88</b>	<b>60</b>	<b>478</b>
<i>Foreign Predicate Offences</i>	51	38	34	39	24	186
<i>Domestic Predicate Offences</i>	61	82	64	49	36	292
<b>Number of individuals convicted for ML by C&amp;ED</b>	<b>2</b>	<b>5</b>	<b>0</b>	<b>0</b>	<b>9</b>	<b>16</b>
<i>Foreign Predicate Offences</i>	0	0	0	0	0	0
<i>Domestic Predicate Offences</i>	2	5	0	0	9	16

188. **Fraud:** The authorities have responded robustly to the high threat that fraud poses, including as a foreign predicate. Fraud and deception are the predominant crimes investigated and prosecuted for ML (accounting for over 70% of all ML cases). Case studies include some high-end ML involving complicated foreign schemes with third countries and complex funds flows. Some cases also involve very large proceeds. Fraud-related ML cases can involve mixed proceeds from different predicates, although the extent to which this occurs is not clear and the cases cited appear to mainly involve different types of fraud (such as tax fraud) as opposed to fraud and non-fraud predicates.

189. The HKPF established the ADCC to provide a single point of contact for public reports of fraud and co-ordinate internal police referrals and responses among government agencies. The ADCC has helped to disrupt over 90 scams, as well as identify over 150 shell companies involved in fraud for banks to red-flag and the CR to remove from the Companies register. Overall the number of fraud-related investigations and prosecutions appears consistent with the assessment of fraud as HKC's highest risk. However, the large volume of fraud cases means that the majority are lower-scale and not high-end ML. While LEAs strenuously pursue fraud cases, the assessment team questions whether the current approach is effectively combating the large-scale fraud and ML syndicates abusing the jurisdiction.

**Table 3.8. ML cases investigated by HKPF (breakdown by predicate offence)**

Predicate Offence	2013	2014	2015	2016	2017	Total
Fraud	649	643	594	661	656	3 203 (41%)
Deception	419	242	516	498	643	2 318 (30%)
ML	458	363	257	389	389	1 856 (24%)
Drugs	30	22	21	8	30	111 (1%)
Tax-related	4	10	4	12	13	43 (<1%)
Loansharking	13	6	4	4	8	35 (<1%)
Corruption/ bribery-related	3	10	9	4	6	32 (<1%)
Gaming-related	8	8	5	2	5	28 (<1%)
Theft / robbery / burglary	8	7	3	2	8	28 (<1%)
Forgery	8	3	3	5	7	26 (<1%)
Organised crime	3	3	3	2	1	12 (<1%)
Vice-related	2	1	4	2	3	12 (<1%)
Others	47	31	39	14	17	148 (2%)
<b>Total</b>	<b>1 652</b>	<b>1 349</b>	<b>1 462</b>	<b>1 603</b>	<b>1 786</b>	<b>7 852</b>

**Table 3.9. Type of ML Cases Prosecuted by HKPF (Breakdown by Offence Linked to Proceeds)**

Year of Prosecution (No of Case)	2013	2014	2015	2016	2017	Total
Fraud	48	48	49	39	41	225 (37.50%)
Deception	49	53	52	22	21	197 (32.83%)
Money Laundering	5	20	1	4	5	35 (5.83%)
Drugs	3	7	1	1	3	15 (2.50%)
Tax-related	-	-	0	0	0	0
Loansharking	13	14	7	7	11	52 (8.67%)
Corruption / bribery-related	-	-	0	0	0	0
Gaming-related	6	-	1	2	3	12 (2%)
Theft / robbery / burglary	6	12	0	1	4	23 (3.83%)
Forgery	2	6	0	0	1	9 (1.50%)
Organised crime	1	2	0	1	2	6 (1.00%)
Vice-related	-	3	0	11	11	25 (4.17%)
Others	-	1	0	0	0	1 (0.17%)
<b>Total</b>	<b>133</b>	<b>166</b>	<b>111</b>	<b>88</b>	<b>102</b>	<b>100%</b>

190. **Stand-alone ML with no identified predicate:** After fraud, stand-alone ML cases account for the highest proportion of investigations (24%), but a much smaller proportion of prosecutions (6%). The authorities consider these tend not to be fraud cases (as victim reporting generally identifies this offence) but involve proceeds from major predicate threats and mixed proceeds cases too. However, the extent to which stand-alone ML cases involve non-fraud risks is unclear and thus difficult to gauge in terms of effectiveness in combating major risks. While LEAs use the stand-alone ML offence extensively for investigations, the lower number of prosecutions likely

reflects the time and complexity involved in establishing the evidentiary grounds for prosecuting such ML cases.

#### Box 3.4. Case example – Stand-alone ML

In the case of *HKC v YEUNG Ka-sing Carson* [2016] 19 HKCFAR 279, the defendant was at the material time the owner of an English football club who had dealt with a total sum of HKD 721 million (almost USD 92 million) in five accounts over a period of six years. There were significant deposits and withdrawals of cash into and from the accounts and the money so dealt with far exceeded the apparent modest means of the defendant as disclosed by his declaration of taxable income generated from operating hair salons. There was no correlating cash generating business in which the defendant was involved. He was convicted of five counts of ML in relation to his own and his father's bank accounts and was sentenced to imprisonment for six years. The convictions were subsequently upheld in the Court of Final Appeal.

191. **Drugs:** While the number of drug-related ML investigations is significantly lower in absolute and relative terms than fraud (see table 3.8 above), LEAs have made efforts to strengthen their capacity to address the challenges they face in combating this medium-high risk. The HKPF and the C&ED have conducted joint operations with a number of jurisdictions targeting foreign drug predicates and ML, as well as sharing intelligence to identify incoming drug proceeds. Even taking the relative complexity and scale of some drug-related ML cases into account, the overall number of investigations (averaging 20 a year, some of which may not proceed beyond preliminary stages) appears lower than expected for a risk assessed as medium-high. The number of prosecutions is also low (five for 2015-2017). The authorities say this is attributable to a number of joint operations that result in prosecutions occurring in other jurisdictions but HKC was unable to say how many cases are prosecuted overseas. As a consequence, the assessment team cannot determine the extent to which foreign prosecutions of drug-related ML cases offset the low number of domestic prosecutions.

192. **Corruption:** The ICAC's investigations appear in line with the assessed low level of domestic corruption risk, and it has prosecuted 13 ML cases out of the 83 cases investigated in 2013-2017 (one ML prosecution was predicated by corruption whereas 12 ML prosecutions started as suspected corruption but proved to be fraud-related). Over the same period, the HKPF investigated 32 foreign corruption-related cases, based on local STRs and requests from Mainland China (nine cases), Macao, China (one case) and a number of other jurisdictions. A number of large-scale cases were involved, in some instances covering alleged proceeds of over HKD 100 million (USD12.7 million). LEAs have taken steps through close liaison and exchanges with Mainland counterparts (see IO.2) to mitigate the potential threats from alleged corruption proceeds outlined in the HRA. Given that HKC identifies foreign corruption as a medium-high ML threat, the number of investigations carried out by the HKPF (which has a mandate to cover ML linked to foreign corruption) appears low (especially as a number of these investigations may represent preliminary enquiries). Based on HKC statistics, no foreign corruption cases have been prosecuted in the jurisdiction.

193. **Foreign tax crime:** The HKPF has conducted over 40 foreign tax-crime related ML investigations during 2013-2017. This excludes some tax fraud cases which were classified as fraud. A number of cases involve large sums (over USD 10 million to almost USD 19 million), asset recovery and restraint or the LNC mechanism to prevent the dissipation of proceeds. The C&ED has conducted a number of foreign tax crime investigations, in response to overseas requests or jointly with foreign counterparts, with some cases also involving large amounts of proceeds. No tax-related ML cases have been prosecuted. While limited foreign co-operation at times hampers their efforts, LEAs appear to investigate foreign tax crimes reactively, rather than proactively in line with the medium-high level of risk and HKC's exposure as an IFC to foreign tax proceeds.

194. **Goods smuggling and other customs-related offences:** The authorities have investigated a number of ML cases related to goods smuggling. This has led to three prosecutions for goods smuggling (see table 3.10 and 3.11 below), with foreign counterparts prosecuting six known cases involving LEA co-operation from HKC (see IO.2). As HKC is a major international trade hub, further efforts need to be made to mitigate the potential cross-border ML risks.

**Table 3.10. ML Investigations by C&ED (broken down by predicate offence)**

Predicate Offence	2013	2014	2015	2016	2017	Total
Customs fraud / evasion of customs duties	2	3	5	9	6	25
Goods smuggling	6	8	1	3	4	22
Drugs	1	1	6	2	5	15
Intellectual property right-related	3	0	2	8	2	15
Dutiable commodities	1	0	0	1	0	2
Others	6	2	5	11	11	35
<b>Total</b>	<b>19</b>	<b>14</b>	<b>19</b>	<b>34</b>	<b>28</b>	<b>114</b>

**Table 3.11. ML prosecutions by C&ED (broken down by predicate offence)**

Predicate Offence	2013	2014	2015	2016	2017	Total
Goods smuggling	0	0	3	0	0	3
Customs fraud / evasion of customs duties	0	0	1	0	0	1
Dutiable commodities	0	0	0	0	1	1
Intellectual property right-related	0	0	0	1	0	1
Others	0	0	0	3	0	3
<b>Total</b>	<b>0</b>	<b>0</b>	<b>4</b>	<b>4</b>	<b>1</b>	<b>9</b>

195. For the reasons above, the assessment team considers the relative level of investigations and prosecutions between fraud and non-fraud ML threats is not fully commensurate with the relative level of the different ML risks faced by HKC. Limitations with statistics and other information make it difficult to determine the reasons for the disparity. Challenges in pursuing foreign cases are no doubt significant but are unlikely to be the only factor. Moreover, the team has not received sufficient information to be able to be satisfied with the authorities' view that the qualitative factors of cases related to non-fraud risks offset, for effectiveness, the

markedly lower number of investigations and prosecutions of those medium-high risks.

196. Whether the authorities sufficiently target more high-end ML fraud and non-fraud cases than lower-scale ML is also unclear. For instance, the police commissioner's annual priorities make no mention of focusing on large-scale or high-end ML. The approach in places appears reactive, as opposed to a more proactive stance that would be in line with the stated AML/CFT policy of deterring illicit funds flows exploiting HKC. The generally lower end sentencing discussed later in IO.7 also does not support the authorities' view that their approach for non-fraud risks is mainly to pursue high-end ML cases.

### *Types of ML cases prosecuted and convicted*

197. Based on the statistics and case studies presented, HKC prosecutes all forms of ML- self laundering, stand-alone ML, third-party ML as well as ML originating from foreign predicate offending. Stand-alone ML is the most frequent type of ML prosecuted, followed by third-party ML (HKC states the latter generally involves lending bank accounts to others for the purpose of ML). As noted above, it is established in HKC that there is no need for the prosecution to prove the predicate offence in an ML case, and that proof of the ML act combined with evidence of reasonable grounds to believe that the property was criminal proceeds is sufficient. This principle has been confirmed in the case of *HKC v YEUNG Ka Sing, Carson* [2016] 19 HKCFAR 279 (see case study in Box 3.4 above).

198. The Prosecution Division (PD) of the DOJ prosecutes all ML cases in HKC, and has a good relationship with LEAs. Case files are submitted by LEAs to PD for legal advice both on the predicate offences (if known) and on ML offences. These cases are advised by different sections in PD, but the majority of the more complex ML cases are advised by the Commercial Crime Unit which contains more specialised and experienced counsel. Case conferences are held between PD and the LEAs to ensure that all the evidence concerned is thoroughly assessed so that the total criminality involved in each different legal entity in the case would be considered. Legal advice is given on (i) the sufficiency of evidence, (ii) the appropriate charge(s) and (iii) the venue of trial.

199. More complex ML prosecutions require three to 12 months on average to complete from the first receipt of case files (this includes the time taken where interim legal advice is sometimes given to LEAs for further investigations to be conducted before seeking further legal advice). Once charges are laid, PD and LEAs work closely together to prepare and bring the case to trial. Trials are conducted both by in-house counsel and by fiat-counsel. ML-related training is also prioritised by the PD and implemented across the organisation.

200. The statistics show a temporary downward trend in prosecutions of ML cases, from 133 in 2013 to 92 in 2016, before increasing marginally in 2018. As advised by HKC, this was due to CFA judgments which clarified the law concerning the elements of the offence, and how individual ML transactions could be charged. During this time (February 2015 to July 2016), ML charges against suspects were not laid and trials for ML offences were temporarily adjourned pending the decision of the outcome. After the CFA judgements, which affirmed the view of HKC authorities and were in

favour of the existing broad application of the ML offence, the number of prosecutions has begun to pick up in 2018 (to 148 cases).

201. The HKPF continues to bring the most ML cases for prosecutions given its wide remit and status as the main LEA in HKC. However, the number of ML cases brought for prosecution by both the C&ED and the ICAC are comparatively low. For the ICAC, the low number of ML prosecutions may reflect the assessed lower risk for domestic corruption, although the proportion of prosecutions is low compared with investigations. Even taking the C&ED's narrower ML remit than the HKPF, the small number of cases it has prosecuted gives rise to the view that it is more concerned with the prosecution of predicate offences than ML.

202. With the clarification of the recent court judgments, the overall number of ML prosecutions has increased in 2017 and 2018. It is hoped that this trend will continue. In terms of convictions, HKC is achieving good results, and the assessment team is of the view that the conviction of 620 individuals for ML is a positive achievement.

203. The collection of data, at least where prosecutions are concerned, could also be improved given that no data was provided by HKC concerning the number of cases actually referred by LEAs to the PD, relative to the number of prosecutions. These numbers would assist in determining whether the PD is not prosecuting many ML cases because of the low number referred or whether the PD is merely taking a cautious approach to prosecuting ML. Comprehensive figures concerning the number of predicate crimes actually prosecuted were also not provided but would have been useful in comparison to ascertain the degree to which ML is prosecuted in relation to different predicate crimes.

### **Box 3.5. Examples of Successful Prosecution of ML related to Domestic Predicate Offences**

#### **Case 1 - Drug trafficking and money laundering**

Acting on intelligence, a male drug trafficker Mr. A was intercepted by officers of Drug Squad of a Police District in June 2013. Upon search, a small quantity of suspected crack cocaine was seized from him and the search of Mr. A's residence found cash of over HKD 5 million (USD 640 000). Mr. A was charged with drug trafficking and money laundering and Mr. A pleaded guilty to both charges in the District Court. In September 2014, Mr. A was sentenced to an imprisonment for 34 months and the monies seized from his residence were confiscated.

#### **Case 2 - Financial investigation involving a mix of predicates**

Mr. A was suspected to have engaged in bookmaking and loansharking activities. Investigation revealed that the personal bank account of Mr. A had received deposits totalling HKD 13 million (approx. USD 1.66 million) into his accounts. Although the investigation failed to establish the link of money to underlying predicates, Mr. A was charged with one count of money laundering in August 2014. Case was adjourned for a number of reasons at Mr. A's application to court including awaiting the outcome of final appeal on a leading money laundering prosecution [HKSAR v YEUNG Ka-shing Carson (FACC 5/2015)]. In December 2018, the District Court convicted Mr. A after trial and sentenced him to an imprisonment for 45 months.

### Box 3.6. Example of Successful Prosecutions of ML related to Foreign Predicate Offences

#### Case 1 – Human smuggling

In 2015, intelligence from the Mainland indicated that defendants (Deft) 1 and 2 were identified to be the masterminds of a human trafficking syndicate arranging illegal immigrants from Vietnam to HKC. Deft 1 and Deft 2 admitted having used Deft 1's bank accounts to launder the crime proceeds. Most of the withdrawals from Deft 2's bank account (Account A) were used to purchase a village house, but Deft 1 was the real owner of the house. Deft 1 and Deft 2 also remitted the crime proceeds to Vietnam. Deft 1 and Deft 2 were convicted of ML in 2016 and sentenced to 32 months and 24 months' imprisonment respectively. Confiscation order against their realisable assets amounting HKD 4 million (approx. USD 510 000) was fulfilled in 2018.

#### Case 2 – Drugs

Intelligence revealed two males involved in transferring drug proceeds totalling HKD 5 million (approx. USD 640 000) out of Jurisdiction X to five males in HKC. The HKPF started a financial investigation which showed the five males in HKC had received suspicious remittances from Jurisdiction X in their accounts and dissipated the money by cash withdrawals. In 2014, the two males in Jurisdiction X were convicted in Jurisdiction X. Sealed copies of the court judgments were obtained from Jurisdiction X and tendered as prosecution evidence in the HKC trial. In March 2017, the five males were convicted of ML in the District Court and sentenced to imprisonment ranging from 12 months to 51 months.

#### Case 3 - Stand-alone and third party ML

Upon investigation into a smuggling syndicate, the C&ED found that eight general merchandise operators had carried large quantity of cash suspected to be generated from smuggling offences, from the Mainland China into HKC. The eight persons either deposited the cash or arranged transfers, through their personal bank accounts, to the same local bank account controlled by the syndicate, to earn rewards. Between 2011 and 2012, the total amount laundered was HKD 54 million (approx. USD 6.89 million). Without adducing evidence of the predicate offence during the trial, in 2017 all eight were convicted for conspiracy of ML and sentenced to between 12 and 48 months' imprisonment.

### *Effectiveness, proportionality and dissuasiveness of sanctions*

204. The maximum punishment for ML is 14 years' imprisonment. Whilst it is a high maximum deterrent, statistics shared by HKC authorities show that the large majority of defendants convicted received between 0-2 or 2-4 years' imprisonment. Between 2013 and 2017, of the 620 persons convicted for ML, fewer than 10% received a sentence of four years or more, and only nine received a sentence above six years.

**Table 3.12. Sentences laid down by the Court for ML convictions**

	2013	2014	2015	2016	2017
No. of ML convictions (individuals)	137	154	132	103	94
Under 24 months	68	56	57	62	50
2 to 4 years	36	61	68	34	31
4 to 6 years	15	16	3	2	4
Over 6 years	5	2	1	0	1
<b>Total</b>	<b>124</b>	<b>135</b>	<b>129</b>	<b>98</b>	<b>86</b>
Probation order	3	0	0	0	2
Community Service Order	2	8	2	3	6
Drug Addiction treatment Centre	1	0	0	2	0
Rehabilitation Centre	0	0	0	0	1
Detention Centre	0	0	1	1	0
Suspended Sentence	3	4	0	2	0
Fine	4	8	3	1	9
<b>Total</b>	<b>13</b>	<b>20</b>	<b>6</b>	<b>9</b>	<b>18</b>

205. The maximum sentence imposed for ML in HKC during this period was 10.5 years' imprisonment in the case of *HKC v LUO Juncheng* HCCC 159/2012, where the defendant laundered HKD13 billion (USD1.657 billion) over one year. In another case of *HKC v LAM Mei Ling* HCCC 241/2012, the defendant laundered HKD 6.8 billion (USD867 million) over 3.5 years, and was sentenced to imprisonment for ten years. Such high sentences are however rare and appear to relate to cases that occurred several years ago, well before the ME. HKC authorities state that there are a variety of reasons behind this. Firstly, the HKC judiciary has through case law, established certain sentencing guidelines in order to determine sentences imposed on cases depending on the amounts laundered. The Court of Appeal in *Secretary for Justice v. WAN Kwok Keung* [2012] 1 HKLRD 201 affirmed ML sentencing guidelines, whereby, the starting point is three years if the laundered proceeds involved between HKD1-2 million, four years for amounts between HKD3-6 million, and over five years where it is above HKD10 million. The totality principle<sup>34</sup> is also applied in HKC.

206. HKC authorities further explained that in recent years, due to more extensive implementation of AML/CFT measures, they believe that ML activities are detected at a much earlier stage, which means that the amount laundered tends to be smaller compared to cases in the past, which may result in sentences falling to the lower end of the scale. The HKC authorities also state that the very heavy sentences imposed in past cases have had their deterrent effects on persons who may be tempted to engage themselves in extensive ML activities.

207. While sentences may be proportionate in individual cases, there is concern as to whether the sanctions being applied are effective, proportionate and dissuasive at

<sup>34</sup> The totality principle is a long-standing common law principle. It requires a judge who is sentencing an offender for a number of offences to ensure that the aggregation of the sentences appropriate for each offence is a just and appropriate measure of the total criminality involved.

a systemic level given the nature of ML/TF risks in HKC. Case law has also established that where an ML and local predicate offence are both on an indictment against an accused person, sentences run concurrently as opposed to consecutively due to the fact that the criminality is derived from the same conduct (HKC v Chan Kim-Chung Nelson [2012] 2 HKLRD 263). This, to a certain extent, almost acts as a “disincentive” for local predicates to be pursued especially where sentencing is not enhanced by the inclusion of an ML offence. The assessment team was also not provided with statistics benchmarking ML sentences against sentences passed for other proceeds-generating crimes.

208. HKC has not prosecuted any legal persons for ML. The HKC authorities state that criminality tends to be attributed to natural persons and in the case of legal persons, the directors of a company. The authorities explain that in the context of HKC, corporate entities or legal persons involved in crime are invariably shell companies being used by natural persons as the stooges or means to commit the ML activities and the prosecution approach has thus been to focus the ML prosecution on the natural persons involved who are the real culprits behind the ML offences. While HKC has not encountered a case of legal person with substantive operations being used to commit ML, the authorities state that they remain vigilant as to the need to consider prosecution of legal persons where the circumstances would warrant it. Given HKC’s risk profile, which includes large involvement of MSOs, secretarial companies and legal persons in general in the financial economy, it nonetheless appears to the assessment team that HKC is not sufficiently pursuing them. As no legal person has been convicted, it is not possible to assess the effectiveness of sanctions against legal persons.

### *Use of alternative measures*

209. HKC applies a range of criminal justice measures in cases where it is not possible to pursue ML. These include asset confiscation by way of absconder or deceased person proceedings if the suspects have absconded or passed away, enforcement by financial regulators under the provisions of unlicensed operations, and initiating striking-off procedures by the CR if the legal persons are locally incorporated companies. HKC authorities have also demonstrated prosecution of predicates where prosecution for ML is not feasible, including where the offences are committed by different offenders. If only the predicate offenders are apprehended while the ML offenders are at large and there is no prospect that the ML offenders could be arrested in the near future, prosecutions will be proceeded against the predicate offenders to avoid delay in prosecution. HKC authorities also advise that depending on the case nature and operational consideration, the names of fugitive ML offenders may be put on the Immigration Watch List.

### *Overall conclusions on IO.7*

210. **HKC has achieved a moderate level of effectiveness for IO.7.**

## Immediate Outcome 8 (Confiscation)

### *Confiscation of proceeds, instrumentalities and property of equivalent value as a policy objective*

211. Confiscation of the proceeds and instrumentalities of crime and property of equivalent value is a high priority in HKC and is actively pursued as a policy objective. Confiscation is one of the five major areas identified in HKC's AML/CFT Policy Statement, which lists the Government's priority areas of focus. The investigation and confiscation of proceeds of crime is also listed as one of the key operational areas under the Commissioner of Police's Operational Priorities.

212. HKC authorities use confiscation as a tool to tackle illicit proceeds and both LEAs and prosecutors are focused on seizing, restraining and confiscating proceeds of crime as a goal in itself. Clear confiscation policies and procedures are embedded across the respective organisations and work plans. All LEAs have dedicated units or divisions that make confiscation a priority and hire forensic accountants as part of their teams to provide support services to investigations conducted on proceeds of crime. Similarly, the DOJ has a dedicated Proceeds of Crime (POC) section under the PD, which consist of five senior Public Prosecutors under the supervision of a Deputy Director of Public Prosecutions, to oversee and handle asset recovery matters. The POC section is well equipped to deal with confiscation and forfeiture and has issued various circulars and internal manuals to guide its work. There is regular interaction with LEAs which is supported by checklists for LEAs to note when assessing the feasibility of restraint order applications. Confiscation and asset tracing also forms a core component of the curriculum delivered to new officers of LEAs as part of their investigative training.

213. The LNC mechanism is an effective tool to immediately withhold further dealing of assets that are the subject of an STR. Given the high risk of fraud and deception offences, emanating both domestically and from abroad, HKC authorities also have successfully applied other innovative policies and initiatives to promote confiscation and restraint of criminal proceeds, such as the ADCC. Such initiatives appear to be promising, and would benefit from further expansion to other high-risk crime types, and provide opportunities for more concrete measures to be developed in the future. Success has been demonstrated with these policies including in relation to a large proportion of fraud and deception cases.

**Box 3.7. HKC Initiatives that support Restraint/Confiscation****ADCC**

Recognising that fraud and deception are the primary internal and external ML threats, the HKPF set up the ADCC on 20 July 2017 to step up action against these threats. Amongst other things, the ADCC provides an instant consultation telephone hotline service to the public for reporting suspected scams and frauds and supports the HKPF's investigation units to stop suspicious payment through liaison with banks. Initial success has been noticed in the stop payment capacity of the ADCC. As at May 2018, the ADCC Anti-Scam Helpline has received 20 404 calls from the public and has successfully prevented or halted 91 ongoing scams by rendering timely advice to potential victims. Internally, the ADCC has received 1 798 enquiries from frontline units and delivered 759 counts of consultation service to them, which have significantly enhanced the support to the HKPF investigators on the investigation of deceptions and frauds. The stop payment capability of the ADCC is also evidenced from the figures. As of May 2018, the ADCC has received 1 058 stop payment requests with HKD 429 million withheld upon urgent liaison with banks and relevant LEAs and frontline scam response teams have been sent out on 18 occasions, in which 25 ML suspects were either intercepted or arrested when they approached the banks for withdrawing money.

**LNC**

The LNC mechanism is an administrative mechanism put in place by the JFIU to prevent assets which are potentially subject to restraint and confiscation from dissipating before a court order can be obtained. Upon receiving an STR, if there is a reasonable prospect of successfully obtaining a restraint or confiscation order in respect of property referred to in the STR, the JFIU will issue an LNC to the relevant reporting entity indicating objection to any further dealing of the property concerned. The effect of an LNC is that the RE may be liable for prosecution under sections 25(1) of the OSCO and/or the DTROP or section 7 or 8 of the UNATMO (as the case may be) if it further deals with such property.

214. Adequate restraint and confiscation statistics are kept and overall show a positive trend in confiscation activities and indicate that efforts to seize, freeze and recover assets are increasingly proving to be successful. Authorities interviewed during the on-site visit stated that confiscation of proceeds and benefits of crime is seen as having a deterrent effect and is therefore actively pursued as a policy.

215. Some improvements can be made as regards the types of information collected. For example, no statistics are collected concerning the amounts or values seized by LEAs overall during the course of investigations. Statistics also do not appear to be kept concerning the value of criminal instrumentalities eventually confiscated.

***Confiscation of proceeds from foreign and domestic predicates, and proceeds located abroad***

216. As detailed in the TC Annex, LEAs have the requisite powers under the OSCO and the DTROP to seize instrumentalities and proceeds of crime during the investigative stage which can be used as evidence as well as being subject to a confiscation application. Following seizure/freezing of suspected proceeds of crime,

whether through investigative means or mechanisms such as the LNC, the matter is referred to the POC unit of the DOJ for final determination as to whether or not a formal restraint order is applied for. All restraint and confiscation applications under the OSCO and the DTROP are undertaken by the DOJ.

217. HKC operates a conviction-based system whereby, upon conviction of a specified offence or drug trafficking offence, an application for a confiscation order under OSCO or the DTROP can be made against a defendant's realisable property, for the equivalent value of his/her benefits. Confiscation in lieu of conviction can also be pursued via, for example, absconder or deceased person proceedings, which are effective for confiscating proceeds of crime where the defendant intentionally avoids the service of any court documents on him/her or has fled HKC or has passed away.

218. Certain legal gaps continue to exist particularly under the OSCO whereby only benefits above HKD 100 000 (USD 12 750) can be subject to formal restraint or confiscation procedures. This mandatory threshold hinders asset recovery actions to some extent. Civil forfeiture does exist but is limited to drug-related offences where the DTROP allows for forfeiture of monies seized when being imported into or exported from HKC without a need to prove a criminal offence.

#### Box 3.8. Case involving Civil Forfeiture Order Under Part IVA of DTROP

A forfeiture order application was made pursuant to section 24D of Part IVA of the DTROP against cash found in the possession of a person when he was about to leave HKC. At the time of interception, a small amount of dangerous drug was found from that person. The cash was seized and detained as it was suspected to be intended for use in drug trafficking. The arrestee was later surrendered to another country and was convicted of drug offences. In October 2018, the money seized and detained in HKC was forfeited under the civil proceedings provided in Part IVA of the DTROP.

219. The LNC mechanism has been successful in halting the flight and dissipation of assets when suspicions have been raised and prior to any formal restraint procedures. This mechanism can also be useful for mitigating the OSCO threshold issue and allowing for smaller amounts below the threshold to be temporarily restrained. The money withheld under the LNC, even though less than HKD100 000 (USD 12 750), can still be confiscated under the OSCO insofar as the benefit assessed in relation to the case exceeds HKD 100 000. These initiatives have received buy-in from LEAs and are also fully supported by the private sector, particularly FIs.

**Table 3.13. Statistics on LNCs issued (2013-Oct 2018, USD)**

Year	2013	2014	2015	2016	2017	2018 (up to Oct)
No. of LNCs issued	392	381	430	500	499	628
Amount frozen	680 000	210 000	180 000	150 000	1 170 000	340 000

220. HKC authorities indicated that 62.1% of funds frozen by the LNC mechanism are converted into formal restraint orders. 18.9 % of the funds are eventually confiscated through the Court process with 17.2% being realised by the Government. There are various reasons for the reduction of figures such as the fact that some

amounts are returned to victims or disbursed for the defendants' living and legal expenses. As a general rule, HKC authorities do not initiate restraint or confiscation proceedings against the realisable property of offenders if the victims have initiated or are contemplating recovery via civil action.

3

### Box 3.9. Case involving Utilisation of the LNC Mechanism

#### Case involving Drugs

In mid-2017, the HKPF raided two cannabis cultivation centres with thousands of cannabis plants and kilograms of cannabis herbal seized. The son and the father of a family were arrested for operating the cultivation centres while the mother was suspected of having assisted in concealing the drug proceeds. The HKPF searched their residence and seized over HKD4 million (USD 510 000) in cash and uncovered the existence of a safe deposit box at a bank, seizing another HKD 2 million (USD 255 000) in cash. LNC was issued against all bank accounts of the above persons with a few hundred thousand balance temporarily suspended. In May 2018, a restraint order was granted against the cash totalling HKD 7 million (USD 893 000) found in their residence, bank accounts and a safe deposit box at a bank. The father and son were prosecuted for drug trafficking offences whereas the father and mother were also prosecuted for ML offences. Trial date is to be fixed.

#### *Formal Restraint and Confiscation*

221. HKC has in recent years further increased its efforts and has restrained and confiscated a significant volume of proceeds of crime. LEAs routinely pursue financial investigations to identify assets for the purpose of recovery and their efforts are ably supported by the DOJ with large amounts restrained and confiscated annually. Between 2013 and the time of the onsite visit (November 2018), authorities restrained approximately HKD11 231 million (USD 1 439 million) with HKD 1 991 million (USD 255 million) being confiscated and HKD 1 621 million (USD 207 million) ultimately being realised. Authorities obtained 223 restraint orders and 179 confiscation orders during this period. In overall terms the number of orders made and the value of property restrained/confiscated are significant.

222. The value of assets restrained declined from 2014 until 2017 and there was a noticeable drop in the number of applications in 2015 and 2016. HKC authorities advise that this drop was due to two CFA cases which concerned important points of law related to ML (see IO.7), causing certain confiscation actions to be put on hold. However the number of cases and value of assets increased since 2017 and significantly in 2018, from 29 restraint orders and 12 confiscation orders in 2016 to 43 restraint orders and 35 confiscation orders in 2018. More funds were restrained in 2018 than in 2013 to 2017 combined. HKC authorities advise that this is due to the restraint of a very large amount in one case, which is still at an early stage.

223. In terms of amounts confiscated and realised, the largest amounts were in 2013, though the amounts are increasing after the decrease in 2015-2016. The DOJ acts swiftly to seek the necessary court orders and LEAs similarly are quick to respond to asset recovery actions, which are testament to the central focus given to such actions in national AML/CFT policy. HKC authorities do however indicate that confiscation cases are often complex, and time and resource intensive, and that

criminal proceedings can take years to complete. Hence, in terms of statistics, restraint actions initiated in one year may not be translated into confiscation actions until several years later.

**Table 3.14. Statistics on restraint and confiscation under the DTROP and the OSCO (2013-15 Nov 2018)**

Year	Property restrained		Property confiscated		
	No. of orders	Amount (USD)	No. of orders	Amount (USD)	Collected by Government (USD) (No. of orders involved) [amount /no. of order re ML offence]
2013	43	171 649 554.16	34	89 860 483.00	81 719 188.22 (22) [81 607 786.69 (21)]
2014	49	139 212 337.14	47	40 603 764.57	6 944 831.51 (33) [6 531 847.90 (28)]
2015	28	45 175 543.93	23	17 696 199.75	7 020 475.51 (31) [6 822 751.50 (30)]
2016	29	38 655 373.57	12	17 059 587.07	550 867.64 (12) [372 367.19 (10)]
2017	31	8 525 177.77	28	42 909 850.65	59 688 808.72 (23) [59 565 896.21 (20)]
2018 (up to 15 Nov)	43	1 029 437 239.70	35	45 973 397.90	50 951 742.66 (37) [42 178 381.69 (33)]

### Box 3.10. Examples of HKC's successful restraint and confiscation actions

#### **HKC v Zeng Xiong Wei, DCCC 1035/2015 (ML re smuggling in other jurisdictions)**

In early 2013, the C&ED conducted a joint investigation with the LEA of Jurisdiction X against a syndicate involved in exporting luxury left-hand drive vehicles from HKC to Jurisdiction Y and then smuggling them into Jurisdiction X. The payments for the vehicles were made into bank accounts in Jurisdiction X held by the mastermind Zeng who then arranged transfer of such monies into bank accounts in Jurisdiction X held by an MSO in HKC. Zeng subsequently laundered the crime proceeds of HKD59 million (USD 7.53 million) by collecting the monies from the MSO. A restraint order was obtained against Zeng. Zeng was charged with ML. At trial, the two staff members of MSO testified as prosecution witnesses against Zeng. In March 2018, Zeng was convicted of ML as charged and was sentenced to imprisonment for five years. A confiscation application for about HKD17 million (USD 2.17 million) of realisable properties has been made. As a result of Zeng's application for extension of time for legal representation and to file papers in reply, the hearing was adjourned to 26 March 2019.

#### **HKC v Ng Yuet Fei & Kan So Fong, DCCC 1381/2011 (ML re managing a domestic vice establishment)**

Ng Yuet Fei ("Ng") and Kan So Fong ("Kan") were repeatedly arrested at vice establishments in HKC for providing illicit sexual services. Financial investigation revealed that they had controlled 19 bank accounts to launder HKD 31.38 million (USD 4 million). They were then charged with managing a vice establishment and ML offences. Restraint orders were obtained against both of them. Upon their convictions of those offences, two confiscations orders for the respective amount of HKD 8.8 million and HKD 11.3 million (USD 1.12 and 1.44 million, respectively)

were made against them in August, 2014. In order to settle the confiscation orders, Ng and Kan sold their real estate property. Both confiscation orders were fully satisfied in March 2018 and paid to the Government.

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224. Authorities have the ability to seize all assets, cash and non-cash, and have seized a wide range of property, including securities, real property, jewellery and other valuables and goods such as ivory in the course of their investigations. No examples were provided where HKC authorities seized non-tangible forms of property such as businesses. HKC was also able to demonstrate effective asset management procedures, which are embedded in the LEAs' standard operating procedures and underpinned by detailed manuals and guidance. Moreover, once a restraint order is applied for, the OSCO and the DTROP empower the Court to appoint a third-party receiver to manage and deal with the restrained property. Cash is the most commonly seized asset and complex cases involving asset management are referred to the Court for further directions. HKC authorities advise that in some cases, agreement on management of assets is negotiated with defendants. Normally, assets would be sold only with the consent of the defendant. However, in some cases, assets would be realised even without the defendant's consent, for instance, in cases where the real property is subject to a mortgage action.

225. The confiscation of instrumentalities is covered under HKC law and LEAs, as a matter of practice, apply under various laws, mainly the Criminal Procedure Ordinance (CPO), for the forfeiture of instrumentalities used in the commission of the crime. Some statistics concerning the total value of seized articles that were forfeited by the C&ED were provided, which demonstrates to a good extent that the C&ED is taking efforts to identify instrumentalities of crime. It was also advised that such applications occur in almost every case involving property believed to have been part of the commission of the offence.

226. The IRD issues notices of assessments to those accused of tax evasion for the payment of back taxes and provided figures showing the completion of around 9000 cases with assessed back tax and penalties around HKD13.59 billion (USD 1.73 billion). Out of the 9 000 cases, 17 related to criminal prosecution. HKD 4.4 million (USD 560 000) was collected from those 17 cases.

227. Where the restitution of proceeds of crime to victims is concerned, the Prevention of Bribery Ordinance (POBO) has its own pecuniary penalty provisions that can be invoked to effect restitution where, upon conviction, the court can order that the amount of advantage received or a portion of it can be returned to any person or public body as the court directs. This however is limited to cases involving bribery with a HKC nexus.

**Table 3.15. ICAC Statistics on Restitution under POBO**

	2013	2014	2015	2016	2017	2018 (up to Sept)	Total
Amount restituted (in USD million)	0.94	1.81	0.22	0.14	0.23	0.026	3.37

228. If victims are identified and the amounts subject to restraint or confiscation belong to the victims, HKC's policy is to encourage victims to pursue separate civil

proceedings to recoup their losses. Victims can do so through either civil injunctions or garnishee orders. HKC authorities also advised that the recovery of proceeds of crime for the benefit of victims can only occur before a confiscation order is realised as there is no mechanism available for victims to be paid out from what has been recovered by the Government. Such a situation is not ideal as it would seem that victims can only have recourse through their own initiative through civil proceedings, rather than being able to have the funds of which they have been defrauded returned as part of the restraint/confiscation proceedings. HKC should consider the creation of an asset recovery fund or another mechanism whereby funds can be returned to victims where appropriate, without them having to pursue their own civil proceedings.

229. In certain cases, upon the conviction of the defendant a compensation order may be applied for and granted by Court under the CPO in favour of identified victims.

**Table 3.16. Number of Garnishee Orders issued and amount involved in HKPF cases**

	2013	2014	2015	2016	2017	2018 (up to Oct)
No. of Garnishee orders (against those cases with LNC issued)	11	35	98	155	132	48
Amount of those Garnishee orders involved (USD million)	2.4	18.69	21.55	111.74	64.67	39.95

### *International recovery and sharing of assets*

230. HKC is responsive to international co-operation where asset recovery is concerned and has entered into asset sharing agreements with other foreign jurisdictions.

#### **Box 3.11. Cases illustrating successful asset sharing and response to international confiscation requests**

##### **Case involving Drug Trafficking and ML**

In April 2012, Jurisdiction X made a request to HKC for assistance in a drug trafficking and ML investigation and prosecution. The drug proceeds were laundered through and traceable to a number of bank accounts in HKC. On the strength of orders of Jurisdiction X, HKC's assistance was sought to restrain dealings in seven identified bank accounts. The accounts were restrained in May 2012. In August 2015, Jurisdiction X sought the assistance of HKC in enforcing two final orders of forfeiture. These were registered as external confiscation orders in March 2016. In December 2016, Jurisdiction X made a further request for sharing 50% of the confiscated funds and after realisation of around HKD 8.54 million (USD 1.09 million), 50% of which was shared with Jurisdiction X in July 2017. The request for enforcement of external confiscation order was executed around six months upon receipt of the request (and within two months from the date on which the request was executable, i.e. rectification of the final orders).

##### **Case involving Trade-Based ML of Drug Proceeds**

In May 2012, Jurisdiction B made a request to HKC for assistance in restraining bank accounts, obtaining records, and service of documents for an investigation of a trade-based ML of drug proceeds by a drug trafficking cartel based in Jurisdiction Y. Investigation revealed that drug proceeds were traceable to bank accounts of

two HKC based companies. The accounts were restrained in March 2013. In July 2012, Jurisdiction B commenced civil forfeiture action against the accounts. In January 2014, owners of the accounts reached a settlement with Jurisdiction B which was recorded in a judgment in July. In October 2014, HKC applied to register the judgment per request as an external confiscation order and was enforced in January 2015, whereupon a sum of HKD1.4 million (USD 180 000) was ordered for forfeiture. In March 2015, Jurisdiction B made a further request for sharing 50% of the confiscated funds which was acceded to in January 2016. The request for enforcement of external confiscation order was executed around three months upon receipt of the request.

231. Whilst HKC has pointed to some successful cases of foreign recovery of proceeds, there is further scope for the HKC to increase its use of outgoing formal requests for tracing, restraint and confiscation for pursuing offshore movement of proceeds of criminal activity that occurred in HKC. HKC authorities advise that the lack of outgoing formal requests is somewhat mitigated by: (i) the use of informal means; (ii) the assets restrained locally being sufficient to satisfy the confiscation order; and (iii) convicted persons voluntarily repatriating assets from abroad to satisfy the confiscation order and avoid additional sentences. The assessment team however is of the view that this does not occur in the majority of cases and that more efforts need to be made in pursuing proceeds of crime outside of HKC. Due to technical gaps in the MLAO, asset recovery with other parts of China is confined to drug-related cases under the DTROP, with co-operation limited to law enforcement efforts only.

**Table 3.17. Outgoing requests for restraints / confiscation 2013-October 2018**

		2013	2014	2015	2016	2017	2018 (end Oct)
Restraint request	No. of requests made	3 <sup>35</sup>	4	0	0	0	0
	Value of assets restrained (USD million)	14.62	0	0	0	0	0
	Value of assets pending restraint (USD million)	0	0	0	0	0	0
Confiscation request	No. of requests made	0	0	2	0	0	0
	Value of assets confiscated (USD million)	0	0	0	0	0	0
	Value of assets pending confiscation (HKD million)	0	0	7.82	13.01 <sup>36</sup>	0	0

**Note:** No asset was shared under outgoing request during 2013-2018

232. Given HKC's position as a global financial centre, there is a need for HKC authorities to take a more proactive approach to identify, restrain and confiscate overseas assets representing proceeds of foreign predicates, with a focus on high-risk crime types. From the figures provided, despite that a large amount of crime proceeds from foreign predicates is confiscated, it appears that HKC does not routinely trace assets abroad for confiscation, with the ultimate aim of depriving criminals of their assets, and adopts a largely reactive approach. Assessors observed that this reactive approach also leads to authorities abandoning investigations/proceedings where funds have been moved abroad. This also supports the observation that more

<sup>35</sup> One out of the three requests was acted upon by the requesting jurisdiction.

<sup>36</sup> This amount relates to one of the two requests made in 2015.

complex cases with international aspects are not vigorously pursued (see IO.7). HKC should take the necessary steps to ensure that confiscation priorities are aligned with its international risk profile and that a more proactive approach is taken to confiscate assets abroad.

### *Confiscation of falsely or undeclared cross-border transaction of currency/BNI*

233. HKC implemented legislation for the declaration of imports of CBNI valued above HKD 120,000 (USD 15000) from July 2018. For exported CBNI, HKC relies on a disclosure system with customs officers making requests to travellers, although for CBNI carried as cargo, there is a declaration system for both import and export<sup>37</sup>. There has not yet been any confiscation under the legislation. In light of the recent implementation, effectiveness is still to be demonstrated in this area and it is too early to tell whether the confiscation regime regarding CBNI is being applied effectively and is sufficiently dissuasive. Prior to July 2018, authorities demonstrated that some limited actions has been taken regarding the threats posed by CBNI.

234. Irrespective of the implementation of the new law, the HKPF and the C&ED can seize any CBNIs in a person's possession upon arresting him or her under the DTROP, the OSCO or the UNATMO as appropriate, if there is reasonable suspicion that the person is involved in ML/TF activities. There are also mitigating measures under the Import and Export Ordinance (IEO), where unmanifested cargo is liable to forfeiture, as well as the Post Office Ordinance, which prohibits the transmission of CBNI through mail.

235. In relation to declarations made by individual travellers, in the 3.5 months between 16 July and 31 October 2018, the C&ED received a total of 5 953 declarations, with a total value of CBNIs declared being HKD 66.3 billion (USD 8.5 billion). On an annual basis this would amount to about HKD 226 billion being imported. In some cases travellers transported tens of millions of HKD. The vast majority of the total value related to HKD notes being re-imported from Macao, China, since these notes are taken out of HKC for use in Macao, China, where the HKD is widely used as an informal second currency. Of the total volume that is declared on importation back to HKC, about 77% is declared by security firms on behalf of two banks, importing the banknotes on ferries. The other 23% is imported by other travellers. In the same 3.5 month period, the C&ED made 149 924 requests for disclosures to travellers who were about to leave HKC or arrived in HKC not via control points. It is not known what was the disclosed value of the CBNI being exported, though the HKD notes that are imported would have been mostly previously taken from HKC to Macao, China, by individual travellers. It is clear that very large amounts of CBNI are being exported from and imported into HKC.

236. In relation to declarations made concerning cargo shipments (both import and export) of CBNI between 16 July and 31 October 2018, C&ED received a total of 3 134 declarations, with a total declared value of HKD 392.8 billion (USD 50 billion). The authorities advised that most of the declarations (97% of the total value of the declared values) are made on behalf of banks, more specifically one bank that does

<sup>37</sup> Import/export includes with respect to Mainland China and Macao, China.

most of these wholesale cash transactions. These cargo shipments, which are by air, sea and land, relate to jurisdictions other than Macao, China.

237. In terms of enforcement, three cases of unmanifested cargo involving CBNI were detected between 2012 and October 2018, involving CBNI with a total value of HKD 3.23 million (USD 410 000). However, HKC stated that none of these cases involved ML/TF with the unmanifested CBNI being forfeited. The C&ED has also detected 29 breaches of declaration or disclosure requirements, but these cases were described as low risk. HKC authorities state that three cases are being followed up for ML with two cases relating to individuals and one to a legal person. As at 31 October 2018, no seizure had been made in respect of CBNI involved in breaches of the declaration or disclosure requirements, as the CBNI concerned had not been reasonably suspected to be crime proceeds or terrorist property.

**Table 3.18. Number of cases of breaches (16 July – 31 October 2018)**

Total number of cases of breaches	29
Handled by:	
C&ED's issue of written warnings (in the grace period of 16 July – 15 October 2018)	23
Travellers making payment in accordance with section 13 of Cap. 629 (Applicable only to travellers on C&ED's discretion)	5
Arrest (and subject to further investigation)	1
<b>Total value of CBNI involved (HKD) [Equivalent USD]</b>	<b>HKD 15.85 million [USD 2 million]</b>

238. Whilst HKC can be commended for taking initial steps to develop a CBNI system, certain facets of the system can be improved, in particular for addressing the potential risks posed by cross-border CBNI. This includes taking steps to ensure adequate co-ordination with foreign counterparts regarding cross-border movements of CBNI and the detection and confiscation of undeclared CBNI.

### *Consistency of confiscation results with ML/TF risks and national AML/CFT policies and priorities*

239. The largest amounts restrained and confiscated relate to fraud, which was the main predicate crime identified in the HRA, followed by drugs and gambling-related offences (see tables 3.19 and 3.20 below). In this sense, HKC's confiscation results for domestic crime appear to be broadly consistent with the ML/TF risks identified in its NRA. Where foreign predicate offending is concerned, fraud and drug-related activities are identified as key threats and confiscation results are consistent with this. This however is less evident in the area of foreign tax and corruption where the figures provided by HKC do not indicate much activity. HKC should improve confiscation in these areas to ensure that confiscation results align with the medium high risk associated with these criminal offences. The HKPF appears to be the agency most involved in pursuing confiscation. The ICAC and the C&ED have made some confiscation and restraint orders for non-fraud higher risk crimes, although the number is fairly limited. HKC has not confiscated any terrorism-related fund or other assets, which is largely in line with its medium-low TF risk profile.

**Table 3.19. Restraint orders by the HKPF from 2013 to Oct 2018  
broken down by predicate offence (and value, USD million)**

Year		2013	2014	2015	2016	2017	2018 (up to 31 Oct)
Domestic Predicate Offence	Fraud	-	1 (0.19)	-	-	-	4 (0.78)
	Drug-related	2 (0.74)	-	-	-	1 (0.27)	4 (1.78)
	Loansharking	-	-	-	1 (0.59)	-	-
	Gambling-related	1 (0.90)	2 (1.79)	-	-	-	2 (12.57)
	Triad	1 (1.20)	-	-	-	-	-
	Money Laundering	2 (1.61)	3 (1.40)	-	-	1 (0.96)	2 (10.39)
	Theft/Burglary/Robbery	1 (0.39)	1 (0.49)	-	-	1 (0.019)	-
	<b>Total</b>	<b>7 (4.84)</b>	<b>7 (3.81)</b>	<b>-</b>	<b>1 (0.59)</b>	<b>3 (1.25)</b>	<b>12 (25.52)</b>
Foreign Predicate Offence	Fraud	26 (102.33)	33 (6.94)	20 (31.42)	18 (7.86)	18 (2.20)	24 (936.63)
	Drug-related	-	1 (2.80)	1 (0.040)	-	2 (0.38)	1 (4.10)
	Gambling-related	3 (0.67)	2 (25)	-	1 (20.42)	3 (2.43)	1 (3.61)
	Vice-related	3 (0.41)	-	2 (0.15)	3 (1.64)	2 (0.12)	-
	Stand-alone ML	1 (0.20)	2 (1.04)	-	1 (0.098)	-	-
	Theft/Burglary/Robbery	1 (0.082)	1 (0.13)	2 (0.40)	-	-	-
	Bribery	1 (2.81)	-	-	-	-	1 (32.81)
	<b>Total</b>	<b>35 (106.51)</b>	<b>39 (35.90)</b>	<b>25 (32.01)</b>	<b>23 (30.02)</b>	<b>25 (5.10)</b>	<b>27 (977.15)</b>

**Table 3.20. Confiscation orders by the HKPF broken down by predicate offence  
(and value, USD million)**

Year		2013	2014	2015	2016	2017	2018
Domestic Predicate Offence	Fraud	1 (2.97)	-	-	1 (0.018)	-	3 (0.51)
	Drug-related	2 (0.13)	5 (1.90)	3 (1.89)	-	2 (1)	-
	Gambling-related	3 (0.76)	-	-	-	1 (0.55)	1 (0.22)
	Vice-related	-	2 (2.69)	-	2 (0.2)	-	-
	Money Laundering	1 (0.15)	-	1 (0.77)	1 (0.63)	-	3 (1.33)
	Theft/Burglary/Robbery	-	-	-	-	-	1 (0.019)
	Triad	-	-	-	-	-	1 (0.011)
	<b>Total</b>	<b>7 (4.01)</b>	<b>7 (4.59)</b>	<b>4 (2.65)</b>	<b>4 (0.85)</b>	<b>3 (1.56)</b>	<b>9 (2.09)</b>
Foreign Predicate Offence	Fraud	16 (71.33)	31 (5.78)	15 (5.89)	6 (0.27)	17 (1.39)	18 (28.30)
	Drug-related	-	3 (15.51)	1 (7.82)	-	-	1 (0.017)
	Gambling-related	2 (0.87)	-	1 (0.074)	-	3 (38.74)	-
	Vice-related	1 (0.25)	-	-	-	1 (0.55)	-
	Stand-alone ML	1 (10.63)	-	1 (0.61)	-	-	1 (0.098)
	Theft/Burglary/Robbery	1 (0.13)	1 (0.13)	-	1 (0.12)	1 (0.022)	-
	Bribery	-	-	1 (0.64)	-	-	-
	<b>Total</b>	<b>21 (83.20)</b>	<b>35 (21.42)</b>	<b>19 (15.03)</b>	<b>7 (0.39)</b>	<b>22 (40.70)</b>	<b>20 (28.415)</b>

### Overall conclusions on IO.8

240. **HKC has achieved a substantial level of effectiveness for IO.8.**



## Chapter 4. TERRORIST FINANCING AND FINANCING OF PROLIFERATION

### Key Findings and Recommended Actions

#### *Key Findings*

##### *Immediate Outcome 9*

- a) Authorities and RE have a good understanding of HKC's TF risk, which is assessed to be medium-low and is supported by HKCs 2018 HRA. While HKC has no terrorism cases and no prosecutions or convictions for TF to date, this is not inconsistent with its TF risk.
- b) The systems in place to detect potential TF, arising both domestically and from overseas, are sound, and TF investigations are well integrated into HKC's counter-terrorism (CT) framework and investigations of potential terrorism cases. Although gaps in understanding and reporting within certain sectors, such as some MSOs and DPMS, may limit the intelligence available to trace funds potentially used for TF, this is not a major deficiency given HKC's TF risk and context.
- c) HKC has robust CT and CFT policy co-ordination at both strategic and operational levels. Operationally, the Inter-departmental Counter-terrorism Unit (ICTU) facilitates co-ordination across LEAs and reports directly to the Secretary for Security (S for S), who is responsible for strategic CT and CFT policy at a jurisdiction level and is a member of the CCC.
- d) Authorities demonstrated that, even in the absence of prosecutions and convictions, they are actively investigating potential TF using sophisticated tools and intelligence.
- e) The sanctions available under HKC's legislative framework are proportionate and dissuasive and authorities demonstrated their ability to employ alternative measures to conviction, should the need arise.

##### *Immediate Outcome 10*

- a) HKC is currently implementing TF TFS without delay, within one day. Although this regime (which relies on an extraordinary gazettal process) has only been in place since May 2018, large FIs and DNFBPs and those with international exposure demonstrated a good awareness and understanding of their TFS risks and obligations in practice, which somewhat mitigates the gaps in effective implementation of TF TFS that were observed during the period prior to May 2018. Smaller entities (particularly within the MSO and DPMS sectors) had an incomplete understanding of their TF risks and obligations and struggled to articulate them.

- b) HKC has a strong understanding of the TF risks and vulnerabilities within its NPO sector, and has applied proportionate measures to mitigate the relatively higher risks faced by international NPOs. Sufficient monitoring is in place, and NPOs demonstrated a strong understanding of the risks of their activities and the necessary preventive measures to minimise the risk of abuse.
- c) While no TF assets or instrumentalities have been confiscated, this is not inconsistent with HKC's TF risk. Mechanisms are in place to deprive terrorists, terrorist associates, or terrorist financiers of assets and instrumentalities as and when identified, including preventive measures, mechanisms to freeze and forfeit terrorist property, and the framework for making domestic designations and implementing foreign designations.

#### *Immediate Outcome 11*

- a) HKC is currently implementing PF TFS without delay through a recently enhanced regime, but delays in implementing PF TFS (between 3 and 15 days, for an average of 6.6 days) were observed prior to the new regime.
- b) Authorities demonstrated robust intelligence co-ordination mechanisms and the ability to conduct complex financial investigations, including developing leads to unveil deeper layers of financial activities involving networks and fund flows across several jurisdictions. However, the use of corporate structures and front companies is a typology for PF and the lack of regulation in the TCSP sector until recently may therefore have limited the availability of accurate and complete information with respect to legal persons. The recent commencement of the SCR and the TCSP regulatory regimes would provide additional avenues for LEAs to obtain more accurate and complete beneficial ownership information.
- c) No PF-related funds, assets or economic resources have been identified by HKC. Examination of case studies justified this to some extent, but there are residual concerns regarding whether the lack of substantiated cases is reasonable given HKC's exposure, arising from its status as an IFC, the relative ease of company formation, and its geographic location.
- d) Understanding of PF TFS obligations is uneven among REs in every sector. Large, established entities demonstrated sound understanding and implementation, but there are material gaps in understanding and implementation among smaller entities and within newly regulated sectors. These gaps in awareness are material given HKC's exposure to PF.
- e) Monitoring of REs' compliance with PF TFS obligations is robust among Core Principles supervisors, but is still developing among authorities supervising sectors that have recently been brought under the statutory AML/CFT regime.

#### *Recommended Actions*

##### *Immediate Outcome 9*

- a) HKC should continue to actively monitor its TF risk profile, and continue its focus on the risks as a potential transit country for TF that HKC faces as an IFC.

- b) HKC should ensure that the broadest range of intelligence, including sector-specific intelligence, is available to pursue TF investigations, including in particular intelligence regarding sectors where potentially higher risks of TF arise.
- c) The Force Steering Group Committee on Counter Terrorism (FSCCT) should enhance its efforts to trace all possible funds flows in potential CT and TF cases, in particular funds flows outside of core principles institutions.
- d) Regarding co-ordination, the FSCCT should, where appropriate, ensure that it is able to feed back declassified or other strategic information from its investigations regarding typologies, methods and at-risk sectors to civilian authorities to inform national policies and strategies and regulatory/supervisory activities.

#### *Immediate Outcome 10*

- a) HKC should conduct targeted outreach to higher risk sectors, such as MSOs and DPMS, and to smaller entities that demonstrate an incomplete understanding of their TFS obligations in order to support the continued implementation of TF TFS without delay.
- b) HKC should continue its outreach to the NPO sector regarding its vulnerability to abuse, particularly international NPOs and cross-border charities, and should actively monitor the risks of TF in this sector.

#### *Immediate Outcome 11*

- a) HKC should conduct targeted outreach to smaller entities in all sectors and focus in particular on those sectors that demonstrated more systemic gaps in understanding of their TFS obligations, such and MSOs and DPMS.
- b) HKC should continue to prioritise effective implementation of the new TCSP regime, with a particular focus on combating unlicensed operations and ensuring that licensed TCSPs understand and implement their PF TFS obligations effectively.
- c) HKC should monitor and manage its exposure to exploitation for PF purposes by the DPRK as a strategic priority and ensure an even understanding of risks across all authorities is a focus at the jurisdictional level.
- d) HKC should pursue the identification of PF-related funds, assets and economic resources and review whether there are impediments to identifying such assets in HKC.
- e) HKC should ensure that recent amendments to strengthen the ability to obtain information on legal persons are implemented effectively to better support its ability to actively investigate PF and sanctions evasion (see IO.5).

241. The relevant Immediate Outcomes considered and assessed in this chapter are IO.9-11. The Recommendations relevant for the assessment of effectiveness under this section are R. 1, 4, 5-8, 30, 31 and 39.

## Immediate Outcome 9 (TF investigation and prosecution)

### *Prosecution/conviction of types of TF activity consistent with the jurisdiction's risk-profile*

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242. HKC has assessed its terrorism threat as moderate and TF risk as medium-low. The terrorism threat mainly arises from abroad, through links to areas where there is a higher threat of terrorism, posing some risk (including of radicalisation) with regard to the significant migrant population. TF vulnerabilities arise due to HKC's geographical location and status as an IFC. The inherent TF risks HKC faces as an IFC, and due to its open nature and its geographical proximity and economic connectedness with region affected by terrorism, was discussed at length with the authorities, including through a detailed inquiry into the methodology underpinning HKC's risk assessment for TF, examination of case studies, and analysis of the mechanisms and procedures HKC has in place to identify and investigate potential TF. To date, there is no evidence of TF occurring within HKC and, although no system can be guaranteed to detect all instances of TF, the systems in place to detect potential TF, arising both domestically and from overseas, are sound.

243. Authorities have a good understanding of HKC's TF risk, which was informed by both the HRA exercise, and more importantly, additional analysis based on cases and intelligence available to the FSCCT and CTIC. Agencies that co-ordinate intelligence within the CTIC under the FSCCT have a more nuanced understanding of the precise TF risks and vulnerabilities facing HKC (as they necessarily have access to sensitive information that other agencies do not), but other authorities nonetheless demonstrated a satisfactory understanding of HKC's TF risks. A more even understanding of risks across all authorities could be more of a focus at the jurisdictional level (for instance within the ICTU or CCC, discussed below). Prosecutors and investigators in HKC have attended training on TF investigation and prosecution and the assessment team was provided with guidelines for TF cases for judges and prosecutors. While there have been no prosecutions to date, the training and guidance (along with the minimum requirements of judges and prosecutors) appear to be sufficient to ensure prosecutors and judges can handle such cases appropriately should they arise.

244. While HKC has had no terrorism cases and no prosecutions or convictions for TF to date, this is not inconsistent with its TF risk. The assessment team bases this conclusion on a review of the HRA and other relevant assessments/analyses, as well as case studies and discussions with the HKPF and other relevant authorities. As outlined below, while no investigations have resulted in a prosecution for TF, the authorities demonstrated a good understanding of terrorism and TF risks, typologies and application of investigative methods.

### *TF identification and investigation*

245. HKC successfully identifies and investigates potential TF cases through the use of financial intelligence and other information, and in the course of terrorism investigations, which systematically consider a TF component.

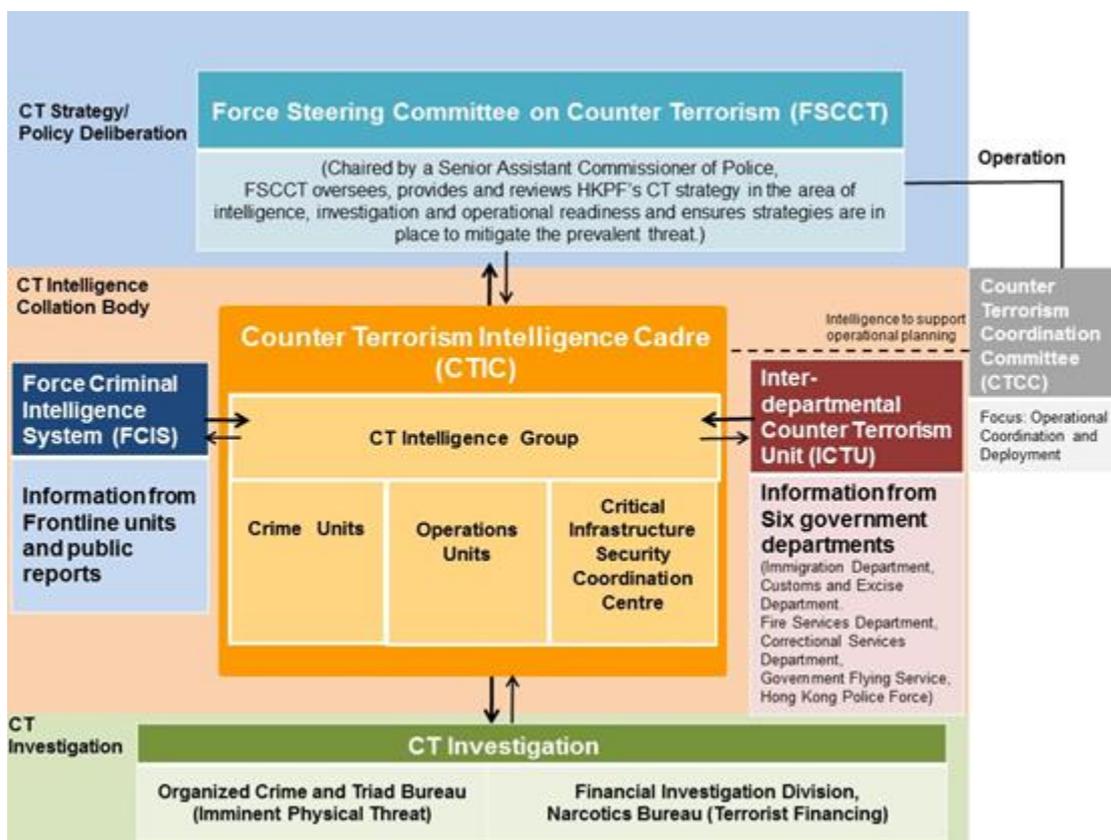
246. HKC's identification and investigation of TF occurs in the context of its counter-terrorism (CT) framework. CT investigations and intelligence primarily sit within the HKPF, through the FSCCT. The FSCCT oversees HKPF's CT strategy with

respect to intelligence, investigation and operational readiness and ensures strategies are in place to mitigate the prevalent threat.

247. Under FSCCT, the CTIC is a CT intelligence collation body comprising members from different police crime and operations units with respective CT roles, including the JFIU. Within the CTIC there is a permanent body established to handle CT intelligence, the Counter Terrorism Intelligence Group (CTIG). The CTIG integrates different sources of intelligence for collation and analysis, including intelligence gathered from local, regional and overseas LEAs, information provided by the public, and intelligence received or generated through the JFIU. The JFIU works closely with the private sector, particularly Core Principles institutions, in order to ensure they are able to identify and report TF and the JFIU indicated that it receives intelligence both proactively through the CTIC which includes the CTIG, and through STRs.

248. Any intelligence in relation to activities suspected to be related to terrorism or TF is referred to the HKPF's two designated CT investigation units: the Organised Crime and Triad Bureau (OCTB), which assesses the physical threat, and the FID of the NB, which assesses the financing components. Intelligence is exchanged freely between OCTB and the FID to ensure that CT and TF investigations run in parallel. There is a designated unit within the FID to handle all intelligence or investigations relating to suspected TF activities.

Figure 4.1. HKPF's CT Intelligence and Investigation Framework



249. From 2013-2017, CTIC member units, under the stewardship of FSCCT, conducted a total of 166 TF investigations, 70 of which arose from STRs relating to suspected TF or terrorism, which is consistent with HKC's medium-low risk profile. Many of the TF-related STRs are submitted by Core Principles FIs. Though there is TF-related STR reporting within the MSO sector, a small number of REs in this sector submit the majority of reports. There have been no TF-related STRs from the DPMS sector or TF STRs relating to DPMS filed by entities in other sectors.

Table 4.1. Number of TF investigations

	2013	2014	2015	2016	2017	Total
No. of TF investigations	15	11	35	49	56	166
Sources of intelligence:						
From TF-related STRs	4	6	20	20	20	70
From non-STR TF intelligence	11	5	15	29	36	96

250. While no investigations have resulted in a prosecution for TF, the CTIC demonstrated a sound understanding of terrorism and TF typologies and investigative methods. Many TF investigations (approximately one-third) related to "false positives" (STRs reflecting name matches with UN designations which, on investigation, were found not to be a match), while others resulted in the

suspicion/allegation failing to be substantiated because funds suspected as TF ultimately proved to be legitimate or because no evidence of TF flows could be uncovered. Whether an allegation is substantiated or not, every investigation is recorded in the HKPF database and any intelligence learnings is fed back into the relevant units.

251. Through a number of case studies, which were discussed in some detail with the assessment team, the FSCCT was able to demonstrate that there have been robust investigations co-ordinated across HKC, including the use of other measures to mitigate the risk of TF where an allegation was unable to be substantiated (see Box 4.2 and section 4.2.5 below).

252. It should be noted that most of the case studies focussed on financial flows through Core Principles FIs and there is some concern as to whether CTIC units under the FSCCT trace all financial flows where it has identified potential TF, for instance through remittances, MSOs or the use of precious metals and stones. Available intelligence will no doubt be enhanced as the supervision of newly regulated sectors matures and would benefit from the regulation of DPMS. Despite this shortcoming, and based on the detailed discussions with authorities, the assessment team is nonetheless satisfied that the absence of TF prosecutions and convictions is reasonable in the circumstances, given the outcomes of the investigations undertaken.

#### **Box 4.1. Illegal Immigrants Transiting HKC for Jihad**

Five illegal immigrants from jurisdiction A were intercepted by the HKPF and extremist materials were found in their mobile phones. Liaison with the HKPF's counterparts in jurisdiction A confirmed their identities and investigation suggested that they intended to transit HKC for jihad in Syria and Iraq. Covert investigation by the OCTB identified Mr. T as the mastermind of a human trafficking syndicate. To deter possible transit of terrorists through HKC, the OCTB promptly co-ordinated with the ImmD and authorities in jurisdiction A for an intelligence-led operation, which subsequently neutralised the syndicate and led to the arrest of 114 persons across two jurisdictions. There were 74 arrests in HKC, including Mr. T and other syndicate members.

Parallel TF investigation by the FID revealed that the core syndicate members in HKC, including Ms. C, had been laundering proceeds of human trafficking to syndicate members in jurisdiction B. However, the investigation uncovered no evidence of TF, at which point the investigation turned to ML arising from human trafficking. In 2017, Ms. C was convicted of ML involving 190 000 HKD and was sentenced to four months' imprisonment. The evidence against Mr. T and two other associates is currently under consideration.

#### Box 4.2. Radicalised Foreign Worker

An intelligence operation by the HKPF, initiated on the basis of internal intelligence, unveiled a foreign worker from jurisdiction B (Ms. F) showing inclination to extremist ideology. The HKPF raised security concerns with the ImmD, which then decided not to extend Ms. F's work visa upon its expiry, and Ms. F departed HKC for jurisdiction B thereafter. After the extremist material was uncovered, Ms. F was placed under active monitoring to manage the CT threat and monitor Ms. F's financial activities. At the same time, the FID conducted a parallel investigation for TF. Both investigations involved active exchange of information and intelligence between the HKPF and its counterparts in jurisdiction B. The TF investigation revealed no STRs relating to Ms. F and no record of remittances by Ms. F. While the investigation has not resulted in a substantiated allegation of TF by Ms. F, the HKPF has passed all relevant information to its counterparts in jurisdiction B (where Ms. F is currently) for their follow up actions and continues to co-operate with jurisdiction B and to maintain close exchange of intelligence on the case's development.

#### *TF investigation integrated with –and supportive of – national strategies*

253. At a jurisdictional level, HKC has a dedicated Inter-departmental Counter-terrorism Unit (ICTU), which includes all relevant law enforcement and intelligence agencies, namely the HKPF, the ImmD, the C&ED, the Correctional Services Department, the Fire Services Department and the Government Flying Service (see Box 4.1 above and Box 4.4 below). The ICTU was established in April 2018 to enhance HKC's CT/TF strategies, action plans, cross-departmental co-ordination, intelligence gathering, training and public education.

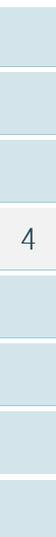
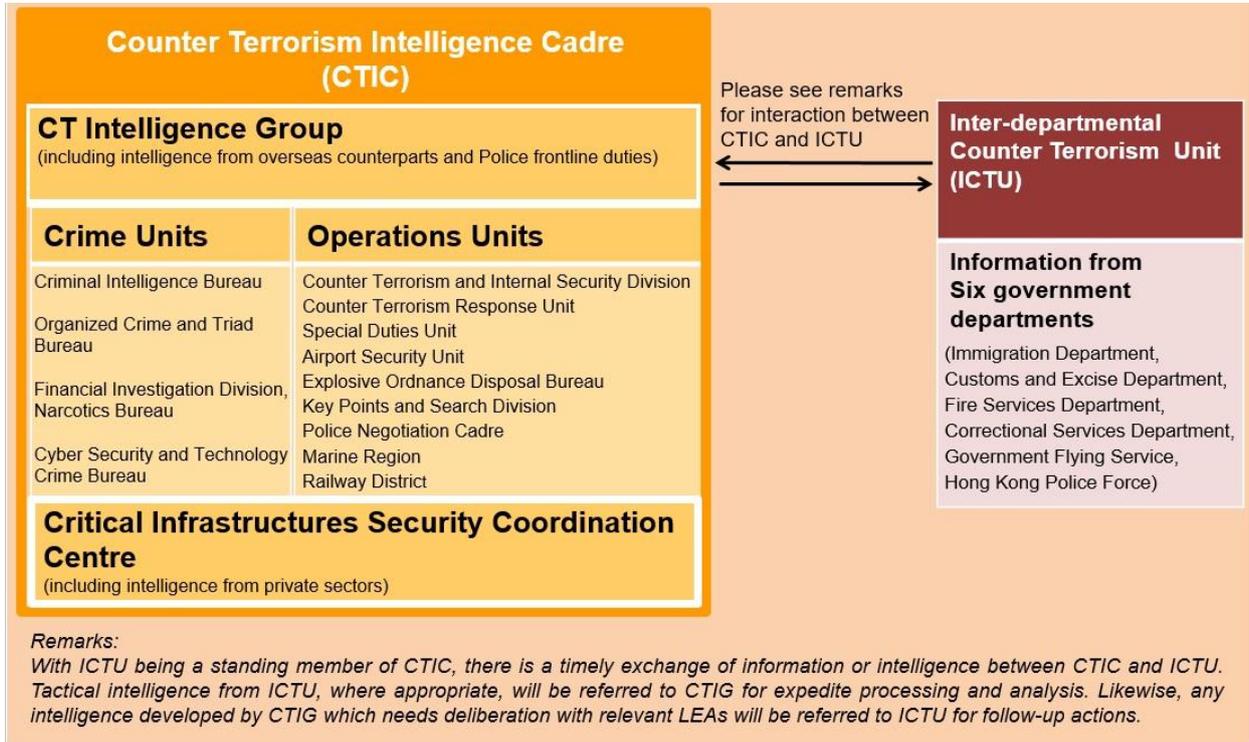
254. As a dedicated inter-departmental intelligence capability, the ICTU integrates and analyses terrorism and TF intelligence from member departments for strategic assessment and identifies potential areas of vulnerability, so that its members can improve systems, policies or practices relating to CT/TF. In addition to intelligence, member agencies provide relevant research on international best practices in CT/TF work related to their departmental areas of responsibility.

255. The ICTU's mandate is to complement the existing intelligence mechanism of member departments. With respect to intelligence gathering and sharing, ICTU members make an initial assessment on the CT-related intelligence received and refer it to the appropriate agency or unit for follow-up. Any intelligence in relation to TF will also be referred to the FID for its follow-up action. The ICTU sits alongside the intelligence function carried out by the CTIG under the FSCCT, discussed above. There is free exchange of information and intelligence between the CTIG and the ICTU and HKPF is represented in both bodies.

256. While the establishment of the ICTU is a welcome enhancement, its membership is largely confined to LEAs. The assessment team observed some hesitation to share information regarding TF with civilian authorities, largely due to the highly sensitive nature of the information involved in terrorism or TF investigations. Authorities should seek to strengthen information sharing and co-ordination at the operational level on TF, including for instance the sharing of

declassified or strategic analysis about common typologies, through established co-ordination platforms such as the AMLRSCG and the STR Working Group, in order to inform civilian authorities’ regulatory or supervision activities.

**Figure 4.2. Intelligence flow between CTIC and ICTU**



**Effectiveness, proportionality and dissuasiveness of sanctions**

257. Under HKC’s law, both natural and legal persons can be prosecuted for TF offences under either the UNATMO, or the United Nations Sanctions (Afghanistan) Regulation 2012 (UN SAR) (Cap. 537AX). HKC authorities report that both the UNATMO and the UNSAR can be invoked depending on the facts and circumstances of the case. Natural persons convicted of a TF offence under sections 7, 8 and 8A of the UNATMO are punishable by up to 14 years’ imprisonment and an unlimited fine (UNATMO, s.14). Alternatively, the maximum penalty for an offence under section 6 of the UNSAR, which does not require *mens rea* to be proven, upon conviction on indictment is imprisonment for seven years and a fine of an unlimited amount. These sanctions are considered to be effective, proportionate and dissuasive. However, there have been no prosecutions for TF in HKC and accordingly no sanctions imposed. This is not unreasonable given HKC’s medium-low risk for TF.

**Alternative measures used where TF conviction is not possible (e.g. disruption)**

258. For the reasons stated above, there has been no need to employ alternative measures where it is not practicable to secure a TF conviction. HKC did, however, demonstrate its ability to use alternative measures (such as immigration measures and deportation) to manage a risk of CT or TF, even where an allegation could not be substantiated. See, e.g., Box 4.3: Radicalised Foreign Worker.

### Overall conclusions on IO.9

259. **HKC has achieved a substantial level of effectiveness for IO.9.**

### Immediate Outcome 10 (TF preventive measures and financial sanctions)

260. As an IFC, there are a large number of multinational firms with branches or subsidiaries in HKC, both in the financial sector and the DNFBP sectors. Most of these companies have a well-established understanding of their TF risks and obligations and have been implementing TFS in relation to UNSCR 1267 designations without delay for many years, based on group-level rules that are in place for their global operations. This, coupled with HKC's medium-low risk of TF and the effectiveness of HKC's activities within the NPO sector, suggests that terrorists are deprived of resources and means to finance or support terrorist activities in HKC to a large extent.

### Implementation of targeted financial sanctions for TF without delay

261. HKC has introduced a system for the implementation of TF TFS without delay. As discussed in R.6, the recently amended UNATMO puts in place a *de facto* freezing regime, under which there is a prohibition on dealing with funds or assets of any designated person or entity, or with specified terrorist property. The prohibition applies to all natural and legal persons in HKC and arises where the person knows or has reason to believe a person or entity has been designated. The prohibition is supported by a dual track system, under which designations are notified in the *Gazette* through an extraordinary gazettal process *and* an early alert of designations is sent to REs through the SB, the FSTB and the relevant supervisors. In practice, since the amendments to UNATMO came into force in May 2018, both notification of designation via *Gazette* and early alert are occurring within one working day (that is, without delay).

**Table 4.2. Timeliness of Designation Notification**

UNSCR	Date of promulgation by UNSC (NY Time)	Date of issuing alert (HKC Time)	Date of Gazettal
1267, 1989 and 2253	29 May 2018	30 May 2018	30 May 2018
1267, 1989 and 2253	5 June 2018	6 June 2018	6 June 2018
1267, 1989 and 2253	18 June 2018	19 June 2018	19 June 2018
1267, 1989 and 2253	17 July 2018	18 July 2018	18 July 2018
1267, 1989 and 2253	9 August 2018	10 August 2018	10 August 2018
1267, 1989 and 2253	23 August 2018	24 August 2018	24 August 2018

262. Prior to the UNATMO amendments, designations were given effect through the normal gazettal process, which could take several days, as the *Gazette* was updated at the end of each week. The UNATMO amendments and the introduction of the dual track system remedy this deficiency. It should also be noted that HKC has not made any domestic designations, nor received any foreign requests through MLA for designation, under its UNSCR 1373 mechanism, but this is not inconsistent with its risk profile.

263. Larger FIs, and the HKC networks/affiliates of international accountants, law firms and TCSPs with strong international presence, demonstrate high levels of

awareness of their obligations under the UNATMO, and these entities have had systems for screening against TF TFS in practice since well before the UNATMO amendments in May 2018. In particular, these entities undertake extensive screening of new clients during the on boarding process, which includes the use of commercial screening services that cover all designations and related persons or entities, as well as ongoing screening of existing clients, usually nightly, using the same commercial services. Screening is supported by internal procedures that require a hold to be placed against accounts that generate a “hit” through sanctions screening while an internal investigation can be conducted and advice sought from the JFIU.

264. However, TFS awareness, understanding and implementation among smaller entities was lower and, for those sectors that have recent requirements under the recent AMLO amendments, compliance with the requirements has not been tested by all relevant supervisors. Smaller entities did not demonstrate the same robust approach to sanctions screening, particularly screening of existing clients against updates to sanctions lists. Those in some sectors, such as MSOs and DPMS, demonstrated an uneven understanding of TF TFS obligations. This raises a concern that there are some pockets in HKC where TFS are not in practice being implemented without delay, which could be targets for TF activities. While HKC relies heavily on the Core Principles institutions’ compliance with TF TFS to demonstrate effectiveness, that reliance itself reinforces the potential blind spot when it comes to smaller entities and recently regulated or unregulated sectors. As at least one of the case studies on HKC’s investigations of potential TF involved some relationship to precious metals and stones, the low awareness within the DPMS sector should be addressed (see the analysis of IO.4 below for further detail).

265. While the alert mechanism has been in operation since January 2018 (10 months before the onsite visit), the other limb (Extraordinary Gazettal) and the amendment to UNAMTO to prohibit dealing with funds or assets were put in place only in May 2018, that is, approximately six months before the onsite visit. In terms of notification, TF TFS are now being implemented without delay and HKC’s medium-low TF risk, and the screening processes that have been undertaken by the larger/more sophisticated REs for many years, can be taken into account in assessing the effectiveness of implementation as it relates to those entities.

#### **Box 4.3. Case Example of Parallel TF and ML Investigation and Co-ordination**

The case started with intelligence received on a possible large-scale drug consignment in HKC arranged by foreigners with allegations about their ex-military background and arms-trafficking records. The covert enquiry unveiled that the consignment consisted of nitrites compound which was different from that described in the source of intelligence. The HKPF commenced investigation focusing not only on the drug trafficking aspect but also the CT and TF perspectives. The CT investigation unit under the OCTB and other tactical intelligence unit were engaged and the FID examined the syndicate’s financial profile from a TF perspective. The co-ordinated investigation resulted in the identification of bank accounts with significant flows of money, other associates and various haunts where substantial storage of gold bars and diamonds were subsequently recovered therein. When the operation turned overt, the consignments, gold bars and diamonds were seized and five persons were arrested. Laboratory tests concluded

that the consignments were found to have contained substance of dangerous goods but with low concentration and could not be classified as explosive or dangerous goods. Subsequent investigation on the five arrested persons and the exhibits seized found no traces of terrorist-related linkage. Whilst the TF suspicion was not substantiated, the investigation continued on the ML front. As a result, all of them were prosecuted for ML and were convicted in 2013 and 2014 with imprisonment terms ranging from 52 to 66 months, and the gold bars, diamonds and other assets amounting to HKD 148 million were confiscated.

### *Targeted approach, outreach and oversight of at-risk non-profit organisations*

266. HKC authorities have a clear understanding of the risks of TF associated with the NPO sector, as described in the HRA and the 2018 updated review of the NPO sector, and HKC takes a targeted RBA to addressing the specific TF risks facing NPOs. HKC considered the risks posed by both domestic and international charities, having regard to the nature of their activities, the types of fundraising conducted and the jurisdictions and individuals with which the charity has relationships. The assessors' conclusions were based on: risk assessments and reports provided by HKC; case studies and statistics illustrating outreach undertaken by the relevant authorities; and discussions with the charity regulators, LEAs, charities of varying sizes, and professional associations within the sector that represent both domestic and international charities.

267. HKC conducted comprehensive reviews of its NPO sector in 2005-2006 and 2018. Between 2006 and 2018, the landscape of HKC's NPO sector remained largely stable. The scope and purpose of the 2018 review were in line with the RBA, to identify the subset of NPOs falling within the FATF's definition, the features and types of such NPOs at risk of TF abuse, nature of TF threats posed by terrorist entities to such NPOs, and the adequacy of measures to prevent such NPOs from being abused for TF. Charities in HKC have various legal structures, such as a company, a society, a trust or a statutory body, their common characteristic is ordinarily that they have obtained tax-exempt status under section 88 of the Inland Revenue Ordinance (IRO) (Cap. 112). The review concluded that the NPO sector in HKC includes approximately 9000 entities falling within the FATF definition and mainly comprises NPOs focusing on the provision of social or community services within HKC. The vast majority of these entities were assessed to face minimal to no TF risk. This conclusion appears to be reasonable.

268. The review found that international and cross-border charities are relatively more exposed to TF risk than local charities and identified 10-15 NPOs in HKC that fall within this subset. The 10-15 "higher-risk" NPOs are largely HKC branches of international charities, as well as one domestic charity, all of which have been identified as relatively higher risk due to the nature of their activities providing humanitarian or relief in regions stricken by conflicts or terrorism. While not every organisation falling within the FATF definition of NPO has tax-exempt status, the review concluded that all of the NPOs assessed to be at relatively higher TF risk have obtained tax-exempt status.

269. In addition to formal reviews, HKC routinely gathers information from various sources (e.g. STRs, intelligence, liaison with the NPO sector, and relevant reports) for

monitoring purposes if individual NPOs are at TF risks or if there are changes to the TF risk of any particular NPO category. The Narcotics Division of the SB convenes inter-departmental meetings involving relevant departments as necessary to, amongst other matters, ensure that they fully understand the CFT objective under FATF's Recommendation 8, observe their CFT and other statutory obligations in respect of NPOs, and maintain close communication for CFT purposes. The Central Co-ordinating Committee on AML/CFT also regularly considers AML/CFT issues, including those related to the NPO sector.

### *Monitoring*

270. With respect to monitoring, all NPOs registered in HKC (including the 10 – 15 higher risk NPOs) are subject to the usual governance and accountability requirements applicable to their legal forms. For charities which are registered as companies limited by guarantee (which constitutes the vast majority of NPOs in HKC), they must file an annual return, which includes the address of the registered office, particulars of company secretary and directors, etc., and keep accounting records for at least seven years. Relevant requirements are actively enforced: from 2013 to 2017, a total of 4 128 compliance notices and 2 587 summonses were issued to companies limited by guarantee (which represents the vast number of NPOs) for failure to deliver annual returns or accounts. For charities established as a statutory organisation, the statutory requirements commonly require the charities to account for the use of all their funds, to prepare and keep proper audited accounts of all transactions, and to be open for inspection.

271. These monitoring requirements are further enhanced by the measures applying to organisations receiving funding from Social Welfare Department (SWD) (which is the major source of government funding for NPOs). A public accountability framework ensures that NPOs receiving government subventions are accountable to the Government and the legislature for the use of public funds. This includes public accountability for funds received, how they are distributed and information on the structure of the NPOs receiving public funds and their activities.

#### **Box 4.4. Example of Additional Requirements for NPOs Subject to SWD**

To encourage NPOs that receive lump sum grants from the SWD to enhance governance, SWD issued the "Best Practice Manual" in 2014, which provides for seven Level One guidelines (i.e. those that NPOs are expected to follow unless they have strong justifications not to do so) and seven Level Two guidelines (i.e. those that NGOs are encouraged to adopt). As of June 2017, all the 165 NPOs under the Lump Sum Grant Subvention System have implemented the Level One guidelines, 57 NPOs have implemented all Level Two guidelines, and 96 NPOs have implemented a number of Level Two guidelines. The guidelines provide for robust financial management, human resource management, corporate governance and accountability.

272. Finally, in addition to the above accountability requirements, there is an additional layer of scrutiny over tax-exempt charitable bodies (including the 10-15 relatively higher-risk charities) by the IRD to ensure that their activities are compatible with their charitable objects. The IRD examines the governing instrument

of the NPO, as well as any activities carried out in the previous 12 months or planned for the following 12 months. In particular, the IRD scrutinises the objects and income clause to ensure that all the objects of the organisation are charitable in nature and that there are adequate safeguards to prevent the channelling of funds for non-charitable purposes. The IRD routinely declines to recognise tax exempt status where it has concerns about: whether an organisation has a genuine charitable purpose, that an organisation might have engaged in activities which are possibly at variance with its charitable purpose, or where the organisation provides insufficient information regarding its operation.

**Table 4.3. Applications for Tax-Exempt Status by financial year**

Financial year	Applications approved	Applications not approved
2013-14	584	137
2014-15	605	153
2015-16	538	163
2016-17	415	286
2017-18	333	252

273. The IRD also conducts periodic reviews of organisations with existing tax-exempt status (normally on a cycle of four years which is shortened to three years starting from January 2018) to ascertain whether they continue to be eligible under the IRO. The IRD will ask the organisation under review to submit documents, including its annual report and financial statements. Statistics provided indicate that IRD has a system in place to ensure all NPOs with tax-exempt status are reviewed on a regular basis.

**Table 4.4. Schedule and Number of Tax Exemption Status Reviews**

Review year	Review questionnaire issued
2013	1 371
2014	1 589
2015	1 364
2016	1 496
2017	2 076

274. The IRD also has the power to withdraw the recognition of tax-exempt status. If there are concerns that an organisation might have engaged in activities which are possibly at variance with its charitable objects or other key provisions in the governing instrument, the IRD would seek clarification with the organisation. If, after investigation, the IRD withdraws the recognition of tax-exempt status of an organisation, the name of the organisation will be deleted from the publicly available tax-exempt list on the IRD's website. The results of IRD investigations into tax exempt status are also shared with LEAs as permitted by law (e.g. where there is suspicion of TF).

**Table 4.5. Exemption Status Cancelled by financial year**

Financial year	Number of charities with tax exemption status withdrawn by the IRD
2013-14	156
2014-15	175
2015-16	213
2016-17	239
2017-18	370

*Outreach*

275. With respect to outreach, the SB first issued an Advisory Guideline on Preventing the Misuse of Charities for Terrorist Financing (the NPO Guideline) in 2007, which is regularly updated to reflect the latest research and intelligence, including FATF typologies and recommendations. The higher-risk NPOs were also involved in the drafting process and their inputs were sought in sharing best practices on good governance which would mitigate the risks of TF. The NPO Guideline is publicly available on relevant Government websites and through the Hong Kong Council of Social Service's networks. The NPO Guideline was most recently updated in September 2018.

276. The SB has conducted focused outreach to the 10-15 higher risk charities over many years, most recently engaging in targeted outreach from March to June 2018 on an institution-by-institution basis to deliver training and provide guidance. The outreach focussed on ensuring the NPOs understand the FATF's best practices against TF abuse of NPOs and advising NPOs of TF risks to which they could be exposed in various facets of their operation. Specific topics canvassed included the collection, retention and transfer of funds, as well as delivery of programmes, recruitment of staff and administration. NPOs were also reminded to screen donors and partners against the lists of designation of terrorists and terrorist associates and the obligation to report suspicious transactions to the JFIU. HKC also conducted outreach to the general NPO sector in September 2018.

*NPOs' understanding of risk*

277. International and local NPOs demonstrated a good understanding of the risk of their potential misuse for TF and have mechanisms in place to manage these risks. The NPOs employ preventive measures to prevent their misuse, for instance prohibiting donors from dictating the ultimate use of their donations, screening and vetting both donors and the organisations and entities receiving donations for distribution (including sanctions screening), and very limited use of cash donations. Typically, cash donations are rare and are only accepted in very small amounts (for instance through anonymous collection boxes); all other monetary donations are received through the financial system which permits NPOs to carry out their vetting and screening.

278. All charities interviewed also indicated that FIs' scrutiny of their transactions further supports their vetting functions, as they are required to provide considerable information on their donors and partners in order to maintain accounts. NPOs reported that they normally reject large amounts of donations from suspicious or anonymous sources.

279. The branches of international charities are well supported by group-level preventive measures. The domestic charity focuses largely on in kind donations to be distributed for humanitarian purposes and demonstrated a sound understanding of risks, including those related to dual-use goods. While the domestic charity has occasionally received monetary donations, it has developed procedures to ensure monetary donations are not misdirected or misused.

4

#### **Box 4.5. Management of Large Monetary Donation by Domestic Charity**

A domestic charity was approached by an individual donor (a natural person) who wanted to provide a large monetary donation to support refugees from the Syrian conflict in neighbouring jurisdictions. The charity vetted and conducted enhanced due diligence on the donor, including inquiries into the individual, their business dealings, whether they were acting on behalf of anyone, and the source of their funds. The charity advised the donor that they would accept a donation for that general purpose, but that the donor would not be able to dictate or influence the specific use of the funds beyond the general intent to support refugees. The charity identified partner organisations within the neighbouring jurisdictions capable of handling the donation and delivering humanitarian relief. These were organisations with which the charity had an existing relationship and the charity conducted a fresh vet of each organisation (including understanding its structure and activities). The charity also conducted site visits to the partner organisations to inspect their operations and verify the nature of their activities, as well as the organisations' own understanding of TF risks. The distribution of the monetary donation was also supported by monitoring and reporting, including detailed plans for the use of the funds and ongoing reporting on activities. When the charity attempted to distribute the donation to its partner organisations, the funds were held up by FIs in HKC, which required further information on the nature of the transaction due to the risk involved. Based on the charity's due diligence, it was able to satisfy the FI that the transactions were safe to proceed with.

### *Deprivation of TF assets and instrumentalities*

280. Mechanisms are in place to deprive terrorists, terrorist associates, or terrorist financiers of assets and instrumentalities as and when identified, including preventive measures, mechanisms to freeze and forfeit terrorist property, and the framework for making domestic designations and implementing foreign designations under the UNATMO, but no TF assets or instrumentalities have been confiscated. This is consistent with HKC's TF risk and context.

281. There has been no suspected terrorist or terrorist associate identified in HKC, and HKC's intelligence has not identified any threat or vulnerability to domestic terrorist cells or terrorist attack.

282. With respect to TF threat from abroad (and of funds moving into or through HKC), as explained more fully in IO.9, thorough investigation has been concluded in respect of 166 cases, resulting in no substantiated case or reasonable suspicion of TF activity.

### *Consistency of measures with overall TF risk profile*

283. HKC has a comprehensive mechanism for preventing terrorists/terrorist associates from raising, moving, and using funds and from abusing the NPO sector. Statutory and administrative freezing mechanisms will be promptly triggered where there is a potential match of designated persons/entities. However, during the past five years, there were no reported cases of matches with the UNSC designated persons/entities, and potential matches with unilaterally designated persons/entities have also been confirmed as false positives. As noted under the analysis of IO.9, all TF intelligence has been cultivated, analysed, and investigated and no substantiated case or reasonable suspicion of TF has been identified. Between 2013 and 2017, the HKPF received no intelligence or STRs on local and international NPOs being misused for TF purposes, though HKC will continue to adopt an RBA in monitoring the activities of and conducting outreach to higher-risk NPOs. These measures are consistent with HKC's medium-low TF risk.

### *Overall conclusions on IO.10*

284. **HKC has achieved a substantial level of effectiveness for IO.10.**

### *Immediate Outcome 11 (PF financial sanctions)*

285. Owing largely to its status as an IFC, the relative ease of company formation, and its geographic location, HKC is exposed to potential PF activities, particularly through the misuse of legal persons, as well as financial channels. During the onsite visit, HKC authorities and representatives from the private sector acknowledged this exposure, particularly through the misuse of HKC-registered shell/front companies, which was exacerbated by the lack of supervision of TCSPs until very recently. HKC's exposure is an important contextual factor that is relevant to determining the materiality of the shortcomings in the implementation of its system.

286. It must be acknowledged that many of the measures HKC has recently put in place will mitigate HKC's exposure to PF, including in particular the recently enhanced PF TFS regime, licensing of TCSPs, the SCR regime, more active supervision by CR and, more broadly, the inclusion of additional sectors within the AML/CFT regime. However, the assessment team has concerns about the recent nature of these measures, in light of HKC's known exposure.

### *Implementation of targeted financial sanctions related to proliferation financing without delay*

287. Similar to its regime for TF TFS, HKC has recently put in place an enhanced freezing regime, which comprises two separate and independent limbs, to implement PF TFS without delay. The first limb of the enhanced system (early alert) had been in place for ten months prior to the onsite visit, while the second limb (extraordinary Gazettal and *de facto* freezing) had only been in place for six months. As discussed in R.7, HKC commenced in May 2018 an extraordinary gazettal process for publishing updated sanctions lists, which triggers a prohibition on dealing with funds or assets of any designated person or entity. While all economic resources, including ships, are covered by the general provisions, an explicit requirement to freeze designated ships was added to the United Nations Sanctions (Democratic People's Republic of Korea

Regulation (the DPRK Regulation) in June 2018 to further clarify the specific obligations. Like TF TFS, the prohibition applies to all natural and legal persons in HKC. The PF TFS provisions impose a reverse onus, in that *mens rea* does not have to be proven by the prosecution, but must be disproven by the defendant. The system is supported by a similar “early alert” mechanism as applies to TF TFS, whereby designations are sent to REs through the CEDB and the relevant supervisors.

288. For the DPRK, this mechanism was further enhanced in June 2018 to provide that the freezing obligations arise by virtue of publication of new designations on the CEDB website, thus alleviating the need for extraordinary gazettal and further shortening the time for the sanctions list to take effect. The enhanced mechanism also allows HKC to implement PF TFS on new designations during weekends and public holidays. In practice, implementation of PFS TF is within one day. However, due to the recentness of the amendments to put this regime fully into place, effectiveness has yet to be demonstrated.

**Table 4.6. Timeliness of PF TFS Designation**

UNSCR	Date of promulgation by UNSC (NY Time)	Date of issuing alert (HKC Time)	Date of Gazettal Publication on CEDB's website
1718	23 May 2018	24 May 2018	24 May 2018
1718	9 July 2018	10 July 2018	10 July 2019
1718	8 August 2018	9 August 2018	9 August 2018

289. For Iran, there have been no new designations since HKC’s new extraordinary gazettal mechanism came into force and consequently no data regarding the timeliness of the publication. The list of entities designated under UNSCR 2231 published by HKC under the United Nations Sanctions (Joint Comprehensive Plan of Action-Iran) Regulation (the Iran Regulation) is up-to-date and reflects the January 2016 amendments.

290. As part of the “alert mechanism” limb of the dual track system for implementation of PF TFS, regulatory authorities (RAs) and SRBs send notifications to each of their REs upon the notification of new designations. RAs and SRBs receive alerts from CEDB regarding new designations, and demonstrated that they proactively monitor for new designations by the UNSC. This practice means that both early alerts and the publication of updated sanctions lists on the CEDB’s website or in the gazette since May 2018 are occurring within one day.

291. Prior to April 2018, however, there were delays in implementing PF TFS of between 3 and 15 days, for an average of 6.6 days, which is not ‘without delay’ under the FATF standards.

292. As noted under the section on *FIs and DNFBBs understanding of and compliance of their obligations*, below, supervision of compliance with PF TFS varies by sector and there are gaps in awareness and understanding of PF TFS among REs in every sector. As with TF TFS, larger FIs, and the HKC networks/affiliates of international accountants, law firms and TCSPs, demonstrate high levels of awareness of their obligations these entities have had systems for screening since well before the recent amendments.

293. However, there are significant gaps in awareness among other sectors, particularly MSOs and DPMS (see core issue 11.3), which are more pronounced than the gaps in awareness and understanding regarding TF TFS. In addition, case examples provided by authorities and anecdotal evidence provided by the private sector highlighted the use of corporate structures for potential PF, making it difficult to reach funds or hold responsible persons to account. While this is likely to improve under the new TCSP regime and AMLO amendments, these amendments are too recent to demonstrate effectiveness. Authorities do have access to beneficial ownership information through the banking sector, but this does not fully mitigate this gap.

#### **Box 4.6. Examples of Investigation Involving Company with suspected DPRK links**

##### **Case 1**

The case started with a piece of intelligence received by HKC, alleging that Company A, a Hong Kong registered company, was a front company of the DPRK. Intelligence suggested that Company A maintained a bank account at Bank X in Hong Kong and was involved in transactions with certain UNSC-designated entities.

The HKPF's enquiry revealed that Bank X had no record involving Company A. The HKPF continued its investigation in collaboration with the JFIU and was subsequently able to identify an account in Bank Y maintained by Company A. The HKPF examined the financial profile and reviewed all financial activities of Company A but no suspicious activities, including any possible linkage with DPRK or any UNSC-designated entities, were found.

Despite the inaccurate information provided in the intelligence, the HKPF continued its investigation which then revealed the existence of Company B, a dissolved company previously registered in Jurisdiction X bearing a very similar name to Company A's. Company B once maintained a bank account with Bank X, which had already been terminated at the time of the investigation. The HKPF examined the financial profile and reviewed all financial activities of Company B and identified three transactions over a seven-year period involving Company C in Jurisdiction Y, which was alleged to be a supplier of trucks for the DPRK on the internet. Apart from that, no direct or indirect transactions with any UNSC-designated entities were found. It was concluded that there was no evidence substantiating any TFS or other sanctions violation by Company B. Details of the persons and entities involved were shared with other agencies, including the C&ED and the CR, for on-going monitoring.

##### **Case 2**

HKC received some financial intelligence indicating that Company A was a company established in Jurisdiction U and allegedly shared the same website address with Company B established in the same jurisdiction. Company B was suspected to be a joint venture with DPRK.

The intelligence alleged that, in 2015, Company A had remitted six wires totalling USD 37 852 to overseas accounts respectively held by two companies operated in Jurisdiction Y and a Hong Kong-registered company owned by a non-HKC resident.

Upon investigation, notwithstanding there were no financial flows via Hong Kong, the intelligence was disseminated to relevant jurisdictions for follow-up.

### *Identification of assets and funds held by designated individuals/entities and prohibitions*

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294. To date, no funds, assets, or economic resources have been found to be associated with designated persons or entities. The assessment team notes that suspected cases of PF have been investigated but no suspicion could be substantiated. However the assessment team has residual concerns on whether the lack of substantiated cases is reasonable given HKC's exposure. Potential impediments to substantiating cases, in the assessment team's view, could include: (1) the use of complex corporate structures to disguise funds or enable them to be held overseas, (2) dissipation of funds while there were delays in implementation of a PF TFS regime, or (3) uneven understanding of PF TFS obligations and its flow on impact on LEA's ability to trace funds. The assessment team's view is based on discussions with authorities, examination of case studies, and analysis of the various preventive measures in place.

295. With respect to co-ordination, the CEDB is the co-ordinating bureau on proliferation of weapons of mass destruction (WMD) and is responsible at the policy level for implementing PF TFS against the DPRK and Iran by way of the DPRK Regulation and the Iran Regulation, including monitoring updates to the 1718 Sanctions List and the 2231 List, notifying other bureaux or departments of such updates for dissemination to the industry (including FIs and DNFBPs), and proposing persons and entities to the UNSC for designation through the Central People's Government of the PRC.

296. The C&ED is responsible for the enforcement of strategic trade controls against import and export of prohibited items, and control of provision of services related to proliferation of WMD and provisions of the DPRK Regulation and the Iran Regulations. The HKPF is responsible for conducting financial investigations in relation to the DPRK / Iran sanctions, in particular cases of suspected violations on (i) prohibition against provision of financial services or transfer of fund that could contribute to a prohibited programme or activity and (ii) prohibition against making funds available to UNSC-designated entities in accordance with prevailing domestic legislation. PF-related intelligence is shared among the HKPF (including FID and the JFIU), the C&ED, and other relevant agencies, such as the CR where companies are involved, and the Marine Department where vessels are involved.

297. The CEDB convenes an inter-agency platform on implementation of the relevant UNSC sanctions to share intelligence; discuss typologies, trends and cases; and co-ordinate government-wide responses. The platform is attended by the FSTB, the HKPF, the C&ED, the CR, the Marine Department and the HKMA on a regular basis, with other relevant agencies invited to join on an as needed basis. The platform has resulted in follow-up actions, such as further investigation of suspected PF, and alerts have been issued to the relevant trades to remind them of the need to comply with sanctions. The participating agencies work closely together, both at formal meetings and on a day-to-day basis, to exchange intelligence and other information for possible investigation.

298. There have been 206 investigations in relation to PF or sanctions evasion resulting from STRs and other intelligence between 2013 and 2018, which includes 329 STRs in relation to potential PF or sanctions evasion. All intelligence on cases of sanctions evasion was examined using a multi-disciplinary approach within the co-ordination framework. On receipt of intelligence (e.g. in respect of a person or an entity), the HKPF conducts a thorough scan, which may cover (a) properties held by such person/entity, including companies, land properties, vehicles, ships, etc.; (b) whether the person/entity holds any bank accounts in HKC, and if so, the transaction pattern; (c) where the intelligence concerns an entity, the ownership structure of the entity (e.g. directors, managers, and company secretaries) and whether there are connected parties; (d) where the intelligence concerns a person, a search of the birth record (which has information of a person's parents) and marriage record to see whether any immediate family member of a person may be suspicious. In respect of (b), the HKPF shares details provided by overseas authorities, LEAs, or obtained from media or other open sources of all alleged persons/locally-incorporated companies to all AIs and require them to identify any business relationship maintained with those persons/ companies.

299. While no funds, assets or economic resources have been identified, authorities did demonstrate the ability to trace financial flows and conduct PF investigations using financial intelligence and other sources of information. In view of 'stooge' or front companies with foreign links being common ML typologies in HKC, authorities indicated that they pay special attention to combating the misuse of company structures, and have generally demonstrated the capability to develop leads to unveil deeper layers of financial activities involving networks and fund flows across several jurisdictions (as observed in the analysis of IO.6 at para 102 above). Authorities employ a similar approach in conducting PF investigations. However, the HKPF's access to the information identified above is necessarily limited by the extent to which this information is available and accurate, particularly for legal persons, including through beneficial ownership information held by FIs. The recent amendments to regulate DNFBNs under the AMLO, particularly TCSPs, as well as the SCR regime will, over time, improve the quality of information on legal persons available to the HKPF.

#### **Box4.7. Case Example – Gold Star 3**

A vessel named Gold Star 3 with IMO No. 8405402, which has been designated by the UNSC on 2 March 2016, intended to enter HKC waters around 10 March 2016. The C&ED had confirmed with the shipping agent of the vessel that there was no cargo on board the vessel and its call to HKC was for bunkering. Although no sanction evasion activity was detected, the vessel was denied entry into HKC on 9 March 2016.

300. HKC also implements a trade control system comprising a licensing system administered by the Trade and Industry Department and an enforcement system under the purview of the C&ED. Strategic commodities under the strategic trade control system include munitions items, chemical and biological weapons and their precursors, nuclear materials and equipment, and dual-use goods that are capable to be developed into WMD. Import, export, and transshipment of strategic commodities

are subject to licensing control and end-use controls apply to dual-use products. Persons who import or export strategic commodities without licence are subject to both fines and imprisonment. From 2013-2017, the C&ED completed 924 investigations, resulting in 208 prosecutions, fines totalling HKD 9.3 million (USD 1 190 260 50) and confiscated goods with a value of HKD 13.1 million (USD 1 676 512 32). In these investigations, no evidence of PF or WMD was uncovered. This suggests that, for goods, sufficiently robust systems are in place to identify cross-border proliferation activities

### *FIs' and DNFBPs' understanding of and compliance with obligations*

301. Larger FIs and the HKC branches of international DNFBPs demonstrated sound understanding of their PF obligations and have robust systems in place to comply, which are driven by group level policies and also modified for the HKC context. These entities utilise commercial screening tools for new and existing clients and generally screen nightly for matches against customers and beneficial owners. The HRA identified PF as a threat in the banking sector, due to HKC's status as an IFC and trading hub. The HKMA has undertaken work with the banking sector to increase awareness among AIs, including issuing industry guidance on TBML in February 2016, seminars on PF typologies in June 2017, and an industry roundtable on the DPRK in May 2018.

302. Amongst smaller entities and more recently regulated sectors, however, key gaps in awareness and understanding were observed. For entities without commercial screening systems, there are inconsistent practices to ensure compliance with sanctions, particularly for existing customers. The MSO sector demonstrated some awareness of PF TFS obligations, particularly within larger MSOs, however smaller entities struggled to articulate the obligations or describe processes in place to ensure compliance. The DPMS sector demonstrated more significant gaps in both awareness of the obligations and compliance with them. The incomplete awareness and compliance within the DPMS sector may be relevant as the use of DPMS is a typology for PF. When considering the DPMS sector's incomplete awareness and compliance, its exclusion of coverage under the AMLO is a relevant consideration.

303. The TCSPs interviewed (which were largely well established businesses) generally demonstrated good awareness of their PF obligations and the systems they have in place to ensure compliance. In the assessment team's view, this is largely due to the CR's outreach to these entities and the enquiries that are made as part of the new licensing regime. However, as this regime is recent and licensing is still underway, many of the first entities to receive licenses were well-established TCSPs or a part of international TCSPs. While 90 % of applications for registration had been completed at the time of the onsite, further implementation will require understanding the scope of unlicensed TCSPs that may still be operating and continuing to take appropriate action against them. It remains to be seen whether smaller TCSPs will have the same awareness of their obligations as larger entities and, necessarily, the assessment team did not interview unlicensed TCSPs.

304. While HKC has conducted some outreach to sectors on PF, and more is planned, this has not yet resulted in a consistent understanding of and compliance with obligations.

### *Competent authorities ensuring and monitoring compliance*

305. Supervision of REs' implementation of PF TFS varies by RA, with some examples of robust and thorough supervision but other examples of key gaps.

306. RAs that supervise larger FIs, or that have been supervising for some time, monitor compliance with TFS as part of ordinary supervision activities. The HKMA carried out thematic examinations of 26 AIs in 2017 to test the effectiveness and efficiency of sanctions screening systems. This work included a specific review of AIs' effectiveness in detecting relationships and transactions involving persons or entities designated under the Iran and the DPRK Regulations and taking freezing action where persons or entities are identified. The HKMA has put action plans in place for those entities found to be lacking in sufficient controls. The key observations and good practices from the review were also shared with SVF licensees to assist them in understanding and optimising the performance of their screening systems. The HKMA has also been working with the banking sector to develop typologies relating to PF and provide a platform for large banks to share information and experiences.

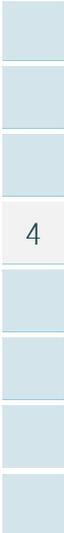
307. The HKMA has also done work on TBML, including the issue of dual-use goods. Between 2013 and 2015, trade finance was included in the scope of on-site examinations for 10 AIs, with some findings and recommendations made in relation to identification of WMD and dual-use goods. All AIs concerned were required to address any shortcomings.

308. For other RAs, such as the C&ED, supervision of compliance with PF TFS has similar gaps to the deficiencies in supervision identified under IO3.

309. The CR has just taken on supervision activities for TCSPs after the 2018 amendments and, while the CR has incorporated supervision of PF TFS compliance into its oversight activities, these supervision activities are relatively recent. This is particularly relevant in the context of the TCSP regime. HKC recognises that TCSPs may be used to form companies that may take part in sanction evasion, particularly with respect to the DPRK, and this concern was echoed by entities interviewed during the onsite. The CR requires applicants for a TCSP licence to declare that they do not have any business relationship with any designated person or entity which is subject to PF TFS and has commenced thematic inspections on a RBA, covering companies and TCSPs more prone to ML/TF risk as primary targets. While the CR's activities as of the onsite visit are to be commended, the newness of the regime means that HKC is not yet able to demonstrate that non-compliance is effectively identified and acted on across the sector.

### *Overall conclusions on IO.11*

**310. HKC has achieved a moderate level of effectiveness for IO.11.**



## Chapter 5. PREVENTIVE MEASURES

### Key Findings and Recommended Actions

#### *Key Findings*

##### *Financial institutions*

- a) Large FIs and those belonging to international financial groups have a good understanding of their AML/CFT obligations and ML/TF risks. The understanding and appreciation of ML and, in particular, TF risks, and the implementation of AML/CFT measures needs significant improvements among the smaller FIs (particularly in the MSO and moneylender sectors), especially with regard to risks posed by non-resident customers.
- b) Large FIs and those belonging to international financial groups implement their CDD and beneficial ownership requirements to a good level. However, the smaller FIs, particularly non-banking FIs, demonstrate a less sophisticated implementation of CDD requirements.
- c) Large FIs and those belonging to international financial groups have a good understanding of specific higher risk situations which require EDD and have implemented adequate EDD measures. However, the smaller FIs, including smaller MSOs in particular, did not demonstrate a comprehensive understanding of high-risk situations and obligations, particularly in relation TFS obligations. Weaknesses in understanding and implementation of PEP requirements among FIs derive from technical deficiencies with respect to obligations for PEPs from other parts of China.
- d) Most STRs are filed by large banks. Although STR reporting by the large banks has improved, the level of reporting by MSOs and moneylenders raises concerns. There are also concerns about the quality of STRs filed by MSOs and defensive filing by authorised institutions remains an issue.
- e) FIs generally have adequate internal control policies and procedures in place, and no obstacles seem to exist with respect to information sharing within international financial groups.
- f) Stand-alone financial leasing companies (i.e. that are not a bank or a moneylender) are not subject to the AML/CFT regime under the AMLO.

##### *DNFBPs*

- a) Large international accounting and law firms and TCSPs with a strong international presence generally demonstrate a reasonable understanding of their ML/TF risks and have implemented adequate risk mitigating measures commensurate with these risks. Understanding of risks is less developed for

other DNFBPs. DPMS are legally required to file STRs and meet TFS obligations, but are not subject to other AML/CFT obligations.

- b) Most DNFBPs do not take a risk-based approach to mitigate their ML/TF risks. They have implemented basic CDD and record-keeping measures.
- c) Regarding requirements to identify and verify the identity of beneficial owners, the domestic TCSPs and estate agents do not have a good understanding of the concept of beneficial ownership and tend to understand it as legal ownership.
- d) DNFBPs, except large international accounting and law firms and the TCSPs with a strong international presence, have a poor understanding of EDD measures for higher risk situations, particularly in relation to PEPs. For these DNFBPs, the lack of adequate measures/systems to identify and detect customers who are PEPs or subject to TFS is a concern. Weaknesses in understanding and implementation of PEP requirements derive from technical deficiencies with respect to obligations for PEPs from other parts of China.
- e) The level of STR reporting by DNFBPs is low and is not commensurate with the risks, especially in the TCSP sector.

### *Recommended Actions*

#### *Financial institutions*

- a) HKC should ensure that FIs, particularly MSOs and moneylenders, deepen their ML/TF risk understanding, especially in relation to cross-border financial flows, non-resident customers and PEPs and apply mitigating measures commensurate with their ML/TF risks, including by providing guidance, training and feedback from the supervisors.
- b) Competent authorities should work more closely with smaller FIs (particularly non-banking FIs), to strengthen their controls in relation to CDD (particularly with regard to the risks posed by non-resident customers) and EDD for foreign PEPs and TFS.
- c) HKC should ensure that FIs, in particular MSOs, strengthen their transaction monitoring systems and ensure adequate, appropriate and timely reporting of STRs. Competent authorities, including the JFIU, are encouraged to provide more feedback and guidance to FIs in relation to the STR obligations, including on red flag indicators and on avoiding defensive filing where appropriate.
- d) HKC should review the risks associated with stand-alone financial leasing companies to exempt them on the basis of proven low risk or to ensure that they implement the appropriate level of AML/CFT measures.
- e) HKC should address the deficiencies identified in the TC Annex, in particular the gaps relating to measures for PEPs from other parts of China.

*DNFBPs*

- a) HKC should ensure that DNFBPs take action to enhance their ML/TF risks understanding and apply preventive measures commensurate with the risks, including by providing guidance, training and feedback from the SRBs.
- b) SRBs should work more closely with DNFBPs and provide enhanced guidance and feedback to strengthen their awareness of ML/TF risks and the implementation of AML/CFT requirements, particularly beneficial ownership requirements; EDD requirements in higher risk situations in relation to PEPs (both domestic and foreign); TFS requirements; and STR obligations.
- c) HKC should review the appropriate level of AML/CFT measures to be implemented for the DPMS sector, in line with ML/TF risks identified and should address the deficiencies in relation to PEPs identified in the TC Annex.

311. The relevant Immediate Outcome considered and assessed in this chapter is IO.4. The Recommendations relevant for the assessment of effectiveness under this section are R.9-23.

#### **Immediate Outcome 4 (Preventive Measures)**

312. For the reasons of their relative materiality and risk in the HKC context, implementation issues were weighted: most heavily for the banking sector, which plays a dominant role in HKC; heavily for the securities, MSOs and TCSP sectors; moderately heavily for the SVF, legal, accounting, DPMS and real estate sector; and less heavily for the insurance and moneylenders sectors. All types of casinos are illegal in HKC and were therefore not considered for this chapter. This is explained in Chapter 1 (under materiality).

313. Assessors' findings on IO.4 are based on interviews with a range of private sector representatives, findings from enforcement actions and input from supervisors, and information from the HKC authorities (including the HRA). Meetings with the private representatives revealed that the implementation of preventive measures varies across and within sectors. While the banking and securities sectors, especially the larger international institutions, demonstrated a good understanding of their ML/TF risks and good implementation of preventive measures, the meetings with the MSO, TCSP and DPMS sectors revealed concerns about ineffective implementation of preventive measures.

#### ***Understanding of ML/TF risks and AML/CFT obligations***

##### *Financial institutions*

314. Since the enactment of the AMLO in 2012, FIs in the HKC are required to periodically assess ML/TF risks at an institutional level in order to establish AML/CFT policies, procedures and controls commensurate with these risks. The level and understanding of ML/TF risks and AML/CFT obligations varies across sectors depending on the size of the institutions, the products and services they provide and

their geographical footprint. Overall, the level of understanding of ML/TF risks and application of a RBA is more sophisticated in the banking sector, followed by the securities and insurance sectors. Risk understanding among the SVF and MSO sectors is uneven and needs improvement for moneylenders. The implementation of a RBA is relatively new for some sectors, particularly for moneylenders and SVF licensees, and models are being developed.

315. Across the sectors, the large FIs, and the FIs which belong to international financial groups, have a good understanding of their ML/TF risks and AML/CFT obligations. They periodically identify, assess and review their exposure to ML/TF risks, in line with their line of business, products and services, customer base and geographical footprint. In addition, they develop their AML/CFT policies and procedures commensurate with their understanding of ML/TF risks and make use of monitoring systems to determine the effectiveness of controls implemented to mitigate those risks.

316. Smaller FIs, especially the smaller non-Core Principles FIs, demonstrate a less sophisticated understanding of their risks, particularly those related to TF. They seem to be more focused on domestic risks (e.g. fraud) and do not fully consider the ML/TF risks arising from the cross-border nature of their products and services as identified by the HRA. Their controls tend to be driven more by compliance than risk. The moneylenders generally tend to focus on mitigating credit risk, to ensure loan repayment, and demonstrated an overall lower understanding of their ML/TF risks.

317. FIs were generally aware of the results of the HRA and were consulted in the process of developing it. Most of them had used the report for their own risk assessment. Most FIs interviewed mainly focus on fraud-related crimes as supported by HRA and to a lesser extent on other cross-border ML risks or other ML risks related to non-resident customers. The customer base of one of the licensed corporations (LCs) met during the onsite consists mostly of non-resident customers, but it did not show a comprehensive understanding of the ML/TF risks involved and the impact on its risk profile, which is of concern. FIs also indicated that the HRA could be further enhanced and better take into account the feedback that they provided.

318. The Core Principles supervisors (the HKMA, the SFC and the IA), especially the HKMA, monitor closely how well supervised entities understand their ML/TF risks through periodic reviews of their institutional risk assessments. The findings of these reviews are shared with the financial sector via AML seminars and forums. The continued focus of the Core Principles supervisors on the risk assessments should contribute to a further improvement of understanding of ML/TF risks.

#### *DNFBPs*

319. DNFBPs' understanding of ML/TF risks and AML/CFT obligations is generally less developed than in the financial sector. The main reasons are that DNFBPs have only recently (March 2018) been placed under the statutory AML/CFT regulatory framework and current supervisory efforts are mainly focused on outreach and awareness building. Moreover, due to their recent nature, the guidelines issued to the DNFBP sectors appear not yet to have had impact on the level of effectiveness of preventive measures applied by these sectors.

320. The DNFBPs were generally aware of the results of the HRA, especially those related to their sector. Large international accounting and law firms, and the large TCSPs with a strong international presence, demonstrated a better understanding of their ML/TF risks and of their AML/CFT obligations. The understanding of the other DNFBP sectors of AML/CFT obligations (particularly relating to PEPs and TFS) appeared to be limited.

- TCSPs – The TCSPs have a mixed level of understanding of their ML/TF risks and AML/CFT obligations. The large ones, especially those with group policies and a strong international presence, tend to have a better understanding of ML risks, but a more limited understanding of TF risk, and focussed almost exclusively on sanctions screening. The smaller TCSPs did not demonstrate adequate awareness of their ML/TF risks.
- Lawyers and accountants – The international accounting and law firms met have a sound understanding of ML/TF risks and the AML/CFT obligations. They would typically apply a group-wide approach to assess their ML/TF risks and benefit from group policies and procedures. The smaller firms did not display a comprehensive understanding of their ML vulnerabilities and risks and demonstrated lower understanding of TF risks, particularly those emanating from abroad.
- Estate agents – The estate agents, in particular the small operators, demonstrated a lower understanding of their ML/TF risks and AML/CFT obligations. They focus mainly on red flag indicators, but they do not seem to encompass a broader understanding of the ML/TF risks they face.
- DPMS – The DPMS sector is not subject to AML/CFT obligations other than general STR reporting and TFS obligations. DPMS have a limited level of awareness of ML risks and a low level of understanding of TF risks. They seem to underestimate the potential importance of their role in addressing the ML/TF risks they face.

### *Application of risk mitigating measures*

321. Regulated entities across the financial and the DNFBP sectors have implemented AML/CFT preventive measures to mitigate their ML/TF risks. However, the extent to which these preventive measures are adequately applied varies between and within these sectors. With respect to TF, many regulated entities rely exclusively on sanctions screening tools to mitigate their TF risks.

#### *Financial institutions*

322. Large banks, LCs, IIs and FIs belonging to international financial groups have put in place internal systems and controls to mitigate ML/TF risks.

323. In particular, the large international banks appeared to have developed a leadership role on the implementation of adequate ML/TF risk mitigating measures. They have implemented more sophisticated AML/CFT controls. Their AML/CFT policies and procedures include a broad range of measures to mitigate ML/TF risks and a “three lines of defence” (business, compliance and audit) approach has been established for ML/TF risk management involving also the boards and senior management. They typically use a risk scoring model for customers, which

categorises the customers' risk profiles (risk level low, medium or high, or a numerical score), and apply differentiated mitigating measures: for high risk customers more scrutiny is applied, such as obtaining additional information, more frequent review of the customer file, escalation procedures and stricter monitoring rules.

324. Smaller banks in general have less structured and sophisticated ML/TF risk mitigating measures in place. The HKMA has identified some areas requiring improvement. For example, a number of banks were found to have relatively weaker transaction monitoring and internal controls to mitigate risks arising from suspicious transactions.

325. The situation in the securities and insurance sectors is very similar to the banking sector, including how AML/CFT programmes are fostered within these institutions and how AML/CFT controls have been established. To drive better behaviour at LCs, the SFC took one step further by implementing the Manager-In-Charge (MIC) regime in 2017, which heightened awareness of senior management's accountability, regulatory obligations and potential liabilities. Under this initiative, all LCs must appoint at least one fit-and-proper individual to be the MIC for the AML/CFT function, who is expected to be held accountable and responsible for overseeing all aspects of the LC's AML/CFT systems.

326. The MSO and moneylender sectors have generally less robust and sophisticated AML/CFT systems. They tend to approach their risk mitigating measures in a rule-based manner and primarily focus on obtaining basic CDD information and certain risk factors (e.g. risks associated with the use cash).

### *DNFBPs*

327. The risk mitigating measures taken by DNFBPs present a mixed picture, with the large international law and accounting firms and TCSPs which have a strong international presence being stronger compared to other DNFBPs in terms of scope, degree and sophistication of implementation.

328. The approach to AML/CFT requirements by the smaller DNFBPs across the whole DNFBP sector is mostly rule-based. The domestic TCSPs' and estate agents' AML/CFT preventive measures, which mainly focus on CDD during on-boarding and to a lesser extent on other risk mitigating measures, do not seem to be commensurate with their risks. They generally are aware of their AML/CFT obligations and in some instances lack adequate resources to ensure compliance with the AML/CFT obligations. The limited understanding among these DNFBPs of the ML/TF risks that they are facing is an obstacle to implement effective risk mitigating measures.

## *Application of CDD and record-keeping requirements*

### *Financial institutions*

329. FIs met understand well the CDD and record-keeping requirement and apply adequate measures. Large FIs and those belonging to international financial groups apply more comprehensive CDD measures as they adopt a RBA and focus on the risks posed by their customers, taking into account the distribution channel, the product

and services involved, and risk indicators, e.g. if high risk countries are involved in the business relationship or transaction.

330. Smaller FIs, particularly those outside the banking sector, demonstrated a less sophisticated implementation of CDD requirements. They tend to approach their AML/CFT obligations in a rule-based manner and in some instances they have shown a preference for avoiding business with certain higher-risk customers (e.g. trusts), rather than applying graduated mitigating measures. Non-bank FIs seem to rely to some extent on banks as a gatekeeper, for example in some instances LCs will not always look at the legitimacy of the source of funds when the money of a client is transferred through a bank. This is of concern in high risk situations which would require FIs to establish the legitimacy of the source of funds.

331. Although deficiencies regarding AML/CFT obligations were still noted, the results of supervisory work, in particular by the Core Principles supervisors, suggest the application of the CDD measures is improving and being applied more effectively and consistently.

332. Regarding ongoing monitoring, the large FIs, especially members of international financial groups, generally have established transaction monitoring systems to generate alerts for dedicated staff to follow up. A few of the international banks also indicated that they are exploring new ways (e.g. using data analytics) to supplement their transaction monitoring. The alert thresholds are more stringent for high-risk customers and situations. The monitoring measures of the smaller FIs, in particular outside the banking sector, seem to be relatively less developed. These institutions (particularly MSOs) tend to set their parameters on the basis of the value or volume of transactions only, without (periodically) testing the effectiveness of these parameters and, where necessary, adjusting them.

333. Where the customer is a legal person or legal arrangement, the large FIs identify the beneficial owners by conducting online company searches, obtaining an ownership or corporate structure chart identifying the natural person (if any) who ultimately owns or controls the customer and requesting relevant documents, e.g. trust deed. Smaller FIs, in particular non-Core Principles FIs, tend to rely on the information on companies which is publicly available through the CR's website, which might not include the most up-to-date information and only include legal ownership information.

334. The FIs are aware that they should refuse or terminate business relationships if the CDD process cannot be completed, and then consider reporting an STR. They were able to provide examples of such cases where relationship was refused on that basis.

335. All FIs have sound record-keeping procedures in place.

#### *DNFBPs*

336. The level of compliance varies among DNFBPs. The understanding and sophistication of implemented CDD measures are better developed in large international accounting and law firms and the large TCSPs with an international presence. They have AML/CFT policies that facilitate the categorisation of customers in different risk levels. The intensity of the risk mitigating measures increase with the

risk level. The estate agents, especially the small operators, and the smaller TCSPs have implemented basic CDD identification measures.

337. The effectiveness of the process for identifying beneficial ownership details by the DNFBPs and their understanding was uneven. The large international accounting and law firms, and the large TCSPs with a strong international presence, were more mindful of the requirement to understand who was behind each business relationship or transaction and ensure that adequate CDD was conducted on the beneficial owner. The domestic TCSPs and the estate agents, in particular the small operators, do not seem to have a good understanding of the concept of beneficial ownership and tend to associate it as legal ownership. Basic identification and verification is the norm for them and they tend to rely on the customer's self-declaration on beneficial ownership.

338. In general, the obligation to refuse a transaction and refuse or terminate a business relationship if the CDD process cannot be completed seems to be understood but seems, especially among the estate agents and the smaller TCSPs met, to be applied only in cases of highly unusual transactions and they rarely consider reporting an STR. The large international accounting and law firms and the large TCSPs with an international presence, were able to provide examples of the refusal and termination of a client relationship because CDD was incomplete.

339. DNFBPs met were aware of the requirement to keep the records for at least five years.

### *Application of EDD measures*

#### *Financial institutions*

##### *PEPs*

340. Application of the PEP requirements varies depending on the size and geographical footprint of the FIs. Those FIs that are part of international financial groups adhere to their group policy and go beyond the local legal requirements by applying the same enhanced measures (such as account opening approval at a senior level and enhanced monitoring) to both domestic and foreign PEPs. HKC's statutory AML/CFT framework contains a deficiency in the definition of foreign PEPs which does not include PEPs from the rest of China (see R.12 in the TC Annex). Systems to identify such persons and their family members and close associates are in place and they generally use commercial databases for the screening process, both at the onboarding stage as well periodically on existing customers.

341. Smaller FIs that are not part of international financial groups follow the local legal requirements and tend to distinguish between foreign and domestic PEPs. They mainly use open sources to identify PEPs and conduct their own research, thus screening tools are less robust and sophisticated. They perform enhanced measures to foreign PEPs and perform a risk assessment to determine whether a domestic PEP (including from Mainland China and Macao, China) poses higher risk and whether enhanced measures will be applied to those classified as high risk. One of the FIs underestimated the risks related to PEPs and suggested that the definition of PEP only captures PEPs that still are in office.

### *Correspondent banking and wire transfers*

342. Given HKC's importance as an IFC, correspondent banking is a key feature of banking operations, whether for general operations, those connected with wire transfer transactions or trade finance. The FIs with cross-border correspondent banking relationships demonstrated a good understanding of the enhanced AML/CFT requirements and of the risks involved. One of the banks indicated it had terminated a substantial number of correspondent banking relationships as a result of a remediation programme.

343. The results of the HKMA's supervisory work suggests that banks in general have appropriate policies and procedures to collect information relating to the business nature, reputation, AML/CFT controls of the proposed respondent bank and the quality of supervision by authorities in the place where the respondent bank is located, before establishing a correspondent banking relationship. Transactions (e.g. wire transfer, trade finance and account activities in Vostro accounts, etc.) with respondent banks are monitored by FIs.

344. The banks and non-bank remitters (SVF licensees and MSOs) met demonstrated a generally good level of understanding of the ML/TF risks associated with wire transfers and apply appropriate measures to comply with the requirements regarding beneficiary/originator information.

### *New technologies*

345. FIs generally analyse ML/TF risks of new products and services prior to their introduction. The larger institutions and those belonging to international financial groups indicated that mandatory advice from the compliance department is part of the product/delivery channel approval process. In addition, the Core Principles FIs usually discuss their proposals or initiatives with the supervisor involved prior to the launch of products or services involving the use of new technologies.

346. Smaller FIs tend to have less developed measures and controls in place when introducing new products and services, and seem primarily focused on the technological possibilities and to a lesser extent on the ML/TF risks involved. This raises concerns, because an individual moneylender and SVF licensee offered some products which could be higher risks (e.g. no face-to-face contact with the customer), and do not seem to fully assess the risks involved. With the increasing influence and growing use of e-money and new payment methods (such as SVFs), this is an area which supervisors should continue to focus on.

### *Targeted financial sanctions relating to TF*

347. The large FIs and those belonging to international financial groups have a sound understanding of their requirements in relation to TFS relating to TF, and have measures in place to comply and screen before the establishment and during the course of the business relationship, for potential hits. They use commercial databases from third-party vendors to screen their customers and beneficial owners against the lists of suspected terrorists or sanctioned persons and entities. Implementation of sanctions screening is inspected by the Core Principles supervisors in the course of their AML/CFT supervision, and the results of that supervision suggest that no

instance of non-compliance with TFS TF has been noted, but that there is room for improvement in the sanctions screening procedures.

348. The smaller firms, especially in the MSO and moneylender sector, demonstrated an incomplete understanding of TF TFS obligations. One firm seemed to confuse the UNSCR lists with the OFAC's sanctions programmes and used the OFAC's website to screen customers for compliance with UNSCRs.

349. The smaller firms mainly depend on a manual screening process, which could be prone to error and delay in implementation. Their screening tends to be limited to the moment of the establishment of the business relationship and is not necessarily performed during the course of the business relationship. This raises risks in relation to their ability to identify and detect customers who are subject to TF TFS in a timely manner.

#### *Higher-risk countries identified by the FATF*

350. The large FIs and those belonging to international financial groups are generally aware of the risks associated with customers or transactions related to high risks countries and apply EDD broadly to most customer relationships based in or connected to countries on the lists. They reference the supervisors' websites which publish (a link to) the FATF's public statements. In addition, they perform their own assessment of country risks. Not all smaller firms were aware of the relevant FATF public statements and did not fully understand why some of these countries are subject to FATF's countermeasures or classified as having higher risks.

#### *DNFBPs*

351. Statutory AML/CFT requirements (including those regarding EDD) for DNFBPs were implemented in March 2018. The application of these requirements significantly varies across the DNFBPs sectors.

352. The large international accounting and law firms and TCSPs with a strong international presence have a more developed knowledge of EDD requirements applicable for higher risk situations. Regarding PEPs, these international firms tended to adhere to their global policies and procedures, and tend not to distinguish between foreign and domestic PEPs, i.e. apply EDD once there is a PEP match. Most of them make use of commercial databases to identify and detect customers who are PEPs, subject to TFS TF or associated with high risks jurisdictions identified by the FATF. Where customers reside in countries or territories identified as higher risk by the FATF or their group's country risk assessment, appropriate enhanced measures are applied.

353. The smaller DNFBPs have a less developed understanding of the application of EDD measures for higher risks situations and in general seem to underestimate the risks associated with PEPs. They generally have adopted manual checks and conduct their own research (e.g. Google search), mainly limited to the on-boarding stage, to identify and detect customers who are PEPs or subject to TFS TF. Some DNFBPs (smaller estate agents and TCSPs) also rely on self-declarations from customers. DPMS demonstrated a lack of understanding of the TF TFS obligations. In general, the smaller DNFBPs are aware to be alert for the customer's jurisdiction, but not all of these firms were familiar with the list of countries considered high risk by the FATF.

## Reporting obligations and tipping off

### *Financial institutions*

354. In general, FIs seem to have a good understanding of the STR requirements, but there is an important variance in the level and quality of STR between sectors. A substantial number of FIs have never filed an STR. This is also the case for the stand-alone financial leasing companies. While this may be commensurate with the scale and nature of business of some of these FIs, the assessment team is not convinced that this is always the case and this suggests that there might be underreporting. There is room for improvement especially in the non-banking sector.

355. The banking sector has submitted most STRs (see Table 5.1). While no data on the predicate offence underlying these STRs was provided, banks met during the on-site indicated that most of these were made on the basis of suspicion for fraud. STRs filed by the banking sector increased from 17 194 in 2011 to 86,029 in 2017, a 400% increase over six years. In 2017, 97% of these STRs were made by retail banks, with the six AIs in category 1 (accounting for 53.2% of total customer base of the banking sector) accounting for 68.5% of STRs. Nonetheless, the increase in STRs filed reflects the increased awareness of the banking sector.

356. The HKMA's supervisory work indicates that the STR reporting requirements are generally well understood by banks. Nevertheless, some findings and recommendations were made in respect of adequacy of key customer information in STRs, the level of due diligence and timeliness of reporting; and defensive STR reporting by AIs – although declining – remains an issue.

357. The number of STRs filed by MSOs is relatively low and in 2017 there was a significant decrease in the number of STRs filed by the MSOs. In 2016, the MSSB found that an MSO was filing STRs based on a certain monetary threshold being exceeded despite there being no knowledge or suspicion of ML/TF. Since then, the MSO ceased filing such threshold-based STRs, resulting in a decrease of 65% of STRs filed by the sector in 2017. In that year the number of STRs filed by the insurance and the securities sector outnumbers the STRs filed by MSOs. The number of STRs filed does not correspond to the ML/TF risks associated with the MSO sector and indicates a low awareness of the risks they face and a low level of understanding of the STR reporting requirements.

358. In addition, information from the JFIU shows that the quality of STRs submitted by MSOs was at average level. Some STRs contained insufficient or inaccurate information and some did not provide rationale as to what suspicion triggered the filing of STRs. Steps should be taken to improve understanding of the requirements and risks in the MSO sector. The number of STRs reported by moneylenders is low and might be indicative of a low understanding of the STR obligations.

359. FIs indicated that the feedback they receive from the JFIU can be improved through the provision of information on the usefulness and quality of reported information, complemented by strategic analysis and typologies tailored to the need of their specific sectors. Regarding the FMLIT (see. IO.6), the assessment team noted the desire of FIs met during the on-site to expand the scope of the FMLIT by including

other stakeholders (e.g. the C&ED, the ICAC) and disseminating strategic information to relevant sectors, especially the small FIs.

360. FIs generally displayed good knowledge regarding the obligation of no tipping-off and ensure compliance with this obligation by their staff through internal policies and procedures and training initiatives.

361. The JFIU and the main FI regulators, particularly the HKMA, have been working to improve RE's awareness of STR requirements, including through quarterly STR analysis reports by the JFIU and the STR Working Group convened by the JFIU and comprising HKPF, regulators and key RE's that provide feedback on and discusses STRs. The JFIU is also promulgating a revised STR template to address reporting inconsistency and facilitate timely input, data uniformity and automated intelligence searches. This is welcome, but further work is required.

**Table 5.1. Number of STRs submitted to the JFIU by FIs**

	2013	2014	2015	2016	2017	2018*
Banks	27 328	31 095	34 959	68 745	86 029	60 133
Licensed corporations	1 410	1 574	1 095	1 423	2 090	1 211
Insurance institutions	401	446	495	928	1 094	1 026
Money service operators	2 108	2 772	3 566	2 554	908	954
Moneylenders	28	32	33	24	28	35
Stored value facility licensees	/	/	/	67	590	410
<b>Total No. of STRs filed</b>	<b>31 275</b>	<b>35 919</b>	<b>40 148</b>	<b>73 741</b>	<b>90 739</b>	<b>63 769</b>

*Note:* The regulatory regime for SVF licensees came into full operation in November 2016

\* 2018 statistics are up to the end of October

### DNFBPs

362. DNFBPs are familiar with the STR reporting obligation. Nevertheless, the understanding of the STR reporting requirements varies across the sectors and is more developed among large international accounting and law firms, and TCSPs with a strong international presence. Other DNFBPs have a less developed understanding of what the STR requirements entail. One TCSP was under the impression that the STR reporting requirements only apply since the introduction of the AML/CFT requirements for TCSPs recently. This reinforced the concerns expressed about the inadequate level of understanding of ML/TF risks and AML/CFT obligations by these sectors.

363. Most of the STRs in the DNFBP sectors come from the legal professionals. The other DNFBP sectors are filing few STRs, despite some of them having higher vulnerabilities (e.g. the TCSP sector). Although AML/CFT requirements have been put in place since March 2018 for the DNFBPs, the STR reporting requirements (which apply to all natural and legal persons in HKC) have been in place for many years and were imposed at the same time as on FIs. Thus, the low level of STR reporting by these DNFBP sectors cannot be explained on the basis of recent legislative changes. This suggests the need for more capacity building to encourage STR reporting by these DNFBP sectors. The competent authorities and regulatory bodies indicated that outreach has been and will continue to be organised to ensure that the obligation and

expectations regarding quality of STR reporting are clearly understood. However, DNFBPs met during the on-site would welcome additional sector-specific guidance from the JFIU, the competent authorities and the regulatory bodies, which could include red flag indicators, typologies reports and concrete examples of suspicious activity. This would allow them to develop a better understanding of suspicious transactions and raise the quality of reporting.

**Table 5.2. Number of STRs submitted to the JFIU by DNFBPs**

	2013	2014	2015	2016	2017	2018 *
Legal professionals	235	222	894	969	555	333
Estate agencies	12	29	31	58	71	41
DPMS	26	18	6	59	60	52
TCSPs	27	46	22	27	31	67
Accounting professionals	4	3	6	3	19	19
<b>Total No. of STRs filed by DNFBPs</b>	<b>304</b>	<b>318</b>	<b>959</b>	<b>1 116</b>	<b>736</b>	<b>512</b>

\* 2018 statistics are up to the end of October

## *Internal controls and legal/regulatory requirements impending implementation*

### *Financial institutions*

364. FIs have a good understanding of the internal controls and procedures requirements. This was apparent, particularly for larger FIs and FIs which belong to international financial groups. They have sophisticated group-wide internal controls and procedural programmes that are well documented and reviewed.

365. These FIs allocate substantial resources to overseeing and testing these programmes and are subject to internal audits. They generally have screening programmes for staff on recruitment and also have ongoing training programmes on AML/CFT matters. Financial secrecy does not seem to impede implementation of the AML/CFT requirements. Information can and is shared within groups for AML/CFT purposes.

366. Smaller FIs, with the exception those that belong to international financial groups, seem to have less sophisticated programmes.

### *DNFBPs*

367. The large international accounting and law firms, and TCSPs with a strong international presence have put in place compliance programmes, including appointed compliance officers, and ongoing AML/CFT training programmes subject to audits by their internal audit departments. They noted that their internal procedures are reviewed, assessed, and updated periodically to ensure their effectiveness, and a number of them indicated that they can also rely on their existing group-wide policies and procedures as a reference basis. They conduct regular annual training on AML/CFT issues for their staff.

368. The other DNFBP sectors, especially the small TCSPs and estate agents, have basic CDD controls, with some of these firms not having an independent compliance

officer or structured compliance function, and other controls mostly pertaining to training. These internal rules are not periodically updated.

*Overall conclusions on IO.4*

369. **HKC has achieved a moderate level of effectiveness for IO.4.**

## Chapter 6. SUPERVISION

### Key Findings and Recommended Actions

#### *Key Findings*

##### *Financial Institutions*

- a) Financial supervisors generally apply robust licensing/registration and screening measures to prevent criminals and their associates from abusing FIs. In addition, HKC regularly detects and convicts unlicensed MSOs.
- b) Core Principles supervisors (the HKMA, the SFC and the IA) maintain an overall good understanding of the ML/TF risk profile of their respective sectors and at individual institution level. C&ED and the Registrar of Moneylenders (RML) demonstrated a basic understanding of sectoral risks, but they need major improvements in their ML/TF risk understanding at an individual institution level.
- c) Core Principles supervisors have a reasonable supervisory framework to monitor AML/CFT compliance but the scope and depth of inspections by the C&ED and the RML are too limited.
- d) Core Principles supervisors generally take remedial actions in an effective manner but, except for the SFC, have imposed a few sanctions. These sanctions appear to be dissuasive but are not sufficient to fully demonstrate their effectiveness and proportionality. The C&ED and the RML have not applied remedial actions and sanctions proportionately and the RML is not empowered to take an adequate range of remedial actions or apply sanctions.
- e) Financial supervisors generally provide guidance and conduct a range of outreach activities. However, there are important gaps in the understanding of AML/CFT obligations, and ML/TF risks and in the identification of suspicious transactions, particularly for MSOs and moneylenders. This indicates that their supervisory activities should be strengthened.
- f) Stand-alone financial leasing companies are not subject to AML/CFT supervision and this is not based on a proven low risk.

##### *DNFBPs*

- a) While some mechanisms exist, implementation of robust screening measures to prevent criminals and their associates from abusing DNFBPs is uneven across the different sectors.
- b) The SRBs and other DNFBP supervisors demonstrated some understanding of their sectoral ML/TF risks, but their understanding at an institutional level needs major improvements. The limited scope and depth of AML/CFT compliance monitoring, the

limited remedial actions applied and the absence of sanction imposed result in an overall inadequate level of supervision/monitoring. The high non-compliance rate identified among TCSP licence applicants and the absence of regular monitoring and sanction for legal and accounting professionals raise concerns particularly.

- c) The SRBs and other DNFBP supervisors provide a reasonable amount of guidance but conduct outreach activities to a varying degree. Additionally, there are significant gaps in DNFBPs' understanding of their AML/CFT obligations and ML/TF risks, particularly in the identification of suspicious transactions.
- d) DPMS are not subject to AML/CFT supervision and this is not in line with the sector's risk.

### *Recommended Actions*

#### *Financial Institutions*

- a) HKC should continue to take action against unlicensed MSOs and strengthen co-operation among authorities to identify them as necessary.
- b) The C&ED and the RML should review their risk profiling methods to improve the understanding of risks at individual institution level which could strengthen their sectoral risk understanding and form a robust basis for appropriate risk-based supervision. Core Principles supervisors should continue monitoring their risk-profiling methodologies and fine-tune them as necessary.
- c) The HKMA and the IA should apply sanctions on a graduated basis against material non-compliance with AML/CFT requirements to send further dissuasive signals. The C&ED and the RML should apply a broader range of remedial actions and sanctions proportionately. The RML should be empowered to apply proportionate, effective and dissuasive remedial actions and sanctions.
- d) Financial supervisors should identify the areas where there is a lack of understanding of AML/CFT obligations and ML/TF risks by FIs, and strengthen their guidance and outreach activities toward the identified areas.
- e) HKC should take necessary actions commensurate with the ML/TF risks of stand-alone financial leasing companies that are not supervised for AML/CFT, based on the review recommended in Chapter 2 (IO.1).

#### *DNFBPs*

- a) The SRBs and other DNFBP supervisors should review the robustness and scope of screening measures to prevent criminals and their associates from abusing DNFBPs for ML/TF, and implement necessary measures.
- b) The SRBs and other DNFBP supervisors should continue to develop their assessments of sectoral ML/TF risk and to strengthen their understanding of ML/TF risks at the individual institution level to develop a more robust risk-based supervisory plan. In addition, the CR, the LSHK and the HKICPA should conduct appropriate monitoring and follow-up to ensure compliance by TCSPs, legal and accounting professionals with AML/CFT requirements. To this end, HKC should promote co-operation, co-ordination

and knowledge sharing between experienced financial supervisors, SRBs and other supervisors.

- c) The SRBs and other DNFBP supervisors should identify the areas where there is a lack of understanding of AML/CFT obligations and ML/TF risks by DNFBPs, and strengthen their guidance and outreach activities toward the identified areas.
- d) HKC should ensure that DPMS are subject to supervision for AML/CFT, including licensing or registration.

370. The relevant Immediate Outcome considered and assessed in this chapter is IO.3. The Recommendations relevant for the assessment of effectiveness under this section are R.14, R. 26-28, R.34, and R.35.

### Immediate Outcome 3 (Supervision)

371. For the reasons of their relative importance in terms of materiality and risk in HKC, supervision issues were weighted: most heavily for the banking sector, which plays a dominant role in HKC; heavily for the securities, MSOs and TCSP sectors; moderately heavily for the SVF, legal, accounting, real estate and DPMS sectors; and less heavily for the insurance and moneylenders sectors. Casinos are illegal in HKC and were therefore not considered for this chapter. Also, see Chapter 1 for a description of each supervisor and the entities they are responsible for supervising.

372. There are no licensing or registration requirements and no AML/CFT supervision for DPMS, and this is not in line with the sector's risk (see Chapter 2). Stand-alone financial leasing companies, while their size of operation is small, are not subject to AML/CFT supervision. This is not based on a proven low risk. Although credit card companies are also exempted from AML/CFT regime, there is only one stand-alone credit card company which is supervised as a licensed MSO in practice and thus it does not affect the effectiveness of overall AML/CFT supervision.

### *Licensing, registration and controls preventing criminals and associates from entering the market*

#### *Financial Institutions*

373. Financial supervisors apply robust licensing/registration and screening measures to prevent criminals and their associates from holding or being the beneficial owner of a significant or controlling interests or holding senior management positions in FIs (see c.26.3 in the TC Annex). They continue monitoring as part of ongoing supervision whether the relevant person remains being fit-and-proper. The requirement of licence renewal (every two years for MSOs and every 12 months for moneylenders) also contributes to ongoing screening.

374. The measures applied by the HKMA and the SFC include criminal record checks, vetting with domestic or overseas regulators, and checks against commercial database. There are cases where the HKMA discovered conviction records and declined the application and cases where the applicant withdrew its application following further enquiries. There are also cases where the SFC discovered adverse information that was not declared by the applicant and raised doubts on its fitness

and properness. It is worth noting that the HKMA has referred eight cases of suspected unlicensed banks to HKPF since 2015, although no offence was confirmed.

375. The IA<sup>38</sup> relies on domestic sources (e.g. HKPF's criminal record database) to conduct the fit-and-proper screening of relevant person of an insurer. No rejections have been made since 2015 but there is no evidence that insurers are abused by criminals. The three self-regulatory bodies for insurance intermediaries are responsible for conducting the fit-and-proper screening on directors and controllers, and they have rejected 115 applications since 2016.

376. The C&ED's screening measures for MSOs include criminal record checks against the HKPF, the C&ED and commercial databases. These measures resulted in 90 rejections, 103 withdrawals of application and 2 licence revocations (as of December 2017). In addition, the C&ED detects suspected unlicensed MSOs based on information from various internal and external sources. There were 43 convictions of unlicensed MSOs between 2013 and 2017.

377. The RML, in tandem with the HKPF, checks criminal records in relation to an application for a moneylender licence. It can raise an objection in the Licensing Court for the retention or renewal of a licence. In the past five years, three applications have been rejected and 50 applicants have withdrawn their application following an objection. However, in a particular case, the Licensing Court declined an objection while doubts were raised on the fitness and properness of one individual. This decision was taken on the basis of the absence of prosecution despite intelligence linking the applicant to a suspected crime. This indicates a limitation as a result of the separation of licensing power from the supervisory authorities, and raises concerns on the ability of the authorities to screen applicants on their own to prevent criminals and their associates from owning or controlling a moneylender.

### *DNFBPs*

378. SRBs and other DNFBP supervisors are generally empowered to apply screening measures to prevent criminals and their associates from holding or being the beneficial owner of controlling interests or holding senior management positions in DNFBPs. This usually happens during the licensing or professional certification process. However, the extent to which SRBs and other DNFBP supervisors apply the measures is uneven.

379. The EAA's screening measures on applicants and directors of estate agents or salesperson licensees have resulted in a considerable number of refusals and revocation and suspension of licences, including cases identified by EAA's ongoing supervision and licence renewal process (every 12 or 24 months). However, the screening measures do not apply to beneficial owners of estate agents, which raises concerns on the effectiveness of these measures (see c.28.4 in the TC Annex).

380. The CR applies a number of controls during the licensing process to prevent criminals and their associates from owning or controlling TCSPs, including criminal record checks against internal and external sources and selective on-site inspections,

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<sup>38</sup> As the IA commenced the operation in June 2017, the information related to IA includes the information on predecessor organisation (the Office of the Commissioner of Insurance, or OCI) throughout this report.

particularly for high-risk applicants. These controls resulted in the rejection of 33 applications and the withdrawal of 167 applications since the introduction of the new licensing regime (between March and September 2018). While these are good results, the CR is still in the process of licensing TCSPs and it is too early to judge the effectiveness of these measures.

381. In HKC, lawyers must obtain a certificate from the LSHK and renew it annually to practice as a solicitor. As part of this certification mechanism, the LSHK assesses the fitness and properness of applicants, including through a declaration of conviction record by applicants. However, the LSHK could not demonstrate how it verifies the declaration in practice. In practice, the DOJ conducts the fit-and-proper check including the past conviction record of every applicants for admission as a lawyer. LSHK can count on this screening for preventing inappropriate applicants from being accredited to some extent.

382. As part of the process to be a certified public accountant (CPA) and to renew the membership of HKICPA annually, an applicant must disclose his/her criminal record, if any, to the HKICPA. If any issue arises from the certification process, HKICPA's Registration and Practising Committee requests additional information on a case-by-case basis. This process has led to three applications being rejected since 2014. However, HKICPA relies on the declaration made by applicants and does not conduct proactively vet it, which raises a concern about the effectiveness of screening.

## *Supervisors' understanding and identification of ML/TF risks*

### *Financial Institutions*

383. The Core Principles supervisors (the HKMA, the SFC and the IA) maintain an overall good understanding of the ML/TF risk profile of respective sectors, which broadly informed the HRA, and of individual institutions. The C&ED and the RML have a basic understanding of their sectoral risks but they need major improvements in the understanding of risks at the individual institution level.

384. The HKMA applies a RBA for AML/CFT supervision. It has a good understanding of ML/TF risks in the banking sector and a reasonable understanding in the SVF sector. This understanding was developed through ongoing supervision, including ML/TF risk profiling for all AIs and SVF licensees.

385. Regarding AIs, the HKMA is well aware of vulnerable areas such as private banking, trade-related business, cross-border services and sanction controls given HKC's position and role as an IFC and trading hub. It has taken actions to mitigate riskier areas and developed focused guidance for AIs (e.g. on TBML and transaction monitoring). The HKMA classifies AIs into four risk categories<sup>39</sup>, and applies various on-site and off-site supervisory tools accordingly. Moreover, the HKMA assigns officers from the AML & Financial Crime Risk Division to all AIs in Categories 1 and 2

<sup>39</sup> AIs in each category account for approximately the following proportions of the total asset size for the sector. Category 1 (Highest risk): 38.6%, Category 2: 26.1%, Category 3: 25.2%, Category 4: 10.2% respectively. In terms of the number of institutions, Category 1 and 2 account for 16%.

to ensure in-depth monitoring. A risk profiling exercise was conducted in 2015 and these individual profiles are reviewed every two years. In order to collect further information on ML/TF risks, the HKMA requires all AIs to submit biannual financial crime data return.

386. At the time of the introduction of the SVF licencing regime in November 2016, the HKMA's understanding of the sector's ML/TF risks relied on the information gathered during the licensing process, the relevant FATF guidance and benchmarking against the experience from overseas jurisdictions. The HKMA is gathering more information to develop a more comprehensive understanding of the sectoral risks (to be completed in 2019). At the individual licensee level, the HKMA completed the first risk profiling exercise in the third quarter of 2018 where it categorised SVF licensees into four categories<sup>40</sup>. The HKMA also requires SVF licensees to submit biannual financial crime data return. While this framework appears to be sound, the HKMA needs to monitor the validity of the risk factors and categorisation model and fine-tune it as necessary.

387. The SFC has a good understanding of the securities sector's ML/TF risks, building on its ongoing supervision activities and the ML/TF risk profiling for all LCs (see R.26 in the TC Annex). The SFC classifies LCs into three categories (High, Medium or Low priority)<sup>41</sup> through a conservative open-door approach<sup>42</sup> and applies a different cycle of routine inspections, supplemented by other supervisory engagements. The SFC's risk profiling framework is updated through quarterly review and is generally good to the extent that it forms a basis to understand the risks.

388. The IA has a sound understanding of ML risks in the insurance sector and a reasonable understanding of TF risk. This is mainly due to the ongoing supervision activities which also include ML/TF risk profiling for all long-term insurers and intermediaries (except appointed individual agents). The IA classifies IIs into three risk categories<sup>43</sup> and conducts various on-site and off-site supervisory activities accordingly. The IA updates the risk profiling of individual insurers annually, and recently amended a set of factors informed by the HRA for the biennial risk profiling of intermediaries. The IA needs to monitor the validity of the risk factors used for the intermediaries and enhance its model as necessary to ensure the results adequately reflect the risks.

<sup>40</sup> The proportions of total transaction value in each category are approximately: Category 1: 3%, Category 2: 5.5%, Category 3: 89%, Category 4: 2.5%.

<sup>41</sup> The approximate ratio in each category in terms of the number of LCs is as follows. High: 2%, Medium: 17%, Low: 81%; LCs in High category account for 50% both in terms of the number of clients and the client asset size in the sector while LCs not holding client assets occupy the majority of Low category.

<sup>42</sup> The highest score assigned to any of factors becomes the final score, rather than weighted average of all factors or mathematical calculation, e.g. if a single factor hits High, overall High is given as the final rating to the LC even when other factors are Medium or Low.

<sup>43</sup> The approximate ratio of insurer in each category is: High: 18%, Medium: 30%, Low: 52%; in terms of market share: High: 87%, Medium: 11%, Low: 2%. Intermediaries are also classified into t categories, of which over 90% are in Low category.

389. The C&ED has a basic understanding of the ML/TF risks of the MSO sector that are relatively high. The C&ED conducts ML/TF risk assessments for all MSOs at the licence renewal (biennial basis) and classifies them into three risk categories<sup>44</sup> to determine the priority and frequency of inspections. However, the factors taken into consideration in the assessment are not adequately designed to form a basis for appropriate risk-based supervision. For example, the origin of incoming remittance's is not included despite HKC's external threats, nor is the number of higher risk customers, and the CFT measures in place. Furthermore, the fact that only 6% of MSOs are categorised as "High risk" (and subject to more intense supervision) is inconsistent with the risks of the products and services offered, and also confirms the need to review the risk profiling methodology.

390. The RML considers moneylenders' ML/TF risks to be relatively low due to the nature of business and their domestic customer base. The RML recently took steps to strengthen the AML/CFT supervision of the sector by introducing a Supplementary Information Sheet (SIS) that entities need to complete when applying for a licence or its renewal, or during an on-site inspection. This allows the RML to gather information on AML/CFT compliance by individual institution to some degree. The RML identified that around 10% of moneylenders are high risk based on the HKPF's intelligence, complaints received and media reports. These entities are prioritised for on-site inspection. The RML's approach is essentially focused on the selection of priority targets and the RML has not yet developed a comprehensive and risk-based supervisory plan. While the SIS is a positive step in the development of its understanding and identification of risks, it is not sufficient to identify entities that pose higher risks.

### *DNFBPs*

391. SRBs and other DNFBP supervisors demonstrate some understanding of their sectoral ML/TF risks, but their understanding at an institutional level needs major improvements.

392. The EAA has a fair understanding of ML risks of the real estate sector, but TF risks are less understood (though they appear to be in line with the risk profile of the sector). The EAA classifies estate agents into two categories (large or small) depending on the number of offices and prioritises supervisory resource on large estate agents. This categorisation was made on the basis that large estate agents pose higher ML/TF risks given their deeper market penetration, their broader scope, the larger nature of their business and the higher chance of handling more sophisticated property deals and serving corporate customers. While this may capture part of the risks, it does not adequately take into account the risks to which smaller estate agents may be exposed. Furthermore, the result of inspections suggests that there is no meaningful difference in the level of compliance between large and small estate agents, and thus it is necessary to take into account the level of risk understanding and quality of AML/CFT control of individual agents as well. The EAA's understanding

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<sup>44</sup> The approximate ratio in each category in terms of the number of MSOs is: High: 6%, Medium: 76%, Low: 18%

of ML/TF risks at the individual agent or operator level therefore needs major improvements.

393. The CR has a fair understanding of ML/TF risks of the TCSP sector and indicated that the medium-high risk identified in the HRA was reasonable. Since the application of the AMLO and the introduction of the licensing regime to TCSP in March 2018, the CR received 6798 applications and granted 5452 licences (as of the end of September 2018). The CR, in tandem with the HKPF, developed a set of risk indicators to prioritise the screening of higher risk applicants in the licensing process. It has identified a considerable number of high-risk applicants as the prioritised targets of on-site inspections. Additionally, the CR requires applicants and licensees to submit a supplementary information sheet which contains a questionnaire to understand their AML/CFT controls. Given the heavy workload to process all applications in a timely manner, the CR takes into account limited risk factors. While the CR is taking steps to gather information and improve its risk understanding at the individual institution level, the current understanding is quite limited.

394. The LSHK demonstrated a reasonable understanding of the ML risks of its sector, and has a particular focus on involvement in property transactions, especially cash transactions. The LSHK demonstrated a lower understanding of TF risks. It conflates TF risk understanding and TF TFS obligations, with a primary focus on the latter. In addition, the LSHK operates on a reactive basis for supervision, i.e. it can investigate only when it receives a complaint or when it is informed of a serious suspicion. It also does not monitor the compliance of its members and cannot therefore assess the risks at the individual lawyer/law firm level. Its oversight activities are largely focused on outreach and education.

395. The HKICPA demonstrated a reasonable understanding of the ML/TF risks of the accounting professionals and indicated that the higher risk area was trust or company services. The HKICPA started its AML/CFT compliance programme in October 2018. Given the recent nature of this, the HKICPA is in the process of gathering basic information from its members and recruiting staff to monitor compliance with the legal requirements. As a second step, HKICPA plans to develop a detailed questionnaire on AML/CFT compliance and to conduct practice review (i.e. compliance visits) following the creation of the AML/CFT monitoring function. As such, the HKICPA has not yet developed its capacity to identify risk at the individual accountant/accounting firm level.

### *Risk-based supervision of compliance with AML/CFT requirements*

396. Core Principles supervisors have a reasonable supervisory framework to monitor AML/CFT compliance. The shortcomings of risk understanding mentioned in the section above have an impact on the risk-sensitive supervision undertaken by the C&ED and the RML. The C&ED and the RML should also improve the quality of their inspections.

#### *Financial Institutions*

397. The HKMA has a comprehensive and risk-based AML/CFT supervisory model for AIs. It combines on-site and various off-site measures of different intensity, in addition to outreach activities. The frequency of regular on-site inspections for respective risk categories ranges from at least once every two years for the highest

risk category to an unspecified event-driven basis for the lowest risk category. The time and human resources per inspection vary depending on the categorisation of the AI. While there is no specific cycle to conduct regular on-site inspections on AIs in the lowest risk category<sup>45</sup>, the HKMA's monitoring through other supervisory engagement is generally sufficient considering the limited scope and size of business of these AIs. This engagement includes continuous and extensive off-site measures and ad-hoc or thematic review. Regarding SVF licensees, the AML/CFT supervisory model is not finalised as the HKMA just completed its risk assessment exercise. It is worth mentioning that the HKMA conducted an ad-hoc on-site inspection in 2017 in response to a business expansion plan by a licensee into cross-border remittance. Risk-based supervision is not fully implemented in this sector.

398. The SFC has a reasonable AML/CFT supervisory framework that takes into account the LCs' risks. The framework combines on-site and off-site measures with different intensity, in addition outreach activities. The frequency of routine on-site inspections ranges from four years for the High priority category to nine years for the Low priority category, and the time and human resources per inspection vary on the basis of the category to which the LC belongs. The SFC assigns case officers to all LCs and they are responsible for the entire ongoing supervision process. The SFC's routine inspection process is well organised from the planning stage to the completion of follow-up. In practice, LCs in the High priority category are subject to follow-up monitoring and the inspection interval appears to be reasonable. Off-site measures take various forms and are ongoing. However, the SFC could review whether or not monitoring measures during the long interval between routine on-site inspections are adequate to monitor emerging risks among LCs categorised as Medium and Low priority, and make necessary adjustments. These LCs are heterogeneous and represent 50% of the number of clients and of the assets in the sector.

399. The IA has a reasonable AML/CFT supervisory framework that takes into account the IIs' individual risks. The framework combines on-site and off-site measures with different intensity depending on the category to which IIs belong, in addition to other outreach activities. The routine on-site inspection applies to IIs in High and Medium risk categories, and IIs in the Low risk category are subject to off-site review. The frequency of routine on-site inspections for insurers in the High risk category is every three to four years. This is reasonable considering the various and continuous off-site measures and the sector's risk. In 2016, following an increase in the number of customers from Mainland China for five insurers, the IA conducted thematic on-site inspections to check the application of risk-sensitive measures against this type of customers. Further, many of insurers in the High-risk category are subject to the supervisory college where relevant jurisdictions' supervisors exchange information that benefits the IA's supervision (see section on *Seeking and providing other forms of international co-operation for AML/CFT purposes* in Chapter 8).

400. The C&ED has a basic AML/CFT supervisory framework including on-site and off-site inspections focused on AML/CFT compliance. MSOs in the High risk category

<sup>45</sup> These AIs account for 3.9% of total deposits, 0.6% of customers and 1% of cross-border transactions and are (1) locally incorporated AIs with limited scope of business or (2) small foreign banks serving for their own banking groups or limited scope of business.

are subject to AML/CFT on-site inspections every year whereas MSOs in the Medium and Low risk categories are subject to AML/CFT off-site inspections (apart from routine inspection at the time of licence renewal). Other off-site measures include a multiple-choice questionnaire to assess the licence applicants' knowledge of AML/CFT requirements, periodic data returns (limited to the trading volume and the number of STRs) and outreach activities. However, AML/CFT inspection files reviewed during the on-site reveal that on-site inspections are quite short, conducted with very limited resources and focused on basic checks of the business profile and AML/CFT compliance. Furthermore, it revealed that TF-related checks are covered minimally and focus on screening mechanisms rather than a broader understanding of TF risk. Generally, inspectors follow the long checklist with a brief interview which suggests a tick-the-box approach.

401. The AML/CFT supervision by the RML is nascent and it primarily relies on on-site inspection to monitor the AML/CFT compliance and all high-risk moneylenders are subject to on-site inspections. While the RML conducts 40 on-site inspections on average per month, the scope and depth of inspections are very limited as an inspection is completed within a day at most. Off-site measures are also very limited as they only consist of gathering information through the SIS.

402. Table 6.1 summarises the number of on-site inspections and quantifiable off-site reviews.

**Table 6.1. AML/CFT-related on-site/off-site engagements by financial supervisors**

	2013	2014	2015	2016	2017
<b>On-site Inspection</b>					
HKMA – AI	19	21	21	17	22
HKMA – SVF	N/A	N/A	N/A	N/A	1
SFC	242	268	268	294	283
IA	72	97	88	96	106
C&ED	6	25	70	137	146
RML					17
<b>Off-site review</b>					
HKMA – AI		15	22	30	55
SFC	14	31	57	54	79
IA	4	2	13	28	18
C&ED	10	101	67	31	29
RML					165

Source: HKMA, SFC, IA, C&ED and RML

### DNFBPs

403. HKC has made good efforts to establish an AML/CFT supervision framework for most DNFBPs. That said, the level of monitoring of AML/CFT compliance significantly varies amongst DNFBP supervisors. There is no monitoring by SRBs. In addition, the monitoring by other DNFBP supervisors relies on very short on-site inspections and needs considerable improvement.

404. The EAA conducted on-site inspections of 436 agent offices from March to September 2018, of which 174 belong to large operators (14% of large operators' offices covered) and 262 belong to small operators (5% of small operators' offices covered). However, the scope and depth of inspections is very limited and not designed in a risk-sensitive manner. In practice, the EAA's inspectors have to go through a long checklist on CDD and record-keeping requirements and thus appear not to have room to go beyond the compliance check in a uniform manner regardless of the risks to which inspected estate agents are exposed.

405. Since the introduction of the TCSP licence regime in March 2018, the CR's priority is to ensure the fitness-and-properness of TCSP licensees. As part of this, the CR assesses AML/CFT compliance. It has conducted 545 on-site inspections including on the high-risk applicants identified. While these inspections also include some aspects of AML/CFT compliance as an element of fitness-and-properness, the scope and depth of inspections is very limited due to the minimal time devoted to each visit. The CR plans to develop its supervisory action to focus on licensees' ongoing AML/CFT compliance (see also analysis of IO.5 in Chapter 7).

406. The LSHK focuses on awareness-raising among solicitors against higher risk areas. The LSHK only conducts inspection of solicitors when it receives intelligence or complaints suggesting non-compliance with the Practice Direction P (PDP, which sets out AML/CFT guidelines for solicitors; first issued by the LSHK in 2007) and there are two cases under consideration (as of October 2018). However, the LSHK does not monitor solicitor's compliance with PDP and the oversight is therefore very limited.

407. The HKICPA also focus on awareness-raising and capacity building among accounting professionals. The monitoring plan for AML/CFT compliance is under development.

## *Remedial actions and effective, proportionate, and dissuasive sanctions*

### *Financial Institutions*

408. Core Principles supervisors generally take remedial actions in an effective manner, but the number of sanctions is limited (except the SFC). These sanctions appear to be dissuasive but are not sufficient to fully assess their effectiveness, and proportionality. C&ED and RML do not take an adequate range of remedial actions and sanctions proportionally other than criminal sanctions pursued by C&ED against serious violations, and RML is not empowered to take an adequate range of measures.

409. The HKMA has taken a range of remedial actions and imposed disciplinary sanctions on a graduated basis against three AIs in relation to shortcomings and regulatory breaches by AIs (see Table 6.2). The most common action is a remediation request requiring AIs to report back to the HKMA within 30 days. These remedial actions encourage AIs to rectify deficiencies in a timely manner, especially given The HKMA's monitoring of progress. The improving trend in inspection results of AIs' AML/CFT controls indicates the positive impact of the remedial actions. Where serious non-compliance issues such as systemic deficiencies or failure to implement required remedial actions occur, the HKMA imposes statutory disciplinary sanctions. The HKMA has conducted a number of investigations since 2012, and their results are reported to the relevant the HKMA Committees to consider the materiality of the

issue and determine the appropriate sanctions or measures to be taken. Disciplinary sanctions such as public reprimands and pecuniary penalties imposed appear to be dissuasive. However, these represent only a few cases and the effectiveness and proportionality of sanctions could not be demonstrated fully. Regarding SVF licensees, there have been only limited remedial actions.

410. The SFC has taken remedial actions and imposed disciplinary sanctions on LCs on a graduated basis, in relation to shortcomings and regulatory breaches (see Table 6.2). When identifying deficiencies in AML/CFT controls, the SFC issues a letter of deficiencies that requires LCs to take remedial actions, which are monitored by the SFC's good case management system until closure (see case study in Box 6.1). For issues related to fitness-and-properness or systemic impact on the market, the SFC imposes statutory disciplinary sanctions. These sanctions can be applied on LCs and/or responsible individuals depending on the results of the investigation. These sanctions are dissuasive and effective as confirmed by their decreasing trend.

**Table 6.2. Remedial Actions and Disciplinary Sanctions by the HKMA and the SFC**

	2013	2014	2015	2016	2017
<b>HKMA</b>					
Remediation request	19	21	21	17	27
Inform home regulator etc.		3	12	16	2
Independent review request	5	11	29	35	21
Business restriction			1	1	
Advisory letter		1		5	1
Accountability review of management		2			
Disciplinary sanction*			1		1
(Public reprimand)			1		1
(Remediation order)			1		
(Pecuniary Penalty in USD)			960 000		890 000
<b>SFC</b>					
Letter of deficiencies	43	53	88	65	65
Remedial action agreement to resolve disciplinary proceeding	2	2	1	2	4
Disciplinary sanction	28	24	12	12	15
(No. of cases with pecuniary penalty)	10	5	2	4	6
(Pecuniary penalty in USD)	3 840 000	3 650 000	450 000	610 000	2 186 700
(No. of licence Revocation/Suspension and Prohibition)	18	19	10	9	10

*Note:*\* In the third quarter of 2018, an AI was subject to disciplinary sanction with a public reprimand, USD 640,000 penalty and remedial order imposed.

*Source:* HKMA, SFC

**Box 6.1. Example of remedial action by the SFC**

An on-site inspection of a large LC in 2015 revealed a number of significant AML/CFT deficiencies, including deficiencies in suspicious transactions identification, application of EDD and transaction monitoring on high-risk customers.

The SFC issued a letter of deficiencies requesting the LC to take immediate actions to remedy the deficiencies.

The LC engaged a CPA firm to perform a thorough review of its AML/CFT policies and procedures and then to train all relevant staff.

Separately, the LC engaged another CPA firm to perform a look-back review of transactions in all customer accounts for the past two years. As a result, STRs were filed by the LC. In order to enhance the system, the LC engaged a third-party vendor for a new transaction monitoring system, and sought advices from the CPA firm in the design and setting of the parameters for the transactions monitoring alerts.

The LC has also strengthened its compliance resources by increasing the number of compliance staff.

411. The IA issued 211 management letters to IIs between 2013 and 2017 requiring remedial action with respect to deficiencies identified during on-site inspections and off-site reviews. This represents a considerable number of actions. The IA monitors the progress made by IIs on these deficiencies until their completion, and there has been no serious case of non-compliance. Thus, other remedial actions and sanctions empowered by the AMLO or the IO have not been applied and the effectiveness, proportionality and dissuasiveness of these sanctions cannot be assessed.

412. The C&ED primarily relies on criminal investigations and prosecutions to sanction MSOs. Five MSOs were convicted between 2012 and 2017 (fines were imposed in four cases for a total of HKD 270 000 (USD 34 400) and a 200 hour community service order was imposed in one case). Of these, the C&ED imposed administrative sanctions on two MSOs (a pecuniary penalty and a licensing condition). It also has issued warning letters to three MSOs. Other possible remedial actions and sanctions under the AMLO have not been applied. Remedial actions are limited to outreach activities. The C&ED could do more to rectify less serious deficiencies that do not initiate criminal investigations. There are also a number of unlicensed MSO cases as summarised in Table 6.3. While these convicted cases are good achievements, this suggests that there is an important threat of unlicensed remittance. Given that the maximum penalty for unlicensed operation of MSO is a fine of HKD 100 000 (USD 12 750) and imprisonment for six months, the sanctions imposed do not appear dissuasive. Relevant HKC authorities including the C&ED and LEAs need to continue the surveillance and strengthen their co-operation as necessary.

**Table 6.3. Convictions and Fines Related to Unlicensed MSOs**

	2013	2014	2015	2016	2017
No. of convictions	11	8	11	3	10
Amount of fines (USD)	19 130	12 630	26 100	6 000	26 000
Imprisonment with suspension	1 (4 weeks)	1 (2 months)			

Source: C&ED.

413. On the basis of SIS and on-site inspections results, the RML issued 53 advisory letters to moneylenders requiring remedial actions and 29 warning letters to moneylenders failing to implement remedial actions (as of September 2018). These moneylenders are monitored by the RML. If the RML identifies serious breaches, it can refer the case to HKPF for investigation or to the Licensing Court for imposing additional licensing conditions and/or revocation/suspension of the licence as necessary. However, apart from these limited measures, the RML is not empowered to take an adequate range of supervisory actions such as remedial orders, public reprimands or administrative pecuniary penalties (see c.27.4 in the TC Annex) which would allow the RML to enforce the AML/CFT requirements in a direct and prompt manner. This shortcoming may undermine the effective enforcement of compliance with regulatory requirements.

#### *DNFBPs*

414. SRBs and other DNFBP supervisors apply very limited remedial actions and no disciplinary sanctions. Thus, the effectiveness, proportionality and dissuasiveness of sanctions cannot be assessed in all sectors. Further, the shortcoming in monitoring raises concerns about their capacity to conduct effective AML/CFT supervision and monitoring.

415. The EAA identified 101 non-compliant transactions (16% of inspected transactions) with AML/CFT requirements from March to September 2018. The EAA issued advisory letters/recommendations requiring the rectification of deficiencies, and conducted follow-up visits in some instances. The disciplinary sanctions stipulated in the EAO have not been applied since the application of the AMLO to estate agents.

416. The CR identified non-compliance with AML/CFT requirements in 178 out of 545 inspections against TCSP licence applicants. In response, the CR issued 48 advisory letters requiring the rectification of deficiencies, conducted 286 follow-up on-site inspections and rejected 33 licensing applications (as of the end of September 2018). While these are good efforts, the CR is still processing TCSP licence applications and it is too early to assess the effectiveness of these actions. The disciplinary sanctions stipulated in the AMLO have also not been applied.

417. The LSHK indicated that no breach of the AML/CFT requirements of the PDP by legal professionals has been identified and thus no sanctions imposed. The situation is similar for the HKICPA. The absence of regular monitoring and sanctions raises serious concerns.

## *Impact of supervisory actions on compliance*

### *Financial Institutions*

418. Financial supervisors (except the RML) demonstrate the effects of their supervision on AML/CFT compliance to a varying degree. The HKMA presented evidence of measurable improvement in the quality of AIs' AML/CFT controls based on the inspection records. For SVF licensees, the impact of the supervisory actions cannot be assessed as the regime is quite recent and therefore no information is available. However, it should be noted that a number of licensees have increased their AML/CFT-related resources. The SFC, the IA and the C&ED have follow-up mechanisms to monitor the progress of the remediation of identified deficiencies. The C&ED organises small focus group meetings to improve the AML/CFT compliance capabilities of MSOs. These follow-up mechanisms work well to improve the compliance of respective FIs. The SFC also introduced a Manager-In-Charge (MIC) regime for ensuring AML/CFT compliance (see also Chapter 5). Interviews with FIs confirm that enforcement actions, especially public reprimands, are dissuasive and they comply with the instructions given by the supervisor.

419. While the C&ED presented good examples of actions to improve the quality of STRs, the number of MSOs filing STRs remains low despite the vulnerability of the products and services offered. This is indicative of lack of understanding of AML/CFT obligations and risks. Given the recent implementation of the AML/CFT compliance measures to the moneylender sector, the positive impact of RML's supervision remains to be demonstrated.

### *DNFBPs*

420. Overall SRBs and other DNFBP supervisors could not demonstrate that their supervision/monitoring have positive impacts on compliance by supervised entities. Nevertheless, DNFBPs interviewed acknowledged that they are aware of and have to comply with the AML/CFT requirements prescribed by relevant guidelines and instructions by supervisors and SRBs. This suggests that supervisors' awareness-raising activities are having some effect.

## *Promoting a clear understanding of AML/CFT obligations and ML/TF risks*

### *Financial Institutions*

421. Financial supervisors have issued a number of guidelines, circulars and other documents to help each sector to understand and comply with AML/CFT requirements. They have conducted, to a varying degree, a range of outreach activities (e.g. seminars) to raise attention on common shortcomings and to raise awareness against higher risk areas. All supervisors' websites include a dedicated AML/CFT section and keep relevant information publicly accessible, including enforcement actions taken and the list of sanctioned entities. FIs interviewed generally acknowledged the usefulness of supervisory documentation and outreach on higher risk areas. However, not all supervisors could demonstrate the impact of their guidance and outreach especially in relation to the understanding of ML/TF risks.

422. The HKMA puts emphasis on the understanding of risks and sharing of information/intelligence to mitigate the risks. The FMLIT is a good example in the banking sector. The HKMA has also dedicated efforts to improve senior management oversight and has organised targeted seminars for AIs' chief executives and directors to communicate the HKMA's expectations. Further, the HKMA engages with AIs on topical risk areas such as tax evasion, TBML, sanction control and PF. For the SVF licensees, the HKMA has issued sector-specific supervisory documents and organised seminars but further outreach to inform the licensees of sector-specific ML/TF typologies would be useful.

423. The SFC promotes a clear understanding of the role of senior management in oversight and mitigation of ML/TF risk, and has organised targeted seminars for senior managements of LCs. The introduction of the MIC regime reflects this policy. The SFC engages with LCs on topical risk areas, including on third-party fund transfers, nominees and warehousing arrangements, non-face-to-face account opening, sanction control and PF. Those efforts have enhanced LCs' risk awareness and have resulted in an increase in STR filing in the past five years. The LCs interviewed confirmed the usefulness of the guidance provided.

424. The IA noticed some IIs, especially smaller IIs, experience difficulties in understanding and implementing AML/CFT obligations. To remediate this the IA organised seminars designed for IIs' compliance officers and money laundering reporting officers on key findings from AML/CFT inspections. The awareness-raising activities of the IA on ML/TF risks are less compared with the HKMA and the SFC but appear to be in line with the sector's lower risk. The increasing trend of the number of STRs filed by IIs indicates a positive effect.

425. Since 2015, the C&ED has conducted focus group meetings with the MSOs showing unsatisfactory compliance levels to improve their understanding of the AML/CFT obligations. In a joint effort, the C&ED and the HKPF have also conducted some outreach on telephone deception using remittances, which resulted in good achievements to prevent such fraud cases in the MSO sector. However, as previously mentioned, STR filing in the sector is very fragmented. This suggests that further guidance and feedback in relation to ongoing monitoring and STR filing that takes into account ML/TF risks and typologies is needed.

426. The RML issued an AML/CFT Guideline in September 2018 with which moneylenders are required to comply as part of the licensing conditions. Given its recent nature, there has been very limited outreach to the sector on the new requirements. The low number of STRs filed by moneylenders appears to reflect the sector's relatively lower risk. Nevertheless, the fact that extremely few moneylenders have filed STRs in the past five years indicates that more could be done by the RML. Separately, the FSTB and the SB have organised annual AML/CFT seminars to improve the AML/CFT compliance and the risk understanding of the sector but these activities were very limited.

### *DNFBPs*

427. SRBs and other DNFBP supervisors have issued AML/CFT Guidelines and documents on compliance with AML/CFT requirements. The websites of the EAA, the CR and the HKICPA have dedicated AML/CFT section and include guidelines, materials used in seminar/workshop, links to relevant AML/CFT authorities and the

list of sanctioned entities. Other supervisory activities to promote the understanding of AML/CFT requirements and risks vary significantly across the sectors. While these efforts are promising, the effectiveness of outreach remains to be demonstrated especially in relation to ML/TF risk understanding.

428. The EAA started engaging with estate agents on ML/TF risks and on AML/CFT practices before the sector was subject to the AMLO in March 2018. The EAA issued circulars and organised seminars to improve the preventive measures of the sector. The EAA also created checklists, CDD forms and educational kits to assist the industry to comply with AML/CFT requirements. The estate agents interviewed provided positive feedbacks on such outreach activities. However, the fact that extremely few estate agents have filed STRs suggests that more should be done to support estate agents in identifying suspicious transactions.

429. Since the creation of the TCSP licensing regime, the CR organised and participated in a number of seminars to explain the new licensing regime and the application of statutory CDD and record-keeping obligations. TCSPs interviewed provided positive feedbacks on the guidelines and seminars. However, STR filing in the sector is very fragmented. The CR needs to provide further guidance and feedback on ML/TF risks, ongoing monitoring and STR filing.

430. The LSHK focuses on awareness-raising against higher risk areas, and organises seminars with speakers from other authorities such as the HKMA. The fact that most STRs filed by DNFBPs are from legal professionals is indicative of a better awareness by the sector. However, the LSHK appears to have difficulties in increasing the participants in such seminars and in raising awareness about TF risk.

431. The HKICPA has regularly organised seminars and workshops to raise awareness on AML/CFT obligations. These educational activities focus on AML/CFT compliance but virtually do not touch upon the understanding of the ML/TF risks of the sector.

### *Overall conclusions on IO.3*

432. **HKC has achieved a moderate level of effectiveness for IO.3.**



## Chapter 7. LEGAL PERSONS AND ARRANGEMENTS

### Key Findings and Recommended Actions

#### *Key Findings*

- a) The 2018 HRA analyses the ML/TF risks posed by the misuse of legal persons and arrangements (i.e. trusts). This assessment acknowledges that legal persons, particularly shell companies, created or operating in HKC are used to facilitate predicate crimes and ML offences. The assessment, which was primarily focussed on companies, the predominant type of legal person in HKC, would benefit from a more detailed consideration of the range of legal persons that are established in HKC. Authorities also noted that trusts could be abused, although there is less extensive data to support this proposition.
- b) Basic information on companies is publicly available on the CR's website, and legal ownership information is on the register of members held by the company, which could be made available for inspection at the company. There is a potential concern as to whether information is available in a timely manner in practice as: (i) shareholding information with the CR may not always be accurate and up-to-date as companies are only obliged to file updates during submission of annual returns; and (ii) companies have up to two months to include the updated shareholder information in their register of members, although HKC notes that legal ownership only changes when the register is updated.
- c) To better mitigate the risks of misuse of companies, since March 2018, the CR has put in place requirements for companies to collect beneficial ownership information by way of keeping a significant controller register (SCR). The CR has taken encouraging steps to check on a number of companies' compliance with SCR regime, but more time is needed to assess effectiveness.
- d) For trusts, aside from trusts created by regulated entities or professional trustees, HKC also relies on common law fiduciary duties on trustees to keep the relevant information. While there are indications that most trusts in HKC are probably set up through professional trustees, other trusts set-up under HKC's common law do not adequately ensure that trustees maintain adequate, accurate and up-to-date information on settlor/protectors/beneficial owners as required by the FATF.
- e) Competent authorities in HKC may also obtain basic and beneficial ownership information on legal persons and legal arrangements from other sources; HKC has put in place CDD measures for a range of FIs, and more recently lawyers, accountants and TCSPs, to collect beneficial ownership information. Large FIs and those belonging to international financial groups would typically have the beneficial ownership information of their customers. However, due to the more nascent nature and less even level of implementation of AML/CFT requirements in the DNFBP sectors, HKC has not yet been demonstrated that accurate and up-to-date beneficial ownership information is always available in those sectors.

- f) HKC has taken some action against companies for lack of compliance with the reporting requirements, but the regime on companies as well as lawyers, accountants and TCSPs to collect and provide beneficial ownership information in particular, is still nascent and there is insufficient information to conclude that sanctions are effective, dissuasive and proportionate.

### *Recommended Actions*

- a) HKC should conduct a more comprehensive ML and TF risk assessments for all types of legal persons in HKC to better identify the potential ML/TF risks.
- b) HKC should, taking into account how the information is being accessed, review whether shareholding information in the Register of members as well as that filed with the CR can be updated in a more timely manner.
- c) Building on its initial efforts, HKC should continue enhance its monitoring and enforcement of companies' compliance with the new SCR regime and where appropriate, impose proportionate and dissuasive sanctions for non-compliance.
- d) Supervisors, particularly for DNFBPs, should enhance their supervision and monitoring for compliance with CDD requirements in relation to legal persons and legal arrangements (in particular as regards beneficial ownership information) and where appropriate impose proportionate and dissuasive sanctions (see also IO.3).
- e) HKC should consider the further actions it can take to ensure that beneficial ownership information in relation to legal arrangements, especially for trusts that are not created through professional trustees, is more readily available and accurate.

433. The relevant Immediate Outcome considered and assessed in this chapter is IO.5. The Recommendations relevant for the assessment of effectiveness under this section are R.24-25.<sup>46</sup>

## **Immediate Outcome 5 (Legal Persons and Arrangements)**

### ***Public availability of information on the creation and types of legal persons and arrangements***

434. Basic information, such as company number, name, type, date of incorporation, active status and name history, as well as information on how to form a company, is publicly available through the CR's website. Information on the creation of different types of companies is also available, as is the case for open-ended fund companies (OFCs). Information on the creation of other types of legal persons as defined by the FATF Standards (e.g. partnerships) is also publicly available as described in R.24, and for the purpose of IO.5, the main focus for legal persons is on companies.

<sup>46</sup> The availability of accurate and up-to-date basic and beneficial ownership information is also assessed by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. In some cases, the findings may differ due to differences in the FATF and Global Forum's respective methodologies, objectives and scope of the standards.

435. The process for creation of express trusts is governed by common law, and is available through public sources. Express trusts are the only type of legal arrangement that is recognised under HKC law, which covers various kinds of trusts such as charitable trusts (typically a sub-class of NPOs) and real estate investment trusts (a type of collective investment scheme that is being listed and traded on the HKC Stock Exchange). There is no specific source of publicly available information (e.g. dedicated website set up by the authorities) to provide guidance on setting up of legal arrangements in HKC. Other types of legal arrangements are not recognised under HKC law, and no information was available on whether other types of arrangements are used in HKC.

### ***Identification, assessment and understanding of ML/TF risks and vulnerabilities of legal entities***

436. The HRA assesses that front companies and shell companies constitute a significant ML risk in HKC, both for domestic and foreign predicates. The HRA has a chapter focusing on the risks related to legal persons and arrangements, and other parts of the HRA also referred to the risks from shell companies and express trusts. The HRA notes:

*“A good number of the ML cases prosecuted in Hong Kong involve corporate accounts of legitimate businesses which have been exploited, or set up by shell companies to hide beneficial ownership. ....Hong Kong companies are commonly incorporated to carry out transactions (such as holding properties or club memberships) or to open bank accounts. Corporates are used in ML cases in Hong Kong in the layering process to increase the difficulty and time taken to trace proceeds of crime. In cases involving the use of more advanced ML techniques, front companies are established to transfer crime proceeds from one jurisdiction to another under the disguise of payments resulting from legitimate business activities, such as imports and exports.”*

437. The primary focus in the HRA on the significant ML risks associated with companies is reasonable – a stock of over 1.38 million companies, and 150,000 new companies are incorporated every year. This is broadly consistent with HKC’s status as an efficient company formation centre, and the use of HKC companies in HKC or elsewhere, for a range of purposes, including for potential ML.

438. Adopting the WBT, HKC had considered ML/TF risks from a range of legal persons. There is a strong focus on companies, particularly shell companies, taking into account the activities, size, ML cases and typologies observed. Nonetheless, the assessment would benefit from a more detailed consideration of the full range of legal persons (e.g. foreign registered companies, partnerships etc.) that could be established or are operating in HKC to facilitate a more comprehensive understanding of the potential abuse of HK companies for ML/TF.

439. While it should be acknowledged that reports and cases arising from the Panama<sup>47</sup> and Paradise Papers<sup>48</sup> and “Russian Laundromat”<sup>49</sup> do not necessarily or always point to illegal activities in and of themselves, they do point to potential vulnerabilities, and HKC authorities are encouraged to consider the potential risks that may arise from these materials in greater detail.

440. Similarly, in relation to legal arrangements, the HRA notes that there is limited information available on the abuse of trusts formed under HKC law, but that “foreign trust structures thus pose medium to medium high money laundering risks”. Hence, while HKC has taken steps towards identifying, assessing and understanding the risks associated with legal persons (particularly for companies, which is most common) and trusts through the HRA exercise, and recognises that this is generally an area of higher risk, more can be done to strengthen its risk understanding.

### *Mitigating measures to prevent the misuse of legal persons and arrangements*

441. The recent measures taken by HKC were mainly focused on ensuring availability of beneficial ownership information for companies (assessed to be the main ML/TF risk for legal persons). In particular, in March 2018, the CO was amended to require companies to collect and maintain accurate and up-to-date BO information through the keeping of an SCR. There were also recent amendments to the AMLO subjecting TCSPs (as well as other DNFBBs) to CDD and record-keeping requirements. These registers of significant controllers, which are to be retained by the companies themselves, and recent AMLO amendments to extend AML/CFT requirements to a number of DNFBBs, are a positive development for HKC.

442. As discussed in the analysis of IO.3, the CR has implemented measures to check the accuracy of information provided, and has since March 2018 taken steps to check on companies’ compliance with the SCR regime. The Inspection Unit is headed by a Senior Companies Registration Officer. Currently, there are 14 officers acting as inspectors. The Inspection Unit conducts onsite inspections, both on a risk-based approach and random basis, at registered offices of companies to check the correct location of companies and the existence of relevant companies; and to ensure compliance with the requirements for publication of company names and the keeping of proper and up-to-date registers (registers of members, registers of directors, registers of company secretaries and the SCRs).

443. The CR had adopted a set of risk-based factors, including taking into account information from other competent authorities, for triggering an inspection.

444. Nominee directors and shareholders will have to be personally identified, and in practice, nominee directors are treated as directors in law. With the new SCR regime, aside from the nominee shareholders, persons behind the nominee

<sup>47</sup> ICIJ’s website indicated that over 50 000 entities, 30 000 officers, 4 900 intermediaries could be linked to HKC.

<sup>48</sup> ICIJ’s website indicated that over 1 000 entities, 2 800 officers, 260 intermediaries could be linked to HKC.

<sup>49</sup> The organised crime and corruption reporting project reported on 20 March 2017 that suggested that over USD 900 million may have been moved through HKC through front companies and intermediaries: [The Russian Laundromat Exposed](#)

shareholders (or at least shareholders who hold directly or indirectly more than 25% of the issued shares, voting rights or powers to appoint/remove a majority of the board of directors or exercising influence/control) would also be identified.

445. There are no measures taken to specifically prevent misuse of legal arrangements, and reliance is placed on general common law and fiduciary obligations. However, the HKC authorities consider that trusts are mainly set up and administered through professional trustee such as lawyers and TCSPs, and while there are indications that most trusts are set up through such professional trustee, there are still other trusts that are not.

446. The AML/CFT requirements (including CDD and STR reporting requirements) imposed on FIs would help identify and prevent the abuse of legal persons and legal arrangements. Where the legal persons and arrangements created in HKC deal with banks or other FIs, which appears to be common for many legal persons and legal arrangements that are created in HKC, they are subject to the FIs' AML/CFT controls.

447. AML/CFT requirements recently imposed on TCSPs, as well as those relating to lawyers and accountants, could also help to identify and prevent the abuse of legal persons and legal arrangements over time – however as the regime is relatively new with nascent supervision and implementation among these DNFBPs, more time is needed to assess the effectiveness of these measures. A residual gap is thus more about legal arrangements governed by HKC law, but which engage in activities outside of HKC, and without a relationship with an AML/CFT-obliged entity in HKC.

### *Timely access to adequate, accurate and current basic and beneficial ownership information on legal persons*

448. Competent authorities, and in particular law enforcement, advised that they are generally able to obtain basic and beneficial ownership information. The information can be obtained from the CR and the Stock Exchange of HKC (which maintains a public register of disclosure interests of listed companies), from the legal persons directly or from FIs and DNFBPs through the use of law enforcement powers. However, the accuracy and up-to-date nature of the information is predicated on the extent that this is collected and adequately verified, which is generally so only for large FIs and those belonging to international financial groups (see IO.4).

#### **Box 7.1. Example of access to basic and beneficial ownership information**

In March 2016, Jurisdiction A made an MLA request to obtain bank records, restrain a bank account and serve documents for an investigation of offences relating to conspiracy to distribute controlled substances and conspiracy to commit ML, and for civil forfeiture proceeding to recover the drug-related proceeds which had been transferred to a HKC bank account. The request was approved on 5 May 2017. Jurisdiction A's request for records on beneficial ownership of the bank account, was obtained by the Courts on 9 May 2017 requiring the production of such records. On 18 May 2017, bank records, including account opening mandate (which includes

the beneficial ownership information and company records of the account holding company) and monthly statements were provided to Jurisdiction A. The transaction records were provided in a subsequent batch.

449. The CR maintains a wide range of basic information on companies (e.g. directors, registered office address etc.), which is reasonably up-to-date, and publicly accessible. As regards shareholding information, companies have to keep a register of members, and update these registers within two months of receiving notice of any change to the shareholding (s.627(4) CO). HKC authorities explained that it is only upon the update of the register of members that the shareholder would be recognised. This would mean that in the two months where the parties had agreed on their position, there could be a situation of an interim “nominee”, although the beneficial ownership requirements under the SCR regime would apply (if the company is aware of the changes). Further, vis-à-vis the CR, the requirement is to report shareholding changes due to share transfers in a company’s annual returns, which means that third parties (e.g. FIs, DNFBPs and LEAs) who rely on such information may receive out of date information unless they perform additional checks to ascertain the information. For competent authorities, they can also inspect the register of members to better ensure that it is more up-to-date.

450. As regards beneficial ownership information, for companies, the CO (s.653H) has required companies to obtain and maintain up-to-date information on their beneficial ownership through the SCR since 1 March 2018. The SCR must contain the particulars of all individuals or legal entities that have significant control (25% or more shareholding and other circumstances where control is presumed to exist) over the company. Companies are required to take reasonable steps to ascertain whether there are significant controllers of the company and if so, to identify each of them. This includes identifying the chain of ownership, where this exists.

451. As the SCR regime is new, the CR has focused its main efforts on outreach and public education, and has also commenced a number of inspections (2 580) since March 2018. Based on early checks conducted by the CR (see also sanctions below), a significant proportion (77%) of companies inspected have begun collecting and maintaining the SCR. While there are indications that compliance rate is increasing, there is still an appreciable proportion that do not yet have an SCR. And while the CR has taken encouraging initial steps and committed substantive resources, the population of companies inspected is still relatively small as at the time of the on-site, and it is not yet possible to determine whether beneficial ownership information is accurate or up-to-date, or available in a timely manner.

452. Overall, there is more than one mechanism in place in HKC whereby authorities can seek to obtain basic and beneficial ownership information. A range of basic information is available online at the CR or accessible by competent authorities at the company’s registered office. Given HKC’s small geographic size, this should normally be possible in a timely way. Beneficial ownership information can be sought from the SCR held by the company or from regulated entities such as FIs, lawyers and TCSPs etc. For these, while the large FIs from international financial groups would typically have the relevant information, the level of compliance is uneven, especially for the DNFBPs (see IO.4).

### *Timely access to adequate, accurate and current basic and beneficial ownership information on legal arrangements*

453. Competent authorities would normally use law enforcement powers to obtain basic and beneficial ownership information on trusts and HKC provided a few cases where trusts were involved in investigations, and indicated that they had not had difficulties in those cases in obtaining information related to the trust.

#### **Box 7.2. ML Case Study**

This is a case of ML stemming from information from an MLA request from Jurisdiction A involving HKD 61 million. Victims from Jurisdiction A were lured to enter into some investment scams and remitted funds to a trust account held by Mr. A in HKC. Mr. A is a Certified Public Accountant and the sole proprietor of an accountancy firm in HKC. Enquiries revealed that the funds were eventually channelled to a number of accounts held by Mr. B in the Netherlands. Mr. A was convicted of ML after trial and was sentenced to six years' imprisonment.

454. Adequate, accurate and up-to-date basic and beneficial ownership on trusts would typically be available where a trustee has engaged a large FI belonging to international financial groups, e.g. opened a bank account in HKC and the required CDD information is collected and verified by a global international bank, and the authorities are able to identify that account in a timely way. The information may also be available if such legal arrangements were set up through TCSPs, lawyers or professional accountants regulated for AML/CFT but as noted here and in IO.4, implementation of AML/CFT requirements, including the collection of relevant information by DNFBPs, is less robust and uneven in practice.

455. Using compulsory powers authorities may also be able to obtain relevant information on trusts from the trustee, if that person is located in HKC (or, if the person is located in another jurisdiction, through a request for assistance), and where the relevant basic and beneficial ownership information has been collected and verified. For this to work well in practice, it would also require that the LEA has information that will enable it to determine who is the trustee or intermediary involved. Common law obligations do require trustees to maintain a mix of general information relating to the beneficiaries (the main fiduciary duty of the trustee), protectors (when known) and potentially some information regarding the settlors (but this does not explicitly include other controllers behind the settlors, where they exist). Hence, there are gaps in the range of information that a non-professional trustee is required to collect and maintain under the FATF Standards in practice.

### *Effectiveness, proportionality and dissuasiveness of sanctions*

456. From 2013 to October 2018, a total of 44 004 compliance notices and 22 472 summonses for failure to deliver annual returns or accounts were issued, although not all of these relate to the keeping of basic information, and no further breakdown or more detailed information was provided. The total fines imposed were about HKD 28.7 million (USD 3 672 478 69). The fine for failure to provide an annual return is USD 6 400. During this period, 273 069 companies (about 50 000 companies per

annum) were struck off the Companies Register as there was reasonable cause to believe that the company was not in operation or carrying on a business. Timely annual returns are filed by about 85-90% of companies, which indicates that approximately 100 000 companies which do not file annual returns are not struck off immediately – HKC authorities explained that this was because the companies would first be served with compliance notices to comply, and would be struck off if they still do not comply.

457. If a company fails to comply with the requirement of keeping an SCR (s.653H) or if a notice addressee fails to comply (s.653ZA), it is liable upon conviction to a fine of up to USD 3 200 and a further daily fine of USD 90 for a continuing offence. If a person knowingly or recklessly makes a statement in an SCR that is misleading, false or deceptive in any material particular (s.895), the person commits an offence and is liable upon conviction to a fine of up to USD 38 270 and to imprisonment of up to two years.

458. Between March and September 2018, 1 956 companies were inspected for compliance with SCR requirements<sup>50</sup>. About 77% (1 510) of companies had kept their SCRs. For the remaining 23% (446) of companies, which did not keep SCRs, verbal advice for compliance was given to them and follow-up site inspections were being conducted to check compliance. Separately, the CR has issued 12 summonses in October 2018 on companies that failed to keep the SCR. While it is noted that there are indications of increased compliance -559 (89.6%) out of the 624 companies inspected in October 2018 had kept an SCR-, an average of nearly 20% of companies inspected did not have an SCR,. This would indicate that more can be done to create awareness, and where appropriate, for dissuasive and proportionate enforcement actions to be taken. There is also no information available on sanctions taken with regard to non-professional trustees that fail to keep the relevant information.

459. The regime for ensuring that there is adequate, accurate and current beneficial ownership information is new, with the legal obligations for DNFBPs and the SCR being only about eight months old as at the time of the on-site. The measures in place for FIs, particularly banks, are more developed, and there is greater confidence that basic and beneficial ownership information is available through those avenues. Hence, while the steps taken by the authorities, particularly the CR, are encouraging and in the right direction, and over time, the regime would be strengthened further, there is currently inadequate information to determine whether the new measures (taking into account the number of entities inspected, the approach taken, and the enforcement measures) combined with the pre-existing requirements adequately ensure that the required information is accessible in relation to companies, other legal persons and trusts in a timely manner.

### *Overall conclusions on IO.5*

**460. HKC has achieved a moderate level of effectiveness for IO.5.**

<sup>50</sup> As part of the CR's inspection of TCSPs, they would also cover whether companies administered by the TCSPs maintain an SCR.

## Chapter 8. INTERNATIONAL CO-OPERATION

### Key Findings and Recommended Actions

#### *Key Findings*

- a) HKC demonstrates many characteristics of an effective system for international co-operation to a large extent and is able to render MLA, extradition (which is referred to as “surrender of fugitive offenders” in the laws of HKC), and intelligence/information in a constructive and timely manner.
- b) HKC actively responds to formal international co-operation requests for MLA and surrender and has received positive feedback from counterparts concerning the high quality of assistance received as well as on timeliness and the ability to respond to urgent requests. HKC has also been effective in asset sharing with foreign jurisdictions.
- c) Effectiveness is supported by a comprehensive legal framework (though there are some gaps) and a highly efficient central authority, though the central authority would benefit from additional resources given the increasing number of incoming requests.
- d) Whilst it has effectively dealt with increasing numbers of incoming international requests, the low number of outgoing requests is not consistent with HKC’s risk profile. In particular, HKC does not appear to be making enough proactive efforts to pursue proceeds of crime outside the jurisdiction and ML foreign predicate offences through formal means (see also analysis of IO.7 and IO.8), though HKC authorities indicate that in some cases this may be somewhat mitigated by other actions e.g. the defendant choosing to repatriate the proceeds.
- e) Co-operation with the Mainland and other parts of China is administered through court-to-court letters of request, but is limited to the examination of witnesses and production of documents for the purposes of criminal proceedings, criminal investigations and asset recovery investigation or proceedings. While the volume of formal co-operation is limited, informal law enforcement co-operation is robust. This partially mitigates the legal shortcomings, particularly in view of the differences between the legal systems of other parts of China and HKC.
- f) HKC actively uses agency-to-agency international co-operation for AML/CFT purposes, primarily for information exchange and informal liaison, and has undertaken a limited but gradually increasing number of joint operations with foreign counterparts. Core Principles supervisors seek and provide supervisory information with foreign counterparts including regulators in the Mainland for AML/CFT purposes, which is consistent with the international nature of HKC’s financial market. Cross-border supervisory co-operation by other supervisors and SRBs is limited to the C&ED.

**Recommended Actions**

- a) HKC should make more outgoing formal requests for MLA, extradition and asset recovery in line with its risk profile and to follow and restrain assets that have moved to other jurisdictions, and pursue the people involved. The Central Authority should increase its efforts to provide training and awareness to LEAs regarding international co-operation tools.
- b) HKC should explore ways to improve its ability to co-operate with the Mainland and other parts of China through formal means. This can be done by exploring the feasibility of enacting legislation to facilitate formal asset recovery actions (other than for drug offences) as well extending the range of MLA that can be provided beyond examination of witnesses and production of documents.
- c) Given its risk and context and the high volume of incoming international co-operation requests, additional human resources should be allocated to the Central Authority to enhance its ability to respond to incoming requests.
- d) Core Principles supervisors should continue close cross-border supervisory co-operation for AML/CFT purposes, especially with other parts of China.
- e) HKC should remedy the minor shortcomings in its legal framework concerning international co-operation that hinder it from providing fuller co-operation to foreign counterparts. These impediments include the fact that: a) dual criminality is required where non-coercive action is requested; b) MLA cannot be requested to obtain information for the investigation of a tax-related offence unless the requesting jurisdiction is a treaty party with HKC, and (c) there are no legal provisions that oblige HKC to prosecute in lieu of extradition.

461. The relevant Immediate Outcome considered and assessed in this chapter is IO.2. The Recommendations relevant for the assessment of effectiveness under this section are R.36-40.

**Immediate Outcome 2 (International Co-operation)**

462. International co-operation is significant in HKC's context given its position as an international hub for finance, trade and transport. With a free and externally oriented economy, HKC's financial system faces significant cross-border ML (and, to a lesser extent, TF) risks. HKC authorities have observed in their risk assessment that externally, fraud represents a high ML threat, with drugs, corruption and tax evasion also representing threats; as well as citing corporate bank accounts, MSOs and the formation of shell companies as vulnerabilities that may potentially be exploited to launder proceeds of crime.

**Providing constructive and timely MLA and extradition**

463. HKC demonstrates many characteristics of an effective system for international co-operation and is able to render MLA, extradition (known as surrender of fugitive offenders in HKC's context) and intelligence/information in a constructive and timely manner.

464. Within the DOJ, the Mutual Legal Assistance Unit (MLAU) of the International Law Division acts as HKC's Central Authority and deals with all incoming and outgoing MLA and surrender requests in an effective and efficient manner. The MLAU comprises 15 legal counsel (with previous experience in both prosecution and civil litigation) as well as three law clerks and six secretarial/support staff. Counsel not only deal with the execution of requests but also appear in Court to make the necessary applications where coercive measures and orders are required.

465. As noted in the TC Annex, HKC possesses a comprehensive legal regime to render and request international co-operation. Some technical impediments identified in the previous MER continue to exist in HKC's legal framework that may limit its ability to render full international co-operation in certain circumstances to some extent. These impediments include: i) the fact that MLA cannot be requested to obtain information for the purposes of the investigation of an offence relating to taxation unless the requesting jurisdiction is an agreement party with HKC or a party to an applicable international convention; and ii) that there are no legal provisions that oblige HKC to prosecute in lieu of extradition. Meanwhile, HKC has advised that there is an alternative avenue to provide assistance with regard to a criminal matter involving an investigation of an offence relating to taxation. A court-to-court letter of request may be used to seek assistance for such offence. In fact, HKC has advised that there has been no refusal of an MLA request on the ground that it related to an investigation of an offence relating to taxation in the past few years. HKC has further advised that despite the absence of an express statutory provision, the principle of "prosecution in lieu of extradition" has been observed as a matter of practice. Case examples were provided to illustrate the practice. It is also observed that the MLAO requires dual criminality for formal requests for non-coercive actions. This however does not represent a major issue given that the number of requests refused on the basis of dual criminality is low and feedback by foreign jurisdictions has not raised it as a major issue. HKC advises that such assistance can still be rendered outside the MLAO framework and processed by the DOJ. Nevertheless, this minor gap should be rectified and the requirement removed where non-coercive actions are requested under the MLAO.

466. To a large extent, HKC is able to render useful and good quality assistance, a conclusion that is supported by feedback received from 21 jurisdictions. In addition to legislation, HKC has a broad network of bilateral agreements for MLA with 30 agreements in operation as at 31 December 2018. HKC is also able to provide assistance on the basis of international conventions applicable to HKC such as the Vienna, Merida, Palermo and TF conventions, and can also render assistance on the basis of reciprocity for MLA in the absence of bilateral agreements or applicable multilateral conventions.

### *Mutual Legal Assistance*

467. HKC's Central Authority has clear guidelines for prioritisation and the handling of MLA requests with the use of a computerised Work Management System (WMS) to update officers concerning timelines as well as electronically identify cases for prioritisation. A number of criteria determine prioritisation such as whether the requesting party is an agreement partner, whether the case involves co-ordinated law enforcement actions and/or has urgent court dates associated with it. Asset recovery

cases are often prioritised as they often involve suspected illegal proceeds that may dissipate if not acted on urgently.

468. The provision of timely assistance is also underpinned by the MLAU's performance pledge of responding to all requests within ten working days to acknowledge receipt and to provide details of assigned counsel. The work of the Central Authority is underpinned and supported by a wide array of templates, handbooks and internal circulars and guidance manuals surrounding international co-operation issues. Good practice was also observed from the MLAU whereby they provide input on draft requests from requesting jurisdictions as well as being easily accessible via various communication channels such as phone and email with their counterpart central authorities.

469. Statistics illustrate HKC's active international co-operation. From 2013 up until 31 October 2018, HKC received 2486 MLA requests from foreign jurisdictions, 18% of which related to ML and only one to TF. Requests for assistance come most frequently from the United States, France, Switzerland, Germany, Poland and Australia. Requests concerning fraud followed by ML and tax crimes were most common. The data presented by HKC indicate a gradual upward trend of MLA requests received, with the number of requests concerning ML increasing.

**Table 8.1. Number of offences in incoming MLA requests: 2013-October 2018**

Offence	2013	2014	2015	2016	2017	2018 (as at 31.10.2018)	Total
Corruption	18	19	24	13	33	14	121
Counterfeiting and piracy of products	13	1	4	6	2	2	28
Drugs	25	23	19	16	14	14	111
Environmental crime	0	0	0	1	1	1	3
Extortion	2	1	2	0	3	0	8
Forgery	3	14	13	14	7	11	62
Fraud	126	182	183	189	193	172	1 045
Goods smuggling	7	15	20	27	8	13	90
Illicit arms trafficking	2	1	0	1	0	0	4
Illicit Trafficking in Stolen and Other Goods	2	0	0	0	1	0	3
Insider trading and market manipulation	3	1	1	5	3	6	19
Kidnapping, Illegal Restraint of Hostage-taking	2	0	0	0	0	0	2
ML	84	75	69	60	89	62	439
Murder and grievous bodily harm	0	3	3	4	1	3	14
Others	19	6	16	12	59	100	212
Participation in an organised criminal group or racketeering	23	8	6	7	1	0	45
Piracy	0	0	0	1	0	0	1
Robbery or theft	9	15	17	16	11	18	86
Sexual exploitation	1	2	3	2	0	2	10
Tax crimes	24	31	39	33	33	31	191
Terrorism	1	1	0	1	1	0	4
TF	0	1	0	0	0	0	1
Trafficking in human beings and migrant smuggling	0	1	0	2	1	0	4
<b>Total</b>	<b>347</b>	<b>400</b>	<b>419</b>	<b>410</b>	<b>461</b>	<b>449</b>	

470. As illustrated by case studies and statistics, HKC has demonstrated strong capabilities in dealing with a variety of MLA requests for various forms of assistance.

The majority of incoming requests relate to the tracing of fund flows through the provision of bank records, identification of persons owning or controlling corporate entities and the taking of statements or evidence of witnesses before a magistrate by way of summons. Requests also involve more coercive measures such as the issue of search warrants as well as restraint of proceeds of crime and enforcement of foreign confiscation orders. HKC advises that 92% of compulsory court orders obtained pursuant to MLA pertain to the production of financial records to aid investigations and asset recovery actions.

**Table 8.2. Assistance by compulsory procedures under the MLAO: 2013 - October 2018**

Types of assistance provided	2013	2014	2015	2016	2017	2018 (as at 31.10.2018)
Production order (section 15)	167	156	174	232	264	175
Summons to witness (section 10)	16	10	4	5	37	3
Restraint order (section 27)	4	5	1	2	2	0
Registration of external confiscation order (section 28)	0	2	1	5	0	1
Search warrant (section 12)	2	0	2	0	0	0
<b>Total</b>	<b>189</b>	<b>173</b>	<b>182</b>	<b>244</b>	<b>303</b>	<b>179</b>

**Table 8.3. Assistance by voluntary measures: 2013 - October 2018**

Types of voluntary assistance provided <sup>51</sup>	2013	2014	2015	2016	2017	2018 (as at 31.10.2018)
Company records	13	13	9	20	35	17
Business records	4	1	2	3	8	2
Witness statements	11	11	18	12	17	12
Service of documents	8	5	1	1	1	2
Others <sup>52</sup>	4	7	2	1	5	8
<b>Total</b>	<b>40</b>	<b>37</b>	<b>32</b>	<b>37</b>	<b>66</b>	<b>41</b>

471. HKC has also demonstrated sound efforts to deal with asset recovery requests from foreign jurisdictions based on the tables below, which indicate significant amounts of proceeds restrained and confiscated. HKC has also demonstrated its willingness to partake in asset sharing arrangements with requesting countries as demonstrated by case examples provided. Where the case involves corruption or involves victims in a foreign jurisdiction, HKC informs that it will repatriate all assets back to the requesting state in the spirit of provisions adhered to under international conventions such as the Merida Convention.

<sup>51</sup> Each MLA file may contain more than one type of voluntary assistance.

<sup>52</sup> For example, seeking the DOJ's consent to provide materials previously obtained for other purposes; voluntary taking of evidence via video link outside section 10 of the MLAO; to obtain Judgment etc.

**Table 8.4. Restraint and confiscation orders obtained and amount under restraint and confiscated pursuant to incoming requests: 2013- October 2018**

	2013	2014	2015	2016	2017	2018 (as at 31.10.2018)
No. of restraint orders obtained	4	5	0	2	2	0
Value of assets restrained (USD million)	13.5	27.94	0	0.26	6.05	0
No. of confiscation orders registered	0	2	0	5	0	1
Value of assets confiscated (USD million)	0	0	0.18	2.37	0.47	0

**Table 8.5. Assets shared with foreign jurisdictions: 2013 - October 2018**

	2013	2014	2015	2016	2017	2018 (as at 31.01.2018)
No. of assets sharing requests	1	2	0	2	1	2
Amount of assets repatriated or shared (USD)	383 000	842 000	0	842 000	549 000	640 000

472. Feedback received from foreign jurisdictions was largely positive, with delegations stating that responses from HKC were of good/high quality and were provided in a timely manner, and that HKC demonstrated it prioritised urgent requests. Delegations commented that HKC was able to successfully process requests between 6 and 11 months.

### Box 8.1. Examples of handling incoming requests by HKC

#### Production Order

On 26 October 2016, HKC received a request that sought to obtain criminal records of a defendant for the sentencing proceedings in Jurisdiction C. The defendant pled guilty to the offences relating to importing a commercial quantity of a border-controlled drug and trafficking in a commercial quantity of a drug of dependence. The sentencing proceedings were listed for 16 November 2016. The criminal records were admitted into evidence in the defendant's trial and the judge noted the criminal history records were relevant to sentencing considerations. Jurisdiction C considered the documents valuable in securing the sentence. The request was executed within two weeks upon receipt of the request.

#### Witness travelling to requesting jurisdiction to give assistance

On 18 July 2016, Jurisdiction X made a request to HKC for obtaining evidence to assist the prosecution of a syndicate that was accused of purchasing a large amount of drugs from Jurisdiction Y and shipping them to Jurisdiction X for distribution and resale there. Two postal packages containing drugs which the syndicate caused to be shipped from Jurisdiction Y to Jurisdiction X were intercepted in HKC. The request was for obtaining real exhibits (i.e. the two packages of drugs intercepted in HKC), documentary evidence (records of the C&ED and the Government Laboratory), and arrangement of 14 witnesses to travel to Jurisdiction X to testify at the trial of eight defendants for offences relating to conspiracy of drug trafficking

and importation and international ML. The request was urgent due to the imminent trial date. The real exhibits were handed over to the agents of Jurisdiction X on 24 February 2017. The documentary records were transmitted on 27 April 2017. The witnesses gave evidence in Jurisdiction X on 27 June 2017. The request was executed in stages with handing over of real exhibits completed around seven months upon receipt of the request.

#### **Appointment of receiver for management of restrained property**

In 2010, a request was made by Jurisdiction A to HKC to restrain the assets of several defendants pending their prosecution of offences relating to embezzlement and ML. It is alleged that the defendants had caused the collapse of a public bank. The restrained assets consisted of cash of various currencies as well as complex assets in the form of securities and debt instrument held in 30 accounts in seven banks. Receivers were appointed in March 2012 to manage and find out the value of the assets. In 2012, a request was made to enforce the confiscation order made against two of the defendants. On 30 January 2014, the court allowed registration of the confiscation order. The defendants filed appeal against the judgment. Enforcement of the confiscation order is being stayed pending disposal of the appeal. In the meantime, the assets are managed by the receivers.

473. With regards to refusal of requests, HKC rejected a total of 10 requests between 2013 and October 2018. This equates to 0.4% of all incoming requests during that period. The refusal of requests are isolated incidents for compulsory measures based on the lack of dual criminality. In addition to this, HKC noted that it received 107 requests between 2013 and October 2018 which were non-executable, as the subject (e.g. bank account, foreign company, witness) was not located in HKC. Certain requests were not executable because of the absence of necessary information from the requesting jurisdiction as well as dual criminality not being satisfied. Reasons for refused or non-executable requests are communicated to counterparts.

**Table 8.6. Incoming MLA requests not executable / refused: 2013 - October 2018**

	Reason	2013	2014	2015	2016	2017	2018 (as at 31.10.2018)
<b>Request not executable</b>	Absence of necessary information/ material (e.g. bank account no., witness address, foreign court order)	0	4	3	3	5	2
	Subject is not located in HKC (e.g. foreign company or bank account/witness not located in HKC)	10	7	4	8	26	11
	Subject refused to give statement/ unable to provide documents (e.g. seeking documents over 7 years)	1	4	3	2	3	1
	Others (e.g. request is not made by an appropriate authority, restraint action is not feasible)	2	2	1	4	0	1
<b>Request refused</b>	Dual criminality not satisfied e.g. matters that amount to civil dispute in HKC	2	0	3	2	3	0
	<b>Total</b>	15	17	14	19	37	15

474. The MLAO does not apply to other parts of China and only limited formal assistance can occur formally between HKC and its closest regional neighbours. HKC provides MLA to other parts of China by means of a court-to-court letters of request system as stipulated by the Evidence Ordinance (EO). Assistance is however limited to the examination of witnesses and production of documents. Where recovery of

proceeds is concerned, HKC can only enforce confiscation orders made for the purpose of recovery of drug trafficking proceeds as provided under the DTROPO. There were 13 incoming letters of request from other parts of China between 2013 and June 2018, with only three pertaining to ML and none relating to TF.

475. The lack of formal arrangements is somewhat addressed by active law enforcement agency-to-agency co-operation between HKC and other parts of China and HKC has demonstrated some successful outcomes in this regard. In order to facilitate better co-operation with the Mainland and other parts of China, HKC should explore the feasibility of enacting legislation to facilitate formal asset recovery actions for non-drug offences as well as extending the range of MLA that can be provided beyond examination of witnesses and production of documents.

**Box 8.2. Case example on letter of request from other parts of China**

In May 2015, HKC received a request from Macao, China, for assistance in obtaining production of records from ten banks and examination of witnesses. Several defendants in Macao, China, were accused of using fictitious documents to obtain bank loans of almost 30 million. Some of the fictitious documents were purported to be issued by banks in HKC. It was further alleged that some of the crime proceeds were moved to HKC. The defendants were prosecuted for offences relating to fraud. In execution of the request, witnesses were summoned to appear before a Master of the High Court to give evidence and produce documents. The evidence was relevant to prove the fraud and was provided to Macao, China, in April 2016

*Surrender of Fugitive Offenders*

476. HKC is able to effectively respond to requests for surrender from foreign jurisdictions. Between 2013 and October 2018, HKC received 42 incoming requests for surrender, seven of which related to ML and one to TF. Sixteen of these requests were processed successfully within this period. A number of these requests were subsequently withdrawn by the requesting jurisdictions, whereas some were not executable as the fugitive was not located in HKC or for other reasons such as lack of dual criminality and the absence of an applicable agreement. HKC demonstrated an ability generally to surrender a fugitive within 3-4 months of the request at the earliest with more complex cases taking from 10 to 12 months to complete. No major feedback was received from foreign jurisdictions concerning HKC's ability to render surrender. HKC has operative agreements for surrender of fugitive offenders with 19 jurisdictions and states that it can also surrender on the basis of international conventions.

**Table 8.7. Incoming surrender requests and persons surrendered: 2013-October 2018**

	2013	2014	2015	2016	2017	2018 (as of 31.10.2018)
<b>Incoming surrender request</b>	7	6	8	8	3	10
Nature of offence						
ML	0	0	0	2	0	5
TF	0	0	0	0	1	0
Other Offences	10	9	8	11	2	26
<b>No. of persons surrendered</b>	5	3	1	6	0	2

**Box 8.3. Example of HKC's ability to surrender fugitives*****Case with consented surrender***

On 29 November 2014, Jurisdiction Y which does not have an operative agreement for surrender of fugitive offenders with HKC made a request under the Palermo Convention for surrender of a fugitive who was wanted for enforcement of sentence in respect of the offences of creation of an organised criminal group, forgery of electronic payments, possession of equipment for forgery of bankcards and fraudulent performance of financial operations. The fugitive was found in HKC serving a sentence for his conviction of an HKC offence and was due to be released. HKC rendered advice on the preparation of the request for surrender. Pending preparation of the request for surrender on 18 January 2016, Jurisdiction Y applied for the provisional arrest of the fugitive. A provisional arrest warrant was issued on 19 January 2016 and the fugitive was arrested on 21 January 2016 immediately on his release from the HKC incarceration. The fugitive was brought before the magistrates' court on 22 January 2016 and signed papers consenting to his surrender, and the court duly committed him to custody awaiting the CE's decision on surrender. The CE issued an Order for Surrender on 21 March 2016. The fugitive was surrendered to Jurisdiction Y on 20 April 2016.

The request for provisional arrest was executed within one day upon receipt of the request and surrender proceedings were completed in around three months from the arrest of the fugitive.

***Seeking timely legal assistance to pursue domestic ML, associated predicates and TF cases with transnational elements***

477. Whilst it has effectively dealt with increasing numbers of incoming international requests, the lower number of outgoing requests is inconsistent with HKC's risk profile. Between 2013 and June 2018, HKC made 96 outgoing MLA requests to foreign jurisdictions in relation to 120 offences. Twenty-nine requests related to ML and none to TF. Three requests have also been made to foreign jurisdictions for restraint and confiscation with HKC authorities advising that HKD 163.3 million (USD 20.83 million) is pending confiscation pursuant to outgoing requests. Feedback from foreign delegations indicate that requests from HKC are of high quality and that the MLAU takes a constructive approach to co-operation.

**Table 8.8. Outgoing MLA requests (breakdown by nature of offence):  
2013-October 2018**

Offence	2013	2014	2015	2016	2017	2018 (as of 31.10.2018)
Corruption	9	4	6	2	1	2
Counterfeiting and piracy of products	0	1	0	0	0	0
Drugs	0	0	0	6	1	2
Forgery	1	3	0	0	0	0
Fraud	6	10	9	4	9	6
ML	9	11	7	1	0	1
Murder and grievous bodily harm	1	0	0	1	1	0
Others	0	0	2	1	0	3
Robbery or theft	0	0	1	0	2	1
Sexual Exploitation	0	0	0	0	1	0
Tax Crimes	1	0	0	0	0	0
<b>Total</b>	<b>27</b>	<b>29</b>	<b>25</b>	<b>15</b>	<b>15</b>	<b>15</b>

478. The above table demonstrates that HKC is seeking international co-operation to some extent to pursue domestic ML and associated predicate offences. Nevertheless, these outgoing requests largely relate to fraud and corruption offences. The limited, and declining, number of outgoing requests relating to ML is inconsistent with HKC's risk profile given that the main proceeds-generating crimes are largely transnational in nature, as well as HKC's status as a major IFC. Also, considering HKC's position as an IFC, the fact that only nine outgoing requests for foreign restraint / confiscation orders have been made indicates that HKC authorities do not appear to be furthering their investigations abroad when funds are transferred overseas. HKC authorities explain the low numbers are due to factors such as HKC assets restrained being sufficient to discharge the confiscation order or the convicted person voluntarily repatriating his/her assets from abroad to satisfy the conviction order. However, although such actions may occur in some cases, this does not satisfactorily explain the low numbers, and HKC should seek to pursue outgoing requests more actively. As noted, the number of formal outgoing requests has been on a downward trend, and HKC authorities explained that this decline and the low numbers is because there is increasing reliance on informal co-operation amongst LEAs, which is faster and thus preferred.

479. Whilst informal means can expedite the obtaining of such evidence, there are still instances where formal MLA would be required such as the evidentiary use of bank records or the restraint and confiscation of assets. The low number of outgoing formal MLA requests indicates that HKC is not sufficiently pursuing cases with transnational elements abroad. HKC has stated that it continues to enhance LEAs' awareness of ways to seek formal request, e.g. by giving talks to LEAs and the Prosecutions Division.

**Box 8.4. Examples of Outgoing Requests made by HKC****Request for Foreign Restraint Action**

In April 2011, HKC made a request to Jurisdiction X for assistance to restrain property situated in the jurisdiction belonging to two defendants and companies they control which were subject to a restraint order made in HKC in March 2011. The two defendants were charged with ML conspiracy in relation to proceeds of crime transmitted from Jurisdiction Y to HKC bank accounts held by the defendants and their companies. The defendants allegedly smuggled into Jurisdiction Y vessels and a dredger that were intended for rental to companies in Jurisdiction Y by submitting false Customs documents which misrepresented that the vessels and dredger were imported for provisional or international navigation purposes, and thereby evading the Customs import tax and value-added tax that would have been imposed on the vessels and dredger. Of the HKD575 million rental payments made by the companies in Jurisdiction Y and remitted to HKC bank accounts, a sum of HKD189.6 million was transferred to bank accounts in Jurisdiction X held by the defendants and their companies.

Pursuant to HKC's request made in April 2011, a court in Jurisdiction X made a restraining order in April 2011 restraining the defendants' assets in Jurisdiction X up to HKD189.6 million. In October 2011, one of the defendants applied to the court in Jurisdiction X for a motion to dissolve the restraining order made in April 2011. The application was dismissed subsequently. The property of the two defendants in Jurisdiction X remains subject to the restraining order made in April 2011, as are their property restrained in HKC, pending a confiscation order to be made by the HKC court.

As at August 2017, the property restrained in HKC and in Jurisdiction X (pursuant to HKC's request) has a total value of about HKD 541.6 million, of which about HKD 152 million has been restrained in Jurisdiction X. HKC and Jurisdiction X have been liaising closely on the management of the property restrained in Jurisdiction X including the possible repatriation of the property to HKC (with the consent of the defendants) and the possible settlement of certain tax liabilities levied on the land properties.

480. The number of outgoing requests to other parts of China is also low with seven requests being made during the period between 2013 and June 2018, five of which related to ML. While HKC faces the limitations outlined above in paragraph 474 in obtaining formal assistance from its closest regional neighbours for use in judicial proceedings, these limitations are partly mitigated by a robust law enforcement co-operation regime between HKC and other parts of China.

**Box 8.5. Case involving Letters of Request to Other Parts of China**

In April 2016, HKC made a letter of request to the Mainland to seek assistance in examining four witnesses for the purpose of a prosecution relating to ML. The defendant was accused of smuggling vehicles into the Mainland. The proceeds of smuggling were moved to HKC. The defendant was charged with ML while his two accomplices were arrested in the Mainland for smuggling. The two accomplices were convicted in the Mainland and agreed to give evidence against the defendant in HKC. The trial judge and counsel for the defence and prosecution travelled to the Mainland in September 2017 to participate in the examination of the two accomplices and two other Mainland witnesses pursuant to the letter of request.

481. Where surrender of fugitive offenders is concerned, HKC has made a total of 11 requests between 2013 and June 2018 with five related to ML. Six fugitives have formally been surrendered to HKC pursuant to successful completion of their requests for surrender but were concentrated in the years of 2014-2015. HKC has also provided information on the number of persons being placed on INTERPOL Red Notices that indicates that HKC is taking some steps to bring to justice fugitive offenders including those involved in ML.

### *Seeking and providing other forms of international co-operation for AML/CFT purposes*

#### *Exchange of Financial Intelligence & Law Enforcement Information*

482. HKC actively uses agency-to-agency international co-operation for AML/CFT purposes, primarily for information exchange and informal liaison, while it has undertaken a growing number of joint operations with foreign counterparts. As noted above, the significant level of informal co-operation with the Mainland offsets, to some extent, the limitations HKC faces when co-operating through formal channels with its major neighbour. Informal co-operation is largely effective in exchanging information and supporting operational activity with foreign counterparts.

483. The JFIU's role as the gateway for foreign financial intelligence is particularly important in view of HKC's risk profile and the significance of foreign elements in ML and associated predicate cases. It has 14 MOUs with worldwide counterparts (one of which is with a foreign LEA) but is able to share information without the need for formal arrangements. The JFIU's two-way exchange with foreign counterparts (mainly FIUs but also some foreign LEAs) has climbed from over 1 350 in 2013 to almost 2 500 in 2017, with marginally more outgoing requests/spontaneous disseminations than incoming.

484. Referrals of FIU-to-FIU exchanged information to domestic LEAs and regulators are close to 100 a year. Incoming spontaneous exchanges jumped from 61 in 2013 to over 250 in 2017. The JFIU disseminates this information to other competent authorities for investigation or follow-up action as appropriate. The JFIU sends about 50 requests a year via the international FIU network that supplements the large number of LEA-to-LEA requests (close to 700 in 2017 for the HKPF, the C&ED and the ICAC). Fraud accounts for about 60% of incoming spontaneous exchanges but notably under 40% of outgoing FIU-to-FIU exchanges. That 60% of

outgoing requests exchanged through the JFIU relates to non-fraud demonstrates the authorities's growing capacity and actions to identify suspected non-fraud ML and share this intelligence with foreign counterparts.

485. The HKPF and the C&ED both have central units that co-ordinate international activities while co-operation units within each agency maintain close ties and often work directly with foreign counterparts. HKPF has three officers seconded to INTERPOL and officers posted to Beijing.<sup>53</sup> The C&ED has three officers seconded to the World Customs Organisation (WCO) supporting its compliance directorate and Asia-Pacific intelligence liaison and capacity building functions. The HKPF exchanges a large volume of police-to-police information, with the Liaison Bureau (LB) alone handling about 2 000 incoming requests and 1 900 outgoing requests a year. ML matters feature significantly, accounting for slightly more than a quarter of incoming requests (530 on average) and about 20% of outgoing requests (350 on average) a year, with an increase to a quarter of outgoing matters in 2017. Fraud dominates the HKPF's exchange on ML.

486. For other parts of China, a police co-operation mechanism exists similar to the INTERPOL system. The HKPF is particularly proactive in exchanging information with Mainland counterparts. It makes well over double the requests it receives (with requests to the Mainland roughly the same number as requests sent to all other non-China counterparts). Key crime investigation bureaux such as the NB and the CCB have reciprocal working relationships with police narcotics and fraud counterparts in Beijing and some Mainland provinces. Regional offices of the HKPF (e.g. Kowloon West and Kowloon East) likewise liaise regularly with Mainland LEAs.

487. The HKPF also maintains close contact with LEAs in Macao, China, and Chinese Taipei, exchanging a volume of information that appears commensurate with the size of each jurisdiction. It has worked bilaterally with each jurisdiction to combat cross-border fraud cases, including freezing or stopping victims' funds in accounts in HKC. LEAs from all four jurisdictions convene a yearly drug symposium. HKPF also engages in the yearly trilateral 'Thunderbolt' actions with Guangdong and Macao, China LEAs, targeting cross-border Triad activities.

488. Similar to the HKPF, the C&ED works closely with locally based foreign liaison officers on sharing information and operational matters. The Mainland, the UK, the US and jurisdictions in the Asia/Pacific are the main jurisdictions with which C&ED engages. It also co-operates with the WCO and has signed 25 customs co-operative agreements/arrangements with foreign counterparts. The C&ED makes about the same number of general requests to other parts of China as it receives from them. It makes more ML requests to those jurisdictions than it receives which highlights the effort it makes to co-operate with neighbouring jurisdictions to combat incoming customs threats. Non-China counterparts make significantly more general and ML requests than C&ED sends. Overall, foreign cases (Mainland and non-China

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<sup>53</sup> HKPF also has two officers in Beijing and Australia in training roles who it says can be tasked to perform liaison and operational work in each jurisdiction as required. An HKPF officer travelled to Australia to work with LEA counterparts on a successful ML operation to disrupt a cash-smuggling syndicate.

jurisdictions) account for over 60 % of the ML investigations the C&ED handled from 2013-2017.

489. The ICAC also has a significant international engagement program. It is a leading agency in training in its field, with over 230 foreign officers participating in its chief investigator course in recent years. The ICAC maintains regular contact with attachés from Australia, Canada, Japan, Korea, the US and UK, as well as counterparts in the Mainland and, to a lesser extent, Macao, China. While formal agreements are not required, ICAC has established a mutual case assistance arrangement with its Mainland counterparts, including the National Commission of Supervision and the Public Security Bureau. With the Mainland accounting for about 60% of incoming and outgoing information requests, the ICAC's engagement with Mainland counterparts appears appropriate.

490. The IRD primarily responds to incoming foreign requests. These have jumped from 24 in 2012-2013 to 495 in 2016-2017 and almost 800 in 2017-2018, mainly from France, Japan, the Mainland and the US (many of which relate to the US Foreign Account Tax Compliance Act). The IRD has increased staffing to handle the growing workload. Its approach is to collect and send information to foreign counterparts, leaving foreign partners to follow-up as required. In view of HKC's exposure to foreign tax crime risks, the IRD should consider a more proactive approach to following-up matters with foreign partners. The IRD attributes the small number of outgoing requests (six from 2012-2018) it has made to HKC's simple and low tax system, particularly the absence of any tax on foreign income or assets.

491. As discussed in IO.9, the authorities presented a number of case studies that demonstrated effective co-operation with foreign counterparts on TF matters.

#### **Box 8.6. Cases involving JFIU/LEA and foreign counterparts**

##### **Case 1**

In early 2018, the JFIU received STRs revealing a notable trend in residents from Jurisdiction M withdrawing cash from automated teller machines (ATMs) in HKC, including frequent use of multiple debit cards not issued to the person withdrawing the cash. The HKPF seized over 3 700 debit cards and arrested 76 persons. Investigation found no offences had been committed under HKC law but financial analysis suggested the ATMs were possibly used to take advantage of exchange rate arbitrage or circumvent capital outflow restrictions in Jurisdiction M. While ATM withdrawals returned to normal, JFIU subsequently made 17 spontaneous disseminations to its FIU counterpart in Jurisdiction M related to dubious debit card use.

##### **Case 2**

Between 2010 and 2011, the C&ED mounted a joint operation with an LEA of Jurisdiction U and successfully smashed a large-scale overseas drug trafficking and ML syndicate. Through the C&ED's timely provision of financial intelligence and investigation findings, the Jurisdiction U LEA

successfully seized 144 kg of cocaine from an import shipment and arrested the mastermind and core members of the syndicate.

Following the takedown operation mounted by the foreign LEA, approximately HKD 4.8 million (USD 1.89 million) of suspected drug proceeds in the related local bank accounts was temporarily suspended under the LNC mechanism.

Subsequent to the successful enforcement actions, the case was taken forward through the MLA arrangements to restrain and confiscate the drug proceeds. By executing the Jurisdiction U Restraint Order and Confiscation Order, HKD 14.8 million (over USD 1 million) of drug proceeds were restrained in May 2012 and HKD 8.6 million were confiscated in May 2016. HKD 4.3 million (almost USD 550 000) of confiscated funds were shared to Jurisdiction U.

### *Financial and Non-Financial Supervisors*

492. Core Principles financial supervisors (the HKMA, the SFC and the IA) seek and provide supervisory information with their foreign counterparts including Mainland authorities<sup>54</sup> for AML/CFT purposes, even where there is no specific bilateral arrangement. These financial supervisors and foreign counterparts have signed a number of co-operative agreements such as IOSCO MMOU, IAIS MMOU and bilateral agreements that include designated contact points and usually have provisions to safeguard confidentiality of the exchanged information. Positive feedback was provided by international counterparts on the timeliness and quality of supervisory information provided by HKC.

493. The HKMA participates in supervisory colleges and various forms of bilateral engagements. Such engagements include sharing observations from on-site examinations, as well as participating in the tripartite meetings focused on AML/CFT matters among HKC, Mainland and Macao, China authorities. The cases provided by the HKMA demonstrate close co-operation especially with home supervisors responsible for global banking groups with a large volume of operations in HKC.

494. The SFC has paid close attention to LCs that are subsidiaries of Mainland FIs as a number of such LCs had no experience of operations outside of Mainland. As such, the SFC has stepped up the co-operation covering AML/CFT with the counterpart in Mainland (the China Securities Regulatory Commission) including regular high-level meetings and joint seminars for those LCs, among extensive multi and bilateral engagements with various foreign counterparts.

495. The IA considers the supervisory college is an important platform to exchange supervisory information. IA presented an example where it hosted a college to

<sup>54</sup> HKMA and PBoC (which is responsible for AML/CFT supervision in Mainland) are in negotiations to conclude an MOU in the area of AML/CFT supervision (expected to be concluded in the first half of 2019).

discuss AML/CFT measures of an insurance group and supervisors agreed through the discussion to require the insurance group to take necessary actions to fix the identified shortcomings.

496. Other supervisors and SRBs do not exchange information with foreign counterparts, except the C&ED<sup>55</sup> that has organised meetings to share typologies involving remittance services and has seconded officials to gain experiences.

### *International exchange of basic and beneficial ownership information of legal persons and arrangements*

497. HKC shares basic and beneficial ownership information of legal persons and arrangements that is required and collected in HKC. Basic information on companies and businesses is publicly available. Certain information such as company names, date of incorporation/registration/dissolution, history of company name changes and company status are provided free of charge, and other information such as director and shareholder information on companies can be obtained from the CR's website with payment of a small fee.. Relevant authorities, such as the HKPF and the IRD, are able to access this information and share with their foreign counterparts.

498. Authorities such as the JFIU, the HKPF and the IRD, have also responded to requests, including the use of non-coercive powers to obtain additional beneficial ownership information. For instance, the JFIU has shared relevant beneficial ownership information contained in the STRs (relating to both legal persons and arrangements) that it has access to with its foreign counterparts. Supervisory authorities had also shared relevant beneficial ownership information with their foreign counterparts when it is for AML/CFT purposes or under the IOSCO arrangements.

499. As noted above, MLA channels have been used when coercive measures are required (e.g. for prosecution purposes), and production orders are used to obtain CDD information from REs and companies, etc.

### *Overall conclusions on IO.2*

**500. HKC has achieved a substantial level of effectiveness for IO.2.**

<sup>55</sup> Counterparts of this international co-operation include UK, Malaysia and Philippines.

## TECHNICAL COMPLIANCE ANNEX

This annex provides detailed analysis of the level of compliance with the FATF 40 Recommendations in their numerical order. It does not include descriptive text on the jurisdiction situation or risks, and is limited to the analysis of technical criteria for each Recommendation. It should be read in conjunction with the Mutual Evaluation Report.

Where both the FATF requirements and national laws or regulations remain the same, this report refers to analysis conducted as part of the previous Mutual Evaluation in 2008. This report is available [here](#).

### Recommendation 1 – Assessing risks and applying a risk-based approach

These requirements were added to the FATF Recommendations when they were revised in 2012 and therefore were not assessed in the 2008 evaluation.

**Criterion 1.1** – HKC authorities have built up their ML/TF risk understanding over time. In 2014, HKC commenced a territory-wide ML/TF Risk Assessment to examine the threats and vulnerabilities facing various sectors and to identify areas for further work, so that more targeted responses can be formulated. For the HRA, HKC adopted the WBT model and took into account threats, vulnerabilities as well as existing risk assessment done by relevant competent authorities to determine the risks. The outcome of the HRA was published on 30 April 2018 and was made available on the FSTB’s website and the website of other competent authorities. The risk assessment is generally comprehensive and demonstrates HKC has identified and assessed most of the ML/TF risks in HKC. Nevertheless, there are minor concerns about the scope of risk assessment for legal persons, stand-alone financial leasing companies and non-bank credit cards.

**Criterion 1.2** – HKC has a high-level CCC<sup>56</sup>, chaired by the Financial Secretary, which steers the formulation of policies and implementation of the AML/CFT regime. The Steering Committee of the ML/TF Risk Assessment<sup>57</sup> was established in June 2014 under the CCC to oversee the conduct, monitor the progress, and evaluate the findings of the Risk Assessment. The RAU was also established in HKPF in April 2014 to kick start the HRA and support the work of the Steering Committee of Risk Assessment.

**Criterion 1.3** – HKC published the first HRA in April 2018 and plans to update the risk assessment every three years (i.e. next by the end of 2021), taking into account emerging threats and vulnerabilities. Additionally, the policy bureaux of the

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<sup>56</sup> Members of the CCC include the Secretary for Justice, the Secretary for Financial Services and the Treasury, the Secretary for Security, the Commissioner of Police, the Commissioner of Customs and Excise, Commissioner of the ICAC, Commissioner for Narcotics, and representatives of the HKMA, the SFC, and the IA.

<sup>57</sup> The Steering Committee is chaired by the FSTB and members include the SB, the CEDB, the DOJ, the HKPF, the C&ED, the ICAC, the HKMA, the SFC, and the IA.

Government, the RAU, LEAs and the RAs will continue to monitor the territory-wide and sectoral risks as well as the risk of individual institutions.

**Criterion 1.4** – The HRA was published and available on a number of government websites on 30 April 2018. A press statement was issued to notify the public and stakeholders of the publication of the HRA. Relevant government agencies and RAs, which participated in the process are familiar with the findings. They have also disseminated the findings to key stakeholders of the private sector, in particular to FIs and DNFBPs, through circulars and briefing sessions, etc.

**Criterion 1.5** – HKC authorities adopt an AML/CFT regime that is premised on a risk-based approach in allocating resources and applying compliance obligations to the respective sectors. The HRA represents its latest effort to examine the threats and vulnerabilities, and HKC has implemented mitigation measures to address the risks and gaps identified. Nevertheless, minor concerns relate to the risk-based approach taken with certain sectors, particularly for DPMS, which the authorities had assessed to be medium/medium low risk.

**Criterion 1.6** –

(a) HKC has exempted DPMS from AML/CFT obligations other than those related to STR reporting and TFS. This was based on its assessment that the sector has a lower risk than other DNFBPs (i.e. assessed to be medium low/medium)<sup>58</sup>. However, this is not a proven low ML/TF risk, particularly for a significant sector that accounts for 12% of total exports (HKD 466 billion in 2017) and with an estimated HKD 13.1 billion in receipts from overnight visitors in 2017.

(b) HKC has also not applied AML/CFT requirements on some (about 20) stand-alone financial leasing companies (not linked to a bank or moneylender) and non-bank credit card companies. This was on the basis of their small size and perceived low risks, but this was not adequately supported by a detailed risk assessment.

(c) HKC applies a threshold-based approach whereby device-based products are separated from network-based products, with network-based products being further categorised between non-reloadable and reloadable:

- For device-based SVF with a maximum stored value of HKD 3 000 or below, no CDD is required;
- For non-reloadable network-based SVF with a maximum stored value of HKD 8 000 or below, no CDD is required; and
- For reloadable network-based SVF, requirements are based on the functionalities and usage of the product, such as whether the product allows cash withdrawal, as well as the annual transaction amount. In general, for products where the maximum stored value does not exceed HKD 3 000 and annual transaction amount does not exceed HKD 25 000, no CDD is required.

<sup>58</sup> This was due to a lack of ML cases between 2010 and 2015, low number of MLAs received and STRs filed, small percentage of assets confiscated related to the sector; conversion to other form is uncommon as it involves a hefty discount; and retail market is dominated by major chain stores.

- While the thresholds used do not appear unreasonable and were based on ongoing reviews by the the HKMA, the documentation of the risk assessment should be strengthened.

**Criterion 1.7** – The AMLO requires covered FIs and DNFBPs to take enhanced measures for some specified high risk activities (e.g. foreign PEPs (excluding those from Mainland and Macao, China), when the customer is not physically present for identification).

In addition, section 15 of Schedule 2 to the AMLO stipulates that an FI or DNFBP must, in a situation specified by the relevant regulatory authority or body (RA/RB), and in any other situation that by its nature may present a high risk of ML/TF, take additional measures including to obtain approval from senior management to commence or continue the business relationship and to establish the relevant customer's or beneficial owner's source of wealth and the source of funds that will be involved in the business relationship; and take additional steps to mitigate the ML/TF risks involved. Specific requirements are provided for in the respective Guidelines (see e.g. para. 2.6 and 3.2 of AML/CFT Guidelines).

**Criterion 1.8** – The AMLO (s.4, Schedule 2) and the AML/CFT Guidelines stipulate that simplified CDD (SDD) measures may be applied by FIs and DNFBPs only with respect to prescribed customers (e.g. government or public body<sup>59</sup>) or products, which are considered to involve a lower risk of ML/TF. In general, SDD measures mean that FIs are not required to identify and verify the beneficial owner. They would still be required to comply with the other CDD requirements including customer identification and verification, obtaining information on the nature and purpose of the business relationship, and ongoing monitoring. Further, the AMLO stipulates that FIs should not apply SDD where the FI suspects that the customer (or his account) is involved in ML/TF, or when the FI doubts the information previously obtained for identifying/verifying the customer's identity.

**Criterion 1.9** – RAs and RBs adopt varying degrees of RBA (see R.26 and R.28) and are empowered under the AMLO and respective Ordinances governing their sectors to supervise the AML/CFT conduct of FIs and DNFBPs (except for DPMS in particular), ascertain whether FIs and DNFBPs comply with their obligations under AMLO, and impose sanctions in cases of non-compliance. The AML/CFT Guidelines for FIs and DNFBPs give further guidance on the expectations of the regulators as to how FIs and DNFBPs should comply with their AML/CFT obligations.

**Criterion 1.10** – There are guidelines given to most FIs and DNFBPs to conduct an internal risk assessment in order to identify and assess ML/TF risks to which the firms are exposed, taking into account factors including products and services offered, types of customers, geographical locations involved, so as to establish and implement adequate and appropriate AML/CFT policies, procedures and controls.

**Criterion 1.11** – Section 19 of Schedule 2 of the AMLO, particularly section 19(3) requires FIs and DNFBPs to establish procedures in respect of each kind of customer, business transaction, product and transaction, to establish and maintain effective

<sup>59</sup> 'Public body' is defined in Schedule 2 AMLO as including a government department or undertaking. A state-owned enterprise is not a "public body" under AMLO and as such FIs and DNFBPs cannot apply SDD measures for any state-owned enterprises.

procedures not inconsistent with the AMLO for the purpose of carrying out its duties under sections 3, 4, 5, 9, 10 and 15 of Schedule 2. This is supplemented by section 23 of Schedule 2 AMLO which requires FIs and DNFBPs to take all reasonable measures to ensure proper safeguards to prevent contravention of CDD and record-keeping requirements under the AMLO and to mitigate ML/TF risks. Specific requirements are set out under para 3.2 of the AML/CFT Guidelines.

**Criterion 1.12** – The AMLO specifies the circumstances where SDD is permitted and requires FIs and DNFBPs to continuously monitor business relationships (s. 5, Schedule 2). The AML/CFT Guidelines elaborates on where SDD (not conducting beneficial ownership due diligence) may be applied and requires FIs to apply all other aspects of CDD and conduct ongoing monitoring of the business relationships. FIs must have reasonable grounds for using SDD and may have to demonstrate these to RAs. FIs must not apply SDD if they suspect the customer, customer’s account or transaction is involved in ML/TF, or doubt the adequacy or veracity of information obtained for identifying the customer or verifying the customer’s identity (s. 3, Schedule 2, read with s. 4(1) of that Schedule).

### *Weighting and Conclusion*

HKC has demonstrated it has identified and assessed most of its ML/TF risks and supplemented its ongoing efforts with the publication of the HRA in April 2018. Respective supervisors have taken steps to communicate the findings to FIs and DNFBPs. However, some scope gaps (e.g. DPMS) and other minor deficiencies exist.

**Recommendation 1 is rated largely compliant.**

### **Recommendation 2 - National Co-operation and Co-ordination**

In its 3rd MER, HKC was rated largely compliant with these requirements. The main deficiencies were lack of a mechanism to co-ordinate AML/CFT developments at a policy level and reluctance to introduce legislative amendments.

**Criterion 2.1** The HKC’s AML/CFT Policy, issued by the CCC and set out in the HRA, consists of seven principles and generally responds to the risks and vulnerabilities identified. There is a high-level strategy whereby the Government will focus efforts in five major areas to enhance its AML/CFT regime:

- a) Enhancing the AML/CFT legal framework to address gaps in legislation in accordance with international standards and an RBA;
- b) Strengthening risk-based supervision to ensure targeted regulation of the riskier areas faced by the financial and non-financial sectors;
- c) Sustaining outreach and capacity-building to promote awareness and understanding of ML/TF risks by various sectors and the wider community on a continuous basis;
- d) Monitoring new and emerging risks to respond promptly to evolving patterns of predicate offences or terrorism, and modes of ML/TF; and
- e) Strengthening law enforcement efforts and intelligence capability to tackle domestic and international ML/TF, and enhance restraint and confiscation of

the proceeds of crime, including through multi-agency co-operation/partnership.

However, in the absence of complete supervision it is not clear if the policies are fully informed by risks. Nonetheless, HKC reports that the above areas will be reviewed in the annual exercise of compiling Estimates of the HKC Government, and its AML/CFT Policy Statement will be reviewed along with the next risk assessment exercise (targeted in 2021).

**Criterion 2.2** – The Financial Secretary chairs the CCC that oversees and steers HKC’s AML/CFT policy and strategy at the high-level. The CCC comprises senior representatives from Government bureaux/departments with responsibilities for policymaking or law enforcement: the FSTB, the SB, the CEDB, the DOJ, LEAs (viz the HKPF, the C&ED and the ICAC) and RAs (viz the HKMA, the SFC, the IA, and the Money Service Supervision Bureau (MSSB) of the C&ED).

**Criterion 2.3** There are a number of platforms and forums to facilitate co-operation and co-ordination between policymakers, LEAs (including the JFIU) and RAs on the development and implementation of AML/CFT policies and activities, including the AMLRSCG and the Anti-Money Laundering Regulatory Enforcement Co-ordination Group. The Narcotics Division of the SB has been holding regular meetings individually with the RBs of DNFbps (viz the LSHK, the HKCICPA, and the EAA) and relevant professional associations. However, the working groups (e.g. AMLRSCG led by financial supervisors do not include all DNBFP supervisors (and SRBs), and more can be done to enhance co-operation and co-ordination (e.g. how RBA approach can be better implemented by DNFbp supervisors).

HKC also has the following mechanisms to facilitate co-ordination for LEAs related issues:

- i. The Inter-departmental Counter Terrorism Unit (ICTU) set up by the SB where CT (including CFT) work carried out by relevant LEAs is co-ordinated under the helm of Secretary for Security with the HKPF in main support.
- ii. The Suspicious Transactions Reporting Working Group (STRWG) is led by the JFIU and comprises the HKPF, the C&ED, RAs, and representatives from the private sector to provide feedback on the filing of STR.
- iii. The Fraud and Money Laundering Intelligence Task Force (FMLIT), launched in May 2017, is a HKPF-led public-private intelligence sharing mechanism involving the HKPF, the HKMA and the banking industry. It is aimed at detecting, preventing, and disrupting fraud (predominantly), as well as ML and other financial crimes;
- iv. The Anti-Deception Co-ordination Centre (ADCC) was set up by the HKPF in 2017 and works together with the JFIU in strengthening co-operation with FIs, with a view to mitigating victims’ loss and upholding the AML regime in HKC. Specifically, the ADCC has been assuming the role of urgent liaison with local FIs on suspicious cases.

While there are a number of platforms, operational co-ordination and co-operation among LEAs and RAs can be enhanced further. For instance the ICTU could consider sharing more information with relevant RAs, e.g. through JFIU; and supervisors (e.g. the HKMA) can consider providing more timely information on key risks to the HKPF.

**Criterion 2.4** The CEDB is the co-ordinating bureau on matters relating to proliferation of weapons of mass destruction (WMD) with its terms of reference formally approved in October 2018. However, since October 2017 the CEDB has been convening regular inter-agency platforms and meetings on implementation of the relevant United Nations Security Council (UNSC) sanctions, to share intelligence, discuss typologies, trends and cases, and co-ordinate government-wide responses. Attendees include the FSTB, the HKPF, the C&ED, the CR, the Marine Department and the HKMA. Other parties may also be invited to join when necessary.

A referral mechanism on PF-related requests/ information is in place:

- The JFIU receives and analyses STRs, and refers the STRs related to movements of prohibited/specified items to the C&ED and STRs purely related to PF-related movement of funds to the HKPF;
- The CEDB passes PF-related requests/referrals from the Office of the Commissioner of the Ministry of Foreign Affairs or from other jurisdictions to the HKPF and/or the C&ED for investigation, intelligence, and/or other appropriate actions;
- The CEDB provides the same information to the HKMA to enable banks to check whether relationships or transactions can be identified. Where there is a potential match, STRs are made and relevant reference numbers are provided to the CEDB to ensure the fullest possible picture of activity is provided; and
- The CEDB alerts the HKPF and/or the C&ED to relevant findings of the UN Panel of Expert Report and requests responsible department(s) to investigate and take appropriate follow-up actions.

**Criterion 2.5** - Pursuant to section 58(2) of the Personal Data (Privacy) Ordinance (PDPO) (read together with section 58(1) PDPO), data users are exempted from data protection principle 3 in any cases where the use (or disclosure) of the data is for: (a) prevention or detection of crime, (b) apprehension, prosecution or detection of offenders, or (c) prevention, preclusion or remedying (including punishment) of unlawful or seriously improper conduct, etc. Where appropriate, AML/CFT competent authorities have worked with the Privacy Commission.

### **Weighting and Conclusion**

HKC has established mechanisms to co-operate and co-ordinate for AML/CFT and counter-PF purposes, with CCC taking a leading role to provide high-level strategic guidance. There are also a number of inter-agency mechanisms, but the operational level co-ordination and co-operation can be further enhanced.

**Recommendation 2 is rated largely compliant.**

### **Recommendation 3 - Money laundering offence**

In its 3<sup>rd</sup> MER, HKC was rated largely compliant and compliant with the recommendations concerning criminalisation of money laundering. The main deficiency was that predicate offences did not adequately cover environmental crimes.

**Criterion 3.1** – ML is criminalised in line with the relevant articles of the Vienna Convention and the Palermo Conventions. Under section 25(1) of the OSCO and the DTROP, it is an offence to deal with any property when *knowing or having reasonable grounds to believe* that such property in whole or in part directly or indirectly represents a person’s proceeds of an indictable offence. “Dealing” is broadly defined to include (1) receiving or acquiring, (2) concealing or disguising, (3) disposing of or converting, (4) bringing into or removing out of HKC and (5) using to borrow money or as security, and the offence includes the adequate *mens rea* requirement (DTROP & OSCO, s.2). From this definition, possession is criminalised as long as the person knew the property derived from certain criminal offences. For an analysis of the ancillary offences, see c.3.11.

**Criterion 3.2** – All indictable offences are predicate offences for ML (OSCO & DTROP, s.25 (1).) “Indictable offence” is defined as any offence other than an offence that is triable only summarily, and covers all serious offences. With amendments to the Protection of Endangered Species of Animals and Plants (Amendment) Ordinance on 1 May 2018, trading, possession or control of endangered species qualify as indictable offences and dealing with proceeds of these crimes constitutes ML under the OSCO. Nevertheless, there remain some minor gaps in the range of offences relating to trafficking in human beings.

**Criterion 3.3** – HKC determines the underlying predicate offences for ML by reference to a threshold linked to a category of serious offences. The scope of offences includes all indictable offences defined in section 14A of the CPO, namely any offence other than an offence that is triable only summarily. Indictable offences are regarded as offences that are more serious under the laws of HKC, against which more stringent criminal procedures apply. (see respectively s.26 of the Magistrates Ordinance (MO), Cap. 227, s.88 of MO, s.102 of the MO, and s.103 of the CPO).

**Criterion 3.4** – The ML offence in HKC extends to any type of property, regardless of its value, that directly or indirectly, represents any person’s proceeds of an indictable offence or of drug trafficking (OSCO & DTROP, ss.25.)

**Criterion 3.5** – When proving that property is the proceeds of crime, there is no requirement that a person be convicted of a predicate offence, nor is it necessary to prove that the property laundered is in fact the proceeds of an indictable offence. However, the prosecution must establish that the defendant had knowledge or reasonable grounds to believe that the property concerned represented the proceeds of drug trafficking or of an indictable offence. The *actus reus* of the offence is dealing with property. The status of the property is only an element of the *mens rea* of the offence: *Oei Hengky Wiryo v HKC 1 HKLRD 568 (CFA) (paras 96-109.)*

**Criterion 3.6** – ML is punishable when the predicate offence was committed abroad provided that the conduct would have constituted an indictable offence if it had occurred in HKC regardless of whether they constitute an offence in the other country (OSCO, s.25(4); DTROP, s.2.)

**Criterion 3.7** – Self-laundering is covered in HKC. A person who deals with the proceeds of his/her own crime can be prosecuted with both the predicate offence and the ML offence (*HKC v. Lok Kar-win [1999] HKCFA 12 (CFA) (paras 2-8.)*)

**Criterion 3.8** – Proof that the defendant knew or had reasonable grounds to believe that property represented the proceeds of crime can be derived entirely from

objective factual circumstances (*Seng Yuet Fong v HKC FAMC 26/1998 (CFA) (paras 2, 8-14).*)

**Criterion 3.9** – Proportionate and dissuasive criminal sanctions apply to natural persons convicted of ML. ML offences are punishable by 14 years’ imprisonment and a fine of HKD 5 000 000 (OSCO & DTROP, s.25 (3).)

**Criterion 3.10** – Criminal liability and sanctions are applicable to legal persons (both corporate and unincorporated) (s.3 of the Interpretation and General Clauses Ordinance (IGCO).) Such liability and sanctions do not preclude parallel criminal, civil or administrative action with respect to legal persons: (*SJ v. Johnson Cynthia and Another HCMP1789/2016*). Such measures are without prejudice to the criminal liability of natural persons.

**Criterion 3.11** – A broad range of ancillary offences attach to criminal offences (including ML) including attempt, conspiring, aiding, abetting, counselling, procuring, or suborning (Crimes Ordinance, ss.159G, 159A, Criminal Proceedings Ordinance, s.89.)

### Weighting and Conclusion

HKC meets the vast majority of the criteria. There remains a minor gap in the coverage of offences relating to trafficking in human beings.

**Recommendation 3 is rated largely compliant.**

### Recommendation 4 - Confiscation and provisional measures

In its 3<sup>rd</sup> MER, HKC was rated partially compliant with these requirements. The main deficiencies highlighted were that restraint and confiscation procedures under the OSCO did not apply to cases where benefits were less than HKD 100 000; there were no mechanisms for confiscation of the proceeds of TF; and powers to confiscate instrumentalities did not extend to property that did not come into the possession of a court or police or customs agencies. The fact that environmental crimes did not constitute predicate offences also impacted on confiscation powers.

#### Criterion 4.1 –

(a) HKC possesses requisite legislation to confiscate property, proceeds or instrumentalities of criminal defendants, whether held by them or by third parties (OSCO, s.8; DTROP, ss.3, 24D; POBO, s.12AA; CPO, s.102-103; DDO, s.56.)

“Property” is defined to include both movable and immovable property within the meaning of section 3 of the IGCO (Cap. 1) under the OSCO and the DTROP. Under the IGCO, property is defined to include (a) money, goods, choses in action and land; and (b) obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incident to property as defined in (a). The CPO defines property as including goods, chattels, money, valuable securities, and every other matter or thing, whether real or personal, upon or with reference to which any offence may be committed.

(b) The definition of proceeds covers property derived from or realised, directly or indirectly, from any payment or other rewards received in connection with the commission of that offence (OSCO, s.2 (6); DTROP, s.4 (1)). Instrumentalities of crime

can be forfeited by HKC authorities through the CPO, which covers property that comes into possession of the Court or LEAs concerned in connection with all types of offences. Upon the conviction of a specified offence/drug trafficking offence, the defendant's realisable property, which includes instrumentalities, regardless of whether they have come into the possession of the LEAs, could be made subject to a confiscation order. Property used or intended to be used in drug trafficking can be seized and forfeited (DTROP, s.24D.) A gap however remains under the OSCO, which only applies to criminal proceeds above HKD 100 000 ((approx. USD 12 750) - (s.8(3)(a)(ii)&(4) OSCO)). This issue was highlighted in the previous MER.

(c) Under the UNATMO, property which represents any proceeds of a terrorist act or was intended to be used or was used to finance or otherwise assist in a terrorist act can be forfeited (UNATMO, s. 13.)

(d) Value-based confiscation is executed in HKC as confiscation orders made under the OSCO or the DTROP are value-based orders, which take into account the value of realisable property of a convicted person whether it is situated in HKC or elsewhere (OSCO, ss.11(1), 11(3)); the DTROP, ss. 6(1), 6(3)). Realisable property is defined as any property held by the defendant; any property held by a person to whom the defendant has directly or indirectly made a gift caught by both the OSCO and the DTROP and any property that is subject to the effective control of the defendant (OSCO, s.12(1)); DTROP, s.7(1).)

#### **Criterion 4.2 –**

(a) LEAs are able to exercise powers to identify and trace property subject to confiscation under various laws (OSCO, ss. 3-5; DTROP, ss. 20-21; UNATMO, ss.12A, 12B, 12C, 12G; POBO, s. 13,14,17). The Police Force Ordinance (PFO), the Custom and Excise Service Ordinance, and the Immigration Ordinance (Immo) also provide for measures to facilitate investigations into property. The types of powers that can be executed include witness orders, monitoring and production orders as well as search warrants.

(b) Provisional restraint powers are available under the OSCO, DTROP and POBO to freeze properties subject to confiscation. Freezing powers are also available under the UNATMO and the POBO empowering authorities to freeze property associated with terrorism and bribery respectively. HKC has also put in place an administrative "Letter of No Consent" scheme in response to STRs warning reporting entities to prevent further dealing with property suspected to be proceeds of crime or terrorist property which may be subject to confiscation, prior to a restraint order being pursued.

(c) The OSCO and the DTROP contain avoidance provisions to ensure that property is not dissipated. It is an offence under the OSCO or the DTROP to deal with property in contravention of a restraint order; the UNATMO contains an offence of knowingly contravening a freezing order or dealing with terrorist property whether or not it is identified in the freezing order. The LNC mechanism described above also functions as an administrative measure to prevent any attempts to prejudice the ability of authorities to investigate, seize or freeze property subject to confiscation.

(d) HKC's legal framework allows for a broad range of investigative powers to support the existing confiscation powers listed under the OSCO, the DTROP, the UNATMO and the POBO.

**Criterion 4.3** – Rights of *bona fide* third parties are protected by HKC’s legal framework, which enables third parties to seek recourse from the Courts (OSCO, ss.15(6), 16(7), 17(8) and 18(2); DTROP, ss.10(6), 11(7), 12(8), and 13(2); POBO, ss.12AA(3) and 14D(2); UNATMO; s.17(1),(4)).

**Criterion 4.4** – HKC has mechanisms for managing and disposing restrained and confiscated property under the OSCO, the DTROP and the UNATMO. Under the OSCO and the DTROP, the Courts can appoint and empower a receiver (i) to take possession, manage or otherwise deal with restrained property pending the determination of the confiscation application (OSCO, s. 15(7); DTROP, s. 10(7)); and (ii) where a confiscation order is made, to enforce any charge imposed on realisable property and to take possession of any property not subject to the charge, and to realise any realisable property as the court directs (OSCO, s. 17 and DTROP, s. 12). The realised funds, after the deduction of any necessary expenses, are then paid into general revenue. Any sums remaining in the hands of the receiver, after the full satisfaction of the confiscation order, shall be distributed as the court directs (OSCO, s. 18 and DTROP, s. 13). In relation to forfeiture of terrorist property, the Secretary for Security may give directions to an authorised officer to seize any property, and give directions on how the seized property should be dealt with (UNATMO, s.6 (10)). The ICAC, in furtherance of the POBO, also possesses written guidelines and procedures for its officers to deal with frozen, seized and confiscated property.

### **Weighting and Conclusion**

Whilst HKC meets most of the requirements of R.4 with adequate legislation and broad investigative powers for LEAs, a deficiency exists regarding the OSCO threshold.

**Recommendation 4 is rated largely compliant.**

### **Recommendation 5 - Terrorist financing offence**

In the 3<sup>rd</sup> Round MER, HKC was rated partially compliant with these requirements. The main technical deficiencies were that the TF offence did not encompass provision/collection of assets other than “funds” and did not cover provision/collection for an individual terrorist or terrorist organisation. The terrorist acts as defined in the UNATMO also did not extend to intended coercion of an international organisation, and the “civil protest” exemptions to certain classes of terrorist acts were potentially of broad application.

**Criterion 5.1** – The offences under Article 2 of the TF Convention are criminalised under sections 7, 8 and 8A of the UNATMO. HKC criminalises the provision or collection, by any means, directly or indirectly, of property *with the intention or knowing* that the property will be used, in whole or in part, to commit terrorist act(s) whether or not the property is actually so used UNATMO, s.7.

“Terrorist act” is defined as the use or threat of action which is intended to cause serious violence against a person, and the use of threat is (i) intended to compel the Government or an international organisation or to intimidate the public or a section of the public; and (ii) made for the purpose of advancing a political, religious or ideological cause (UNATMO, s.2)

The range of effects within the definition of ‘terrorist act’ are, between them, broad enough to cover an array of factual settings that might be expected to be associated with offences created by the treaties listed in the Annex to the TF Convention. The specific acts criminalised under the international conventions annexed to the TF Convention are also penalised in under HKC law. Nevertheless, this definition gives an exemption to non-violent acts involving a serious risk of health or public safety, or serious interference or disruption of an electronic system or an essential service, facility or system in the course of any advocacy, protest, dissent or industrial action. This issue was identified as a concern in HKC’s previous evaluation.

Section 6 of the United Nations Sanctions (Afghanistan) Regulation 2012 (UN SAR) (Cap 537AX) also makes it an offence for a person to (i) make available, directly or indirectly, any funds or other financial assets or economic resources to, or for the benefit of, a relevant person or a relevant entity and (ii) deal with, directly or indirectly, any funds or other financial assets or economic resources owned by or otherwise belong to, or held by, a relevant person or a relevant entity. The offence under section 6 of the UNSAR does not require *mens rea* to be proven. HKC authorities report that both the UNATMO and the UNSAR can be invoked depending on the facts and circumstances of the case.

**Criterion 5.2** – HKC criminalises making available, or collecting, any property or financial (or related) service, by any means, directly or indirectly, to or for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate (UNATMO, s.8.). According to s.2 of the UNATMO, “terrorist associate” means any group of persons owned or controlled, directly or indirectly, by a person who commits, or attempts to commit, a terrorist act or who participates in or facilitates the commission of a terrorist act. The definition of “terrorist associate” is therefore consistent with FATF’s definition of “terrorist organisation” There is also no need for a link to a specific planned or executed terrorist attack (UNATMO, s.8).

**Criterion 5.2bis** – HKC criminalises the collection or provision, by any means, directly or indirectly, of any property knowing or with the intention that the property will be used to finance the travel of any person between states for (a) the perpetration, planning or preparation of, or participation in, terrorist act(s); or (b) the provision or receiving of training that is in connection with (a), regardless of whether the property is actually so used or whether any terrorist act occurred as a result of the training (UNATMO, ss.11J, K, L.).

**Criterion 5.3** – “Property” under sections 7, 8, and 8A of the UNATMO is defined in the Interpretation and General Clauses Ordinance (IGCO) (Cap. 1) to include (a) money, goods, choses in action<sup>60</sup> and land; and (b) obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incident to property as defined in (a), regardless of whether it is from a legitimate or illegitimate source. This is sufficiently broad to cover ‘funds or other assets’ as defined by the FATF.

<sup>60</sup> A chose in action refers to all personal rights to property which can only be claimed or enforced by an action and not by taking physical possession of the property. It is a right of which a person does not have present enjoyment, but may recover it (if withheld) by action.

This is encompassed as well in within the definition of “Terrorist Property” within the UNATMO which is defined as the property of a terrorist or terrorist associate; or any other property that is intended to be used to finance or otherwise assist the commission of a terrorist act; or was used to finance or otherwise assist the commission of a terrorist act. The definition does not distinguish between properties from legitimate or illegitimate sources and hence applies to both types of property.

**Criterion 5.4** – HKC’s TF offences do not require that the funds or other assets were actually used to carry out or attempt a terrorist act, or were linked to a specific terrorist act (UNATMO, ss.7, 11J).

**Criterion 5.5** – Under the general principle of the HKC legal framework, the intent and knowledge required to prove the offence could be inferred from objective factual circumstances, as demonstrated in the case of *Oei Hengky Wiryo v HKC*.

**Criterion 5.6** – HKC has effective, proportionate and dissuasive sanctions in place for TF offences. Natural persons convicted of a TF offence under sections 7, 8 and 8A of the UNATMO are punishable by up to 14 years’ imprisonment and an unlimited fine (UNATMO, s.14). The maximum penalty for an offence under section 6 of the UNSAR, which is a strict liability, regulatory offence, upon conviction on indictment is imprisonment for seven years and a fine of an unlimited amount.

**Criterion 5.7** – Criminal liability and sanctions are applicable to legal persons. Under section 3 of the IGCO, “person” is defined as including “any public body and any body of persons, corporate or unincorporated”. Section 3 of the IGCO also provides that this definition “shall apply notwithstanding that the word ‘person’ occurs in a provision creating or relating to an offence or for the recovery of any fine or compensation.” Accordingly, the TF offences extend to legal persons as well as to natural persons. Such measures are without prejudice to the criminal liability of natural persons. Sanctions for legal persons (which include a fine of an unlimited amount) are considered proportionate and dissuasive.

**Criterion 5.8** – Pursuant to provisions of general application, a broad range of ancillary offences attaches to criminal offences (including TF) in HKC including attempt (Crimes Ordinance (Cap. 200), s. 159G), conspiring (Crimes Ordinance, s.159A), aiding, abetting, counselling, procuring, or suborning (CPO, s. 89). The principle of joint criminal enterprise was clarified by the CFA through case law: *HKC v Chan Kam Shing (2016) 19 HKCFAR 640*.

**Criterion 5.9** – TF offences under sections 7, 8, and 8A of the UNATMO, as well as an offence against section 6 of the UNSAR, are indictable offences (*as per* CPO, s.14A) and are therefore predicate offences for ML under the OSCO (OSCO, s.25).

**Criterion 5.10** – The TF offences apply regardless of whether the defendant was in the same country or a different country from the one in which the terrorist or terrorist organisation is located, or where the terrorist act occurred or will occur (UNATMO, s.3, 2(2)).

### Weighting and Conclusion

HKC's framing and application of the TF offence is generally compliant with R.5. A minor deficiency however remains where the "civil protest" exemptions to certain classes of terrorist acts are present in HKC's law and is not consistent with the TF Convention.

**Recommendation 5 is rated largely compliant.**

### Recommendation 6 - Targeted financial sanctions related to terrorism and terrorist financing

In its 3rd MER, HKC was rated partially compliant with these requirements. The main deficiencies identified were that (i) targeted financial sanctions (TFS) were not implemented without delay, (ii) the freezing mechanism applied only to property that has been directed as terrorist property by the Secretary for Security (S for S), and (iii) guidance was not provided to financial institution (FIs) or other persons concerning obligations under freezing mechanisms.

On 31 May 2018, HKC enacted amendments to section 8A of the UNATMO to address some of these deficiencies. The HKC also introduced an early alert mechanism to address the other deficiencies.

**Criterion 6.1** – [n/a] HKC is not a sovereign state and is unable to submit proposals directly to the Committees; these are submitted through Ministry of Foreign Affairs of the PRC Government (MFA.) HKC has however established a competent authority to propose persons and entities for designation. The HKPF assesses terrorist threats against Hong Kong, taking into account a wide range of local, regional and international factors, including available intelligence, recent incidents and international terrorist activity trends. The HKC Government maintains close communication with the Central People's Government on terrorism and related issues, and there are established channels for information/intelligence exchange (e.g. between law enforcement agencies of both places). If HKPF considers sufficient grounds exist that a person or entity falls within the meaning of terrorist or terrorist associate under the UNATMO, it recommends to the Chief Executive (CE) (via the S for S) to apply to Court of First Instance (CFI) for an order under s.5 of the UNATMO to specify the person or entity. If the order is granted, the HKC Government submits the relevant information to MFA to consider submitting directly to the 1267/1989 Committee for designation.

#### Criterion 6.2 –

**(a)** The CFI is the competent authority for designating terrorist individuals and entities, and acts on application from the CE (UNATMO, s.5). Designations are made if the CFI is satisfied that the person/entity meets the definition of terrorist or terrorist associate in section 2 of UNATMO (UNATMO, s.5(2)).

**(b)** HKC has formalised a mechanism for identifying targets for designation. HKPF is responsible for assessing terrorist risk. It gathers and cultivates intelligence through various sources (public and confidential) and is responsible for identifying targets for designation, conducting investigation and gathering evidence. The decision is made on the basis of sufficiency of evidence and the applicable provisions of UNATMO in each specific case. DOJ renders legal advice as to whether there is

sufficient evidence to support an application for designation (i.e. evidence proving that a person or property is a terrorist/terrorist associate or terrorist property.) An application for specification of terrorists/terrorist associates and terrorist property under s.5 of the UNATMO is made by an originating summons supported by an affirmation/affidavit. On receipt of HKPF's recommendation, S for S and CE will take into full account the relevant facts and evidence of each case before deciding whether an application should be made to CFI to seek domestic specification pursuant to s.5 of the UNATMO, and whether the relevant information should be sent to MFA for consideration of submitting designation proposals to the relevant UN Committees. To date, no specifications have been made under s.5 of the UNATMO.

**(c)** When receiving a request, HKC has a mechanism in place to determine whether proposed designees meet the criteria for designation in UNSCR1373. Requests may be made through any channels and will be forwarded to HKPF for consideration using the criteria and mechanism described in 6.2(b) to determine what if any follow-up action should be taken. HKPF has not received any foreign request for designation in the past five years, but accords priority to referrals and intelligence relating to CT/TF and would act promptly on any request for foreign designations it received. In the absence of any foreign requests, promptness cannot be verified but this has not been taken into account in the assessment of 6.2(c).

**(d)** Designation of a terrorist or terrorist associate does not require the existence of criminal proceedings. The CFI will make the order if it is satisfied *on reasonable grounds* that the person is a terrorist or terrorist associate (UNATMO, s.5).

**(e)** When making a foreign request, HKC authorities report that they would provide as much identifying information and specific information as possible, although no outgoing requests have been made in the last five years. The UNATMO 12D(2)(b) provides the legal basis to share information with agencies outside HKC, provided they meet the definition of "corresponding person or body" in S.12D(5) which covers any person who or body which, in the opinion of the Secretary for Justice, has under the law of a place outside the HKC, functions corresponding to any of the functions of DOJ, HKPF, C&ED, ImmD and ICAC. HKPF would also consult with DOJ to ensure sufficient information and justification was supplied to enable the requesting jurisdiction to handle request.

### **Criterion 6.3 –**

**(a)** Under the mechanism described in 6.2(b), HKPF is the primary authority to collect and solicit information to identify persons and entities for the application by the CE for designation by the CFI. The general legal powers and investigative procedures for HKPF are described in R.30 and R.31.

The Rules of High Court require an application for a specification of terrorists/terrorist associates and terrorist property under s.5 of UNATMO to be supported by summons supported by affidavit of the authorised officer, which states the grounds for believing that the subject person is a terrorist or terrorist associate. "Authorised officer" includes a police officer and an officer of C&ED, ImmD and ICAC. S.12A, 12B and 12C provide for powers in relation to obtaining information for the purpose of an investigation into a relevant offence, which means any offence against the UNATMO.

**(b)** The CFI has specific powers to consider *ex parte* applications to specify a person as a terrorist or terrorist associate (Rule 3 of Order 117A of the Rules of the High Court.)

**Criterion 6.4** – HKC implements TFS without delay. The CE has authority (delegated to the S for S) under the UNATMO to specify the persons and entities designated by the UNSCRs by a notice published in the Gazette Extraordinary. The UNATMO prohibits making available, or collecting property for terrorists and terrorist associates, or dealing with funds, assets, economic resources to or for the benefit of “specified persons” or “specified entities”; including jointly and wholly owned (s.8 and s.8A). This applies to any person within HKC and all HKC permanent residents or entities associated/incorporated under laws of HKC. It is also prohibited to deal with property, funds, assets, resources, or services where a person knows or has reason to believe they are associated with a designated person / entity. “Deal with”, as defined under the UNATMO, encapsulates all element of “freeze”.

Separately, an alert mechanism runs parallel to the Gazette Extraordinary whereby the SB monitors TFS related to the 1267/1989/2253 and 1988 list at the start of every working day and reporting entities are notified within one working day through their relevant regulatory authority. Such notification triggers an obligation to stop making available any property of any person / entity known or suspected to be on the updated list (s.8 of UNATMO) or deal with property of specified terrorists/terrorist associates (s.8A of UNATMO), and to file an STR to the JFIU (s.12 of the UNATMO). To date, no designations have been made in relation to UNSCR 1373 under section 5 of the UNATMO, but when the CFI does order a designation to be made, the CE will also publish a notice in the Gazette to the same effect as a notice under section 4 of UNATMO.

Therefore, the legal requirement to freeze property takes effect at the earlier of the two events: (i) publishing of the designation in Gazette or (ii) a person becomes aware he is dealing with property relating to a UNSC-designated person / entity (including, but not limited to, through the alert mechanism). The Extraordinary Gazette and the alert must be published at a maximum within one working day of the UNSC designation. Statistics provided indicate that, since the UNATMO amendments and the implementation of the alert mechanism, TFS have been implemented within one calendar day.

**Criterion 6.5** –

**(a)** Section 8 of the UNATMO prohibits making available or collecting/soliciting property or financial services to a terrorist /terrorist associate. Section 8A prohibits dealing with property of a terrorist/terrorist associate once a Gazette notice issued by the CE under sections 4 and 5 of the UNATMO. Section 6 separately empowers S for S to issue a freezing notice in respect to terrorist property that is not linked to a designated person or entity. All obligations apply to natural and legal persons.

**(b)** “Terrorist property” is defined as the property of a terrorist/terrorist associate and need not be linked to a particular act. S.8 of the UNATMO covers **any** property, as long as it is made available or collected for, by any means, directly or indirectly, by a person to another person knowing that, or being reckless as to whether, the latter person is a terrorist or terrorist associate. S.8A of UNATMO also provides that the

prohibition on dealing with property includes property wholly or jointly owned, directly and indirectly controlled and held by those acting on behalf.

**(c)** The prohibitions on making available/soliciting under section 8 and dealing with under section 8A apply to any person in HKC and entities/individuals outside HKC that are HKC permanent residents or incorporated/constituted under the laws of HKC. The definition of persons includes individuals and entities, incorporated or unincorporated.

The definition of property includes every description of interest in property, vested or contingent, present or future. This definition is broad enough to encompass partial interest in property and therefore would cover jointly owned interests (s. 3 UNATMO, read together with the IGCO).

**(d)** Notification to reporting entities occurs through parallel processes including (1) an alert mechanism and (2) publication of a Gazette notice through the process described at 6.4. Guidance is issued to FIs and DNFBPs, including a stand-alone chapter in the uniform AML/CFT Guideline and specific guidance on TFS for FIs and certain DNFBPs. This guidance sets out the relevant legislative requirements as well as the measures required of reporting entities (database maintenance, screening and enhanced checking). HKC reports that designations are further disseminated through issuance of circulars by regulatory authorities (RAs). RAs also conduct briefings, outreach, seminars, etc. to provide guidance for compliance with TFS. All RAs issued circulars in May/June 2018 to draw FIs' attention on the new section 8A of the UNATMO. All the relevant materials including presentation materials in the seminars and circulars issued are available on a dedicated AML/CFT section in the IA's website for insurance institutions' access.

**(e)** Notification of a designation, either through the alert mechanism or the Gazette notice, triggers an STR reporting obligation under section 12 of the UNATMO, "as soon as practicable".

**(f)** Mechanisms for enabling challenges to freezing actions or access to frozen funds or assets, or for otherwise protecting *bona fide* third-party rights, are provided under both the UNATMO and the UNSAR (e.g. . section 17 of the UNATMO, section 6 of the UNSAR). There are also defences to dealing with property that protect the interests of *bona fide* third parties.

#### **Criterion 6.6 –**

**(a)** HKC is not a sovereign state and is unable to submit proposals for de-listing directly to the Committees; these are submitted through the MFA following the same process outlined at 6.1.

**(b)** De-listings are made on the same standard as listing – "reasonable grounds to believe" that the person or property is not, or is no longer, a terrorist/terrorist associate or terrorist property (UNATMO, s.5). If a freezing notice has been issued under section 6, it is revoked in writing by the S for S.

**(c)** Applications to CFI can challenge designation or freezing of property by the designated person or any person affected by the designation or freezing (UNATMO, s.17). Order 117A, Rules 23 – 24, Rules of the High Court (Cap. 4A) governs the procedure for making such applications.

**(d)/(e)** The procedures with respect to requests for de-listing/unfreezing are notified on the SB website.<sup>61</sup> This includes

- Procedures of the Focal Point for De-listing
- Travel ban and assets freeze exemption requests
- De-listed individuals and mistaken identities
- Office of the Ombudsperson to the ISIL (Da'esh) and Al-Qaida Sanctions Committee.

**(f)** The same mechanisms to challenge a listing can form the basis to have assets unfrozen, either by court order, by a formal revocation of a freezing order by the S for S or by the HKPF issuing a consent through the LNC process to permit dealing with such property (UNATMO; ss.5, 6, 17.).

**(g)** The alert mechanisms outlined in 6.4 also cover delisting.

**Criterion 6.7** – Section 15 outlines the criteria the CE may apply when issuing a license to use funds or make funds available, including reasonable living expenses, reasonable legal expenses and payments liable to be paid under the Employment Ordinance (UNATMO, ss.15, 6, 8, 8A). Section 9 of the UNSAR has a similar provision, which tracks the exact language of UNSCR 1452 1(a)-(b). In practice, no requests to use these powers have been made.

### *Weighting and Conclusion*

**Recommendation 6 is rated compliant.**

### **Recommendation 7 – Targeted financial sanctions related to proliferation**

This is a new Recommendation that was not assessed in HKC's 3<sup>rd</sup> MER.

**Criterion 7.1** – The legal basis for the implementation of the U.N. Security Council Resolutions (UNSCRs) pertaining to the financing of proliferation of weapons of mass destruction is set forth in the DPRK Regulation, the Iran Regulation and the Weapons of Mass Destruction (Control of Provision of Services) Ordinance (WMDO).

The mechanism for implementing the UNSCRs relating to DPRK and Iran respectively flows from the Secretary of Commerce and Economic Development or the CE's authority to publish a list of persons and entities designated by the UNSCRs on the CEDB's website or in the Gazette Extraordinary respectively, both of which must be accomplished within one business day of designation. Under the DPRK Regulation, the UNSC designations will come into force the moment they are published on CEDB's website. This in effect allows the CEDB to publish latest designations for the DPRK in a matter of hours and during the weekend or public holidays, if the UNSC promulgates them in New York on a Friday or during HKC public holidays. The two regulations provide a freezing obligation on funds, assets, economic resources to or for the benefit of "relevant persons" or "relevant entities"; including jointly and wholly owned. This applies to any person within HKC and all HKC permanent residents or entities

<sup>61</sup> [www.sb.gov.hk/eng/special/terrorist/terrorist.htm](http://www.sb.gov.hk/eng/special/terrorist/terrorist.htm)

associated/incorporated under laws of HKC. It is also prohibited to deal with property, funds, assets, resources, or services where a person knows or has reason to believe they are associated with any nuclear-related or ballistic missile-related item. Data provided confirms that the Extraordinary Gazettal arrangement commenced in May 2018 and that notices have been issued within one day of UNSC designations since then (see analysis under IO.11).

Separately, an alert mechanism runs parallel to the Gazette Extraordinary / publication on the CEDB's website, whereby the CEDB monitors, TFS lists related to the WMD list at the start of every day and notifies reporting entities within one working day through their relevant regulatory authority. Such notification triggers an immediate obligation to stop doing anything that a person believes or suspects may assist the proliferation of WMD (s.4, WMDO) and to file an STR to the JFIU (s.25A(1), OSCO). The legal obligation to prevent movement of or to freeze the property takes effect once the designation is made *or* FIs and DNFBPs receive the alert. FIs and DNFBPs shall not deal with such property irrespective of whether they file an STR immediately or not, and they commit an offence if they do deal with the property.

For both of the parallel processes, the prohibition on dealing prohibits encompasses a broad definition of "deal with". Under s.8 of the DPRK Regulation and s.9 of the Iran Regulation, "deal with" means (a) in respect of funds (i) use, alter, move, allow access to or transfer; (ii) deal with in any other way that would result in any change in volume, amount, location, ownership, possession, character or destination; or (iii) make any other change that would enable use, including portfolio management; and, (b) in respect of other financial assets or economic resources—use to obtain funds, goods or services in any way, including by selling, hiring or mortgaging the assets or resources.

#### **Criterion 7.2 –**

The CEDB is responsible at the policy level for implementing TFS against the DPRK and Iran, including introducing legislative amendments, monitoring updates to the 1718 Sanctions Lists and the 2231 List, notifying other bureaux or departments of such updates for dissemination to the industry (including FIs and DNFBPs), and proposing persons and entities to the UNSC for designation through the Central People's Government of the People's Republic of China. The HKPF is primarily responsible for enforcing TFS and investigating possible contraventions, while input and assistance from relevant LEAs such as the C&ED will be sought where necessary, for instance, when the case involves the supply, sale, transfer, procurement or import/export of prohibited items; or services related to WMD.

**(a)** HKC's implementation of UNSCRs requires all natural and legal persons in HKC to freeze the funds and other assets of designated persons or entities through a prohibition on making funds available or dealing with funds. The prohibition is triggered by the publication of sanctions lists on the CEDB's website or in the Gazette, completed within one day of new designations, and hence imposes a requirement to freeze funds without delay, within the standard applied under the FATF recommendations. "Deal with", as defined under the DPRK Regulation and the Iran Regulation, encapsulates all elements of "freeze", as outlined in 7.1.

**(b)** The prohibition on making funds available or dealing with funds includes broad definitions of "funds" and "economic resources", as well as definitions of "relevant

individual”/”relevant entity” that cover wholly and jointly owned assets, acting on behalf and resources provided directly or indirectly, and are sufficiently broad to cover the requirements of this sub-criterion.

**(c)** The obligations apply to any person within HKC and all HKC permanent residents or entities associated/incorporated under laws of HKC. The definition of “person” is broad enough to encompass all required elements.

**(d)** Notification is made by the CEDB to all relevant departments, including FTSB, SB, HKPF, C&ED, the Trade and Industry Department and the DOJ. The CEDB also notifies RAs under the process described in 7.1 to facilitate notification in parallel with the publication of the list on the CEDB’s website or in the Gazette notice. Guidance is issued to FIs and DNFBPs, including a stand-alone chapter in the uniform AML/CFT Guideline and specific guidance on TFS for FIs and certain DNFBPs. There is further dissemination through issuance of circulars by RAs. RAs also conduct training, seminars, etc. to provide guidance for compliance with TFS. This includes fora held in a multitude of sectors throughout 2017 and 2018 to provide guidance on proliferation, as well as proliferation-specific alerts sent to all RAs in January/February 2018, and circulars issued by RAs in February/March 2018

**(e)** The CEDB advises that “All persons are required to report any asset frozen or actions taken in compliance with the financial sanctions requirements by way of filing a Suspicious Transaction Report (STR) to the Joint Financial Intelligence Unit (JFIU). The relevant procedures can be found on the website of JFIU.” Sanctions are available for non-compliance by FIs or DNFBPs with the AML/CFT Guideline, as set out under c.1.10 above. There are also criminal sanctions available under s.8 of the DPRK Regulation and s.9 of the Iran Regulation, which provide that contravention of TFS obligations are punishable on conviction on indictment by imprisonment for seven years and a fine of unlimited amount.

**(f)** The rights of *bona fide* third parties acting in good faith are protected as both regulations provide defences to individuals/entities that did not know or had no reason to know the assets/funds/resources were connected to a relevant person/relevant entity (s.8(3); DPRK Regulation; s.9(4) of the Iran Regulation).

**Criterion 7.3** – RAs employ a number of measures to ensure FIs’ compliance with TFS, including the issuance of guidance and circulars, general supervision and monitoring activities that include TFS, and specific thematic examinations related to sanctions and the ability to freeze under relevant designation.

S. 8 of the DPRK Regulation and s. 9 of the Iran Regulation provide that failure to comply with TFS carries criminal penalties of fines or imprisonment, or both, as set out under c. 7.2(e). These criminal offences are investigated and enforced by the HKPF. [There are also sanctions for non-compliance with AML/CFT Guideline, as set out in c.1.10].

**Criterion 7.4** – Information is publicly available regarding the submission of de-listing requests to the relevant UNSC sanction committee. The CEDB is responsible for receiving requests to unfreeze the funds or assets of individuals who are inadvertently affected. The CEDB works with LEAs to determine whether the applicant is a “false positive”. The CE can issue a licences for making funds available to or for the benefit of a relevant person or relevant entity in limited circumstances. This power is granted through regulations specific to the DPRK and Iran, and the

scope of this power is limited to the specific circumstances permitted under UNSCRs 1718 and 2231, respectively. The licence process requires advance notice to the UNSC or the relevant Committee, which HKC provides to the UNSC or the relevant UNSC Committee through MFA. The alert mechanisms and Gazettal / publication process described under 7.1 also cover de-listings and are contained on the CEDB's website.

**Criterion 7.5 –**

**(a)** The DPRK Regulation and the Iran Regulation provide for the crediting of accounts with interest or other earnings due on the account, or payment due under contracts, agreements or obligations that arose before the date of designation. The funds, once credited, must remain frozen.

**(b)** The Iran Regulation permits the CE to issue a licence for the payment of obligations that arose prior to the designation only if the contract or obligation is not related to any prohibited items, materials, equipment, goods, technologies, assistance, training, financial assistance, investment, brokering, or services referred to in UNSCR 2231 and the payment is not directly or indirectly to a person subject to para 6 of Annex B to UNSCR 2231. If this condition is met, the CE must notify the Committee before granting the licence. This is accomplished through the MFA.

### *Weighting and Conclusion*

**Recommendation 7 is rated compliant.**

### **Recommendation 8 – Non-profit organisations**

In its 3<sup>rd</sup> MER, HKC was rated largely compliant with these requirements. The deficiencies identified included some information gaps in relation to the size and financial scope of the NPO sector in HKC, the requirement to identify persons who owned, controlled or directed the activities of NPOs was not fully adequate and the requirement to maintain documents for at least five years was not met for the minority of NPOs not established as companies under the CO.

**Criterion 8.1 –**

**(a)** HKC has a large non-profit sector, only a subset of which meets the definition of NPOs in R.8. As outlined in the analysis of IO.10, HKC undertook a comprehensive review of the NPO sector in 2018 to identify the subset that fall within the FATF definition, as well as the features of these NPOs, nature of the TF threats posed by terrorist entities to these NPOs, and adequacy of measures in place to prevent NPOs from being misused for TF. HKC has identified the charity sector, comprising 8 998 entities, as falling within the FATF definition of NPO based on the 2018 review. The review considered the results of the 2018 NRA (which found that there is no apparent TF threat identified for the NPO sector in HKC), international typologies, and available law enforcement and supervisory information and intelligence. It found that international and cross-boundary charities that raise and disburse funds for the purposes of supporting humanitarian services in the conflict zones or terrorism-afflicted regions are relatively more exposed to TF abuse than local charities. Around 10-15 NPOs in HKC would possess these characteristics. Charities carrying out or supporting domestic services were assessed to face minimal or no TF risk at all. The

review was updated in September 2018 to take into account improved accountability measures for mitigating NPO TF risks.

**(b)** HKC has taken steps to identify the nature of TF threats to NPOs and how terrorists abuse NPOs, including through the 2018 NRA, the 2018 NPO review and the various sources of information outlined in 8.1(a). HKC concluded that the TF risk to NPOs is low due to: the absence of any STRs, MLA requests or foreign intelligence indicating misuse of NPOs; the fact that there are no known NPOs in HKC to sympathise or condone terrorism or linked to terrorist groups; and the fact that the majority of the NPO sector has a domestic focus on social/community services. On this basis, HKC has concluded that there is no apparent TF threat to the NPO sector in HKC and the inherent vulnerability is low. While 10-15 “higher risk” NPOs have been identified, these are HKC branches of international charities that raise funds for humanitarian or relief programmes in regions stricken by conflicts or terrorism, these NPOs are all tax-exempt and subject to monitoring and accountability. HKC has also reviewed these NPOs and concluded that, while they present a higher risk, no TF threat has been identified.

**(c)** HKC has taken steps to review the adequacy of laws and regulations governing at-risk NPOs as part of the 2018 review. Owing to the varying legal structures of NPOs in HKC, they are governed by different legislative and regulatory regimes. A comprehensive review of the NPO regulatory framework was also carried out in 2013 by the Law Reform Commission of HKC and has since been published ([www.hkreform.gov.hk/en/docs/rcharities\\_e.pdf](http://www.hkreform.gov.hk/en/docs/rcharities_e.pdf)). In addition, the Audit Commission reviewed the monitoring of charities and charitable fund-raising activities and set out its recommendation in Audit Report No. 68 in 2017 ([www.aud.gov.hk/eng/pubpr\\_arpt/rpt\\_68.htm](http://www.aud.gov.hk/eng/pubpr_arpt/rpt_68.htm)).

**(d)** HKC undertook reviews in 2005 and 2006, and in 2018 specific to TF risk. Authorities also conducted reviews of the adequacy of NPO measures in 2013 and 2017 (see (c) above). HKC reports that the government is considering recommendations and follow-up from the aforementioned reviews. This is also supported by mechanisms to periodically re-assess the NPO sector by reviewing new information, as detailed in 8.1(a).

#### **Criterion 8.2 –**

**(a)** HKC has implemented a range of policies to promote accountability, integrity and public confidence in NPOs, including ensuring a public list of registered or exempted societies, notification procedures to ensure the HKPF alerts the Inland Revenue Department (IRD) of societies that dissolve or cease to operate, technological improvements to ensure timely reports on any reviews of tax exempt status for NPOs that are charities, enhanced mechanisms to improve timely investigation of accountability measures, guidance for the public and to NPOs on the obligations NPOs must meet, publication of audits, and a dedicated hotline to report complaints about NPOs.

**(b)/(c)** HKC has a range of awareness campaigns aimed at enhancing the transparency and accountability of charities, including guidance on corporate governance, best practices and specific TF-related guidance. Agencies involved include SB, the Efficiency Office of the Innovation and Technology Bureau, the SWD, the ICAC and the Hong Kong Council of Social Service. From March 2018, the

Government has also engaged in targeted outreach to the sector, including the higher-risk charities, specific to TF in the NPO sector and the implementation of the latest FATF guidance. HKC updated its NPO guidance in September 2018. All agencies with oversight of NPOs, including the IRD, are directed by the SB to maintain a high level of vigilance to any TF risks in their work.

**(d)** Authorities report that the disbursement of funds is done predominantly through regulated financial channels. NPOs are encouraged to conduct transactions via regulated channels, through HKCs programme of targeted outreach, as set out in c. 8.2(c).

**Criterion 8.3** – HKC’s approach to risk-based supervision and monitoring relies largely on its assessment that there are 10-15 higher risk charities operating domestically, which are local branches of international charities. In addition, there are a range of monitoring and accountability mechanisms for all NPOs. While many HKC agencies have monitoring or oversight of different segments of the NPOs sector, the IRD is the agency with primary line of sight over the tax-exempt status of charities. Having identified internationally focused charities as higher risk, HKC has demonstrated that mechanisms exist to apply closer monitoring with a TF focus to these charities, and that measures exist for HKC to respond to any change in risk if identified. Relevant HKC agencies, in carrying out their usual business, are aware of the need to identify any TF risk of charities as well as their obligation to file STRs under the UNATMO. In addition, targeted outreach and more active monitoring are conducted against NPOs with relatively higher risk as part of authorities’ general oversight of NPOs. The international charities, like all others, are subject to the usual accountability requirements applicable to their legal forms, and there is an additional layer of scrutiny over tax-exempt bodies by the IRD to ensure that their activities are compatible with their charitable objects, as well as additional outreach by the Government to ensure they are aware of their TF risks, and have taken adequate mitigating measures against the same.

**Criterion 8.4** –

**(a)** HKC makes use of the general accountability mechanisms that exist for charities, with the RBA incorporated, based on the relatively low TF risk of this sector. The general accountability mechanisms are robust and monitoring is spread across a number of HKC agencies, many of which have a specific role in identifying TF risk.

**(b)** The existing accountability regimes, and the TF regime, contain a number of penalties and enforcement mechanisms that can be deployed by the relevant regulator.

**Criterion 8.5** –

**(a)** Information on the specific mechanisms for the co-ordination, co-operation and information sharing among agencies responsible for NPOs, and between those agencies and LEAs, is detailed in the analysis of c. 8.1. In addition, the JFIU is the central operational point of contact for domestic or external exchange of financial intelligence or other information, including information concerning the TF risks of NPOs. Its function is supported by the requirement for non-law enforcement regulatory agencies (e.g. the SWD or the IRD), to make STRs to the JFIU on any known or suspected TF activities.

**(b)** The HKPF has broad investigative powers and LEAs are familiar with the operation of NPOs. LEAs regularly attend international conferences and seminars, and conduct overseas visits to enhance their knowledge of CT and CFT, including that concerning the misuse of NPOs for TF purposes. Typologies reports or relevant guidance are circulated to financial investigators from time to time to update their knowledge of NPOs, including FATF’s “Best Practice - Combating the abuse of NPOs” and “FATF Report - Risk of Terrorist Abuse in NPOs”. HKPF is also the regulatory authority of societies under the Societies Ordinance and has extensive knowledge of the operations of NPOs for enforcing the Ordinance.

**(c)** The HKPF has broad investigative powers as detailed in R.6, R.30 and R31, and, with appropriate authority, may obtain information from agencies responsible for oversight of charities, including the IRD. Under section 12 of the UNATMO, any person must file a TF-related STR to the JFIU if the person knows or suspects any property to be terrorist property. An STR must include information and other matters on which the knowledge or suspicion is based. Section 12(3) of the UNATMO provides that the disclosure to JFIU shall not be treated as any breach of any restriction on disclosure of information imposed by any enactment, including tax secrecy laws.

**(d)** STR reporting is required whenever any person knows or suspects that a property is terrorist property or property of a terrorist or terrorist associate. This obligation extends to all persons, including regulators, office holders, staff of FIs, etc.

**Criterion 8.6** – HKC has good international relationships and a framework to permit international sharing of information. JFIU is empowered under the UNATMO to exchange information with overseas FIUs and LEAs. This is supported by the STR requirements under the UNATMO, detailed at c. 8.5(a), and the information that is publicly available, for instance annual returns.

At the same time, the IRD can provide tax information relating to NPOs under Comprehensive Avoidance of Double Taxation Agreements (CDTA), Tax Information Exchange Agreements (TIEAs) or the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, although this is not the primary mechanism under which HKC shares TF information with international counterparts.

### *Weighting and Conclusion*

**Recommendation 8 is rated compliant.**

### **Recommendation 9 – Financial institution secrecy laws**

In its 3rd MER, HKC was rated compliant with former R.4, which contained the previous requirements in this area.

**Criterion 9.1** –

#### ***Sharing of Information between FIs and competent authorities***

There are no statutory laws or other financial secrecy or confidentiality laws that inhibit the implementation of the FATF Recommendations. The AMLO (s. 49), the BO (s. 120), the SFO (s. 378), the IO (s. 53A), the PSSVFO (s. 50) and the MLO (s. 5) contain provisions on official secrecy that mandate the preservation of secrecy of customers’ information and matters relating to the affairs of the customers in these respective sectors. However, RAs have the power to access the books and records of the FIs and to require FIs to submit information

which the RAs may reasonably require for the exercise of functions under their respective regulatory regime (s. 9, AMLO; s. 55 and 56, BO; s. 12, 12A and 12C, PSSVFO; s. 180, SFO; s. 34, IO). Section. 28 of the MLO similarly empowers the RML to have access to moneylenders' books.

LEAs have a range of powers available under the OSCO, the DTROP, the PFO and other ordinances to obtain information from financial institutions, including by production order and search warrant.

#### ***Sharing of information between domestic competent authorities***

The RAs have legal authority to share information with other RAs and LEAs. Section 49(3) and (4) of the AMLO allow the C&ED to share information with other RAs if it is satisfied that: (i) it is desirable or expedient that the information should be disclosed in the interest of licensees or their customers, or in the public interest; or (ii) or the disclosure will enable or assist the recipient of the information to perform the recipient's functions and it is not contrary to the interest of licensees or their customers, or the public interest, that the information should be disclosed. Public officers employed in the C&ED are allowed to disclose information with a view to the institution of, or for the purposes of, *any* criminal proceedings (s. 49(2)(b), AMLO) or any investigation carried out in HKC or under the laws of HKC (s. 49(2)(c), AMLO). Similar provisions regarding the sharing of information are in place for the other RAs (s. 120(5), BO; s. 50(3) and (4), PSSVFO; s. 378(3), SFO; and s. 53A(3), IO and s. 5(2), MLO).

#### ***Sharing of information between competent authorities internationally***

The RAs have legal authority to share information with their foreign counterparts. The C&ED is allowed to disclose information to a foreign authority or regulatory organisation that, in the opinion of the C&ED: (i) performs functions similar to the functions of the C&ED or regulates, supervises or investigates banking, insurance or other financial services; and (ii) is subject to adequate secrecy provisions (s. 40(3)(d), AMLO). Similar provisions with regard to the sharing of information with foreign authorities are in place for the other RAs (s. 121(1)(b), BO; s. 50(4B), PSSVFO; s. 378(3), SFO; and s. 53B(1)(b), IO).

#### ***Sharing of information between financial institutions (R. 13, 16 and 17)***

The sharing of information between FIs is subject to compliance with the PDPO. The data protection principles outlined in the PDPO are subject to exceptions. S.58(2) of the PDPO, provides that personal data is exempt for data protection where the use of the data is for any of the purposes referred to in s.58(1). The purposes referred to include the prevention or detection of crime, preclusion or remedying of unlawful or seriously improper conduct or dishonesty or malpractice by persons.

### ***Weighting and Conclusion***

**Recommendation 9 is rated compliant.**

### **Recommendation 10 – Customer due diligence**

In its 3rd MER, HKC was rated partially compliant with former R.5, which contained the previous requirements in this area. The main deficiencies were that: (1) key CDD obligations were not set out in law or regulation and only basic CDD obligations were in place for money remitters and money exchange companies; (2) due to the absence of a supervisor for these

entities, it was not possible to determine the extent of implementation of the existing CDD obligations for these companies; (3) the threshold for CDD on occasional customers in the banking sector was not clearly specified and there were no obligations on banks to obtain information on the purpose and nature of the account; and (4) no formal assessment had been undertaken to justify exclusion of moneylenders, credit unions, the post office and financial leasing companies from CDD requirements. Since then, HKC addressed most of these deficiencies and conducted an assessment of the ML/TF risk to exempt credit unions and post offices from AML/CFT requirements. However, no risk assessment was conducted to justify the exemption of the stand-alone financial leasing companies (not being a bank or moneylender) and the credit card companies (operating independently from banks) from the AML/CFT framework and this constitutes a minor deficiency across many of the R.10 criteria.

**Criterion 10.1** – Anonymous accounts and accounts in fictitious names for FIs are prohibited (s.16, Schedule 2, AMLO). Sectoral AML/CFT Guidelines, indicate that where numbered accounts exist, FIs must maintain them in such a way that full compliance can be achieved with the AMLO: FIs must properly identify and verify the identity of the customer. (AIs AML/CFT Guideline: para. 4.14; the SFC AML/CFT Guideline: para. 4.18; IA AML/CFT Guideline: para. 4.16; C&ED AML/CFT Guideline: para. 4.14; SVF AML/CFT Guideline: para. 4.12). While moneylenders are not covered by the AMLO and the CDD principle is not set out in law, enforceable guideline issued by the RML requires them to comply with equivalent requirements (para. 5.44 of the RML AML/CFT Guideline).

#### ***When CDD is required***

**Criterion 10.2** – FIs are required to perform CDD measures: (a) before establishing a business relationship with the customer; (b) when carrying out occasional transactions amounting to HKD 120 000 or more (in line with the designated threshold of USD/EUR 15 000) or an equivalent in any other currency or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked; (c) when carrying out an occasional transaction that is a wire transfer involving an amount equal to or above HKD 8 000 (in line with the applicable designated threshold of USD/EUR 1 000) or an equivalent amount in any other currency, whether the transaction is carried out in a single operation or in several operations that appear to the FI to be linked; (d) when the FI suspects that the customer or the customer’s account is involved in ML or TF; and (e) when the FI doubts the veracity or adequacy of any information previously obtained for the purpose of identifying the customer or for the purpose of verifying the customer’s identity (s. 3(1) Schedule 2, AMLO). These requirements also apply to SVF licensees and moneylenders (para 4.1.3 of the SVF AML/CFT Guideline and para 5.4 of the RML AML/CFT Guideline).

#### ***Required CDD measures for all customers***

**Criterion 10.3** – FIs are required to identify the customer and to verify the customer’s identity on the basis of the documents, data or information provided by a “governmental body”, “the relevant authority or any other relevant authority<sup>62</sup>”, an authority in a place

<sup>62</sup> Relevant authority has the following meaning in the AMLO: “in relation to an authorized institution or SVF licensee, means the Monetary Authority; in relation to a licensed corporation, means the Securities and Futures Commission; in relation to an authorized insurer, appointed insurance agent

outside HKC that performs functions similar to those of the relevant authorities or any other relevant authorities; or any other reliable and independent source that is recognised by the relevant authority (s.2(1)(a), Schedule 2, AMLO). The sectoral AML/CFT Guidelines provide for equivalent requirements for moneylenders and SVF licensees (para. 4.3.1 of the SVF AML/CFT Guideline and para. 5.17 of the RML AML/CFT Guideline). The sectoral AML/CFT Guidelines provide further requirements on the customer's (natural persons, corporations, partnerships and unincorporated bodies, and trusts) identification data (para 5.18 and 5.19 of the RML AML/CFT Guideline and para. 4.3.2 to 4.3.12 of the SVF AML/CFT Guideline).

**Criterion 10.4** – FIs are required to identify the person acting on behalf of the customer, to take “reasonable measures” to verify that person’s identity on the basis of documents, data or information provided by: (i) a government body; (ii) the relevant authority or any other relevant authority; (iii) an authority in a place outside Hong Kong that performs functions similar to those of the relevant authority or any other relevant authority; or (iv) any other reliable and independent source that is recognised by the relevant authority and to verify the person’s authority to act on behalf of the customer (s. 2(1)(d) Schedule 2, AMLO). Moneylenders, which are out of the scope of the AMLO, are also required to take these measures under the sectoral AML/CFT Guideline issued by RML for the moneylenders (para. 5.2(d)).

**Criterion 10.5** – The definition of beneficial ownership provided in s.1 of Schedule 2, of the AMLO is aligned with the definition of the FATF Glossary. FIs are required to identify the beneficial owner and to take reasonable measures to verify the beneficial owner’s identity so that the FI is satisfied that the FIs knows who the beneficial owner is (s. 2(1)(b), Schedule 2, AMLO). Para. 5.2(b) of the AML/CFT Guideline for moneylenders provides for equivalent requirements and provides for a definition of beneficial ownership that is also in line with the definition of the FATF Glossary.

**Criterion 10.6** – FIs are required to obtain information on the purpose and intended nature of the business relationship, “unless the purpose and intended nature are obvious” (s. 2(1)(c) Schedule 2, AMLO). The sectoral AML/CFT Guidelines further require that FIs should understand the purpose and intended nature of the business relationship. It follows from the sectoral AML/CFT Guidelines that in some instances, this will be self-evident, but in many cases, the FIs should obtain information in this regard. (AIs AML/CFT Guideline: para. 4.6.1; the SFC AML/CFT Guidelines: para. 4.6.1; IA AML/CFT Guideline: para. 4.8.1; C&ED AML/CFT Guideline: para. 4.6.1; and SVF AML/CFT Guideline: para. 4.6.1; and the RML AML/CFT Guideline; para. 5.2(c).).

**Criterion 10.7** – FIs are required to continuously monitor the business relationship with a customer, it includes and is not limited to: reviewing from time to time documents, data and information relating to the customer that have been obtained by the FI for the purpose of complying with the CDD requirements to ensure that they are up-to-date and relevant; and conducting appropriate scrutiny of transactions carried out for the customer to ensure that they are consistent with the FI’s knowledge of the customer and the customer’s business and risk profile, and with the FI’s knowledge of the source of the customer’s funds (s. 5(1)(a)

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or authorized insurance broker, means the Insurance Authority; in relation to a licensed money service operator or to the Postmaster General, means the Commissioner; and in relation to a TCSP licensee, means the Registrar (S. 1 of Schedule 1, AMLO).”

and (b), Schedule 2, AMLO). Chapter 6 of the RML AML/CFT Guideline provides equivalent requirements for moneylenders.

### ***Specific CDD measures required for legal persons and legal arrangements***

**Criterion 10.8** – Where the customer is a legal person or a trust, FIs are required to take measures to enable the FIs to understand the ownership and control structure of the legal person or trust (s. 2(1)(b), Schedule 2, AMLO). The sectoral AML/CFT Guidelines further clarifies that such requirement extends to all customers that are not natural persons (AIs AML/CFT Guideline: para. 4.4.14; the SFC AML/CFT Guideline: para. 4.3.13; IA AML/CFT Guideline: para 4.4.14; C&ED AML/CFT Guideline: para. 4.4.14; and SVF Licensee AML/CFT Guideline: para. 4.4.14). The requirement to understand the customer’s business is also included in these Guidelines (AIs AML/CFT Guideline: para. 4.6.1; the SFC AML/CFT Guidelines: para. 4.6.1 and 4.6.2; IA AML/CFT Guideline: para. 4.8.1; C&ED AML/CFT Guideline: para. 4.6.1; and SVF AML/CFT Guideline: para. 4.6.1). Para. 5.2(b) of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 10.9** – FIs should identify the customer that is a legal person or a legal arrangement by obtaining at a minimum its full name, date and place of incorporation or registration and address of registered office, its unique identification number and its principal place of business (AIs AML/CFT Guideline: para 4.3.6-4.3.12; the SFC AML/CFT Guideline: para 4.2.5-4.2.11; IA AML/CFT Guideline: para 4.3.6-4.3.12; C&ED AML/CFT Guideline: para 4.3.6-4.3.12; and SVF AML/CFT Guideline:4.3.6-4.3.12; and the RML AML/CFT Guideline: 5.17-5.18) In verifying the identity of that customer, FIs have to verify its name, legal form, current existence and the powers that regulate and bind the legal person by reference to documents, data or information provided by a reliable and independent source. FIs should also identify the connected parties of the customer, which includes the natural persons holding a senior management position or having executive authority in the customer.

**Criterion 10.10** – FIs are required to identify and take reasonable measures to verify the identity of the beneficial owner(s) where the customer is a legal person (s. 2(1)(b) Schedule 2, AMLO). The definition of legal person “*includes any public body and any body of persons, corporate or unincorporate*” (s. 1 of Schedule 2 of the AMLO). The definition of the beneficial owner of a corporation and a partnership covers the steps defined in c.10.10(a) and (b). With regard to the step defined in c.10.10(c), the definition of beneficial owner in relation to a corporation and partnership is the individual who “*exercises ultimate control over the management*” of the corporation and partnership (s. 1(1)(a)(i)(C) and (b)(1)(C) Schedule 2, AMLO). Sectoral AML/CFT Guidelines further requires that FIs identify “*the natural person who holds the position of senior managing official*” (AIs AML/CFT Guideline: para 4.4.8; the SFC AML/CFT Guideline: para 4.3.7; IA AML/CFT Guideline: para 4.4.8; MSO AML/CFT Guideline: para 4.4.8; and SVF Licensee AML/CFT Guideline: para 4.4.8). Any other legal person not falling within the definition of corporation or partnership falls under Sec. 1(1)(d) Schedule 2, AMLO of the definition for beneficial ownership. Pursuant to that provision, FIs are required to identify “*the individual who ultimately owns or controls*” these persons. If there is no such natural person, the requirement is to identify the persons who hold the position of senior management, and take reasonable measures to verify their identities. Para 5.2(b) of the RML AML/CFT Guideline provides equivalent requirements for moneylenders.

**Criterion 10.11** – FIs are required to identify and take reasonable measures to verify the identity of the beneficial owner(s) (s. 2(1)(b) Schedule 2, AMLO). For FIs, the definition of the beneficial owner of a trust in the AMLO (s. 1(1)(c) Schedule 2, AMLO) does not

encompass all of the categories defined in c.10.11(a). The categories “trustee(s)” and “class of beneficiaries” are not covered in this definition, but are covered under the sectoral AML/CFT Guidelines (AIs AML/CFT Guideline: para 4.3.19 and 4.4.12; the SFC AML/CFT Guideline: para 4.2.13, 4.3.11 and 4.3.13; IA AML/CFT Guideline: para 4.3.19 and 4.4.12; C&ED AML/CFT Guideline: para 4.3.19 and 4.4.12; and SVF AML/CFT Guideline: para 4.3.19 and 4.4.12).

For other persons (not falling within the definition of the beneficial owner in relation to a trust and including other similar legal arrangements) (s. 1(1)(d) Schedule 2, AMLO) FIs are required to identify an individual who ultimately owns or controls the person. The AMLO also contains the general requirement to understand the ownership and control structure (s. 2(1)(b) Schedule 2, AMLO) in relation to legal persons and trusts. Annex D to the RML AML/CFT Guideline provides equivalent requirements for moneylenders.

### ***CDD for Beneficiaries of Life Insurance Policies***

**Criterion 10.12** – As soon as the beneficiary of a life insurance or other investment related insurance policies is identified or designated, FIs are required to: a) record the name of the beneficiary if it is identified by name and b) obtain sufficient information about the beneficiary to satisfy itself that it will be able to establish the identity of the beneficiary when it is designated by description or other means. In both cases, FIs have to verify the identity of the beneficiary at the time the beneficiary exercises a right vested in the beneficiary under an insurance policy or at the time of the payout, whichever is the earlier. If there is more than one payout, the requirement applies at the time of the first payout (s. 11, Schedule 2, AMLO). At the time of payout an FI must also verify the beneficiary’s identity (s. 11(2) and (3) Schedule 2, AMLO).

**Criterion 10.13** – IA’s AML/CFT Guideline sets out specific requirement for the authorised insurers, reinsurers, appointed insurance agents and authorised insurance brokers carrying on or advising on long term business to include the beneficiary of a life insurance policy as a relevant risk factor in determining whether enhanced CDD measures are applicable (para 4.6.8 ). Those FIs have a general duty to implement enhanced due diligence in situation that by its nature may present a high risk (s. 15 Schedule 2, AMLO) FIs are required where the beneficiary is a legal person or trust to identify its beneficial owners and, if there is a high risk of ML or TF having regard to the particular circumstances of the beneficial owners, to take reasonable measures to verify the beneficial owners’ identities so that the FI knows who the beneficial owners are (s. 11(3)(b) Schedule 2, AMLO).

### ***Timing of verification***

**Criterion 10.14** – FIs are required to complete the CDD process before establishing any business relationship or before carrying out a specified occasional transaction (ss. 3(1)(a),(b) and (c) Schedule 2, AMLO).

An FI may verify the identity of a customer and any beneficial owner of the customer after establishing a business relationship with the customer if: a) this is necessary not to interrupt the normal conduct of business with regard to the customer; and (b) any risk of ML or TF that may be caused by carrying out the verification after establishing the business relationship is effectively managed (s. 3(2) , Schedule 2, AMLO). The verification must be completed as soon as reasonably practicable after establishing the business relationship (s.3(3) Schedule 2, AMLO). Para 5.4 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 10.15** – Sectoral AML/CFT Guidelines require FIs to adopt risk management policies and procedures concerning the conditions under which the customer may utilise the business relationship prior to verification. (AIs AML/CFT Guideline: para 4.7.3; the SFC AML/CFT Guideline: para 4.7.3; IA AML/CFT Guideline: para 4.9.4; C&ED AML/CFT Guideline: para 4.7.3; RML AML/CFT Guideline: text box after para 5.8). These policies and procedures should include: establishing a reasonable timeframe for the completion of the identity verification measures and the follow-up actions if exceeding the timeframe; placing appropriate limits on the number, types and/or amount of transactions that can be performed; monitoring of large and complex transactions being carried out outside the expected norms for that type of relationship; keeping senior management periodically informed of any pending completion cases; and ensuring that funds are not paid out to any third party. Exceptions may be made to allow payments to third parties subject to the absence of ML/TF suspicion, the fact that the ML/TF risks are assessed to be low, and upon approval by senior management.

#### ***Existing customers***

**Criterion 10.16** – In relation to a pre-existing customer an FI must carry out the CDD measures when: (a) a transaction takes place with regard to the customer that: (i) is by virtue of the amount or nature of the transaction, unusual or suspicious; or (ii) is not consistent with the FI's knowledge of the customer or the customer's business or risk profile, or with the FI's knowledge of the customer's funds; or (b) a material change occurs in the way in which the customer's account is operated. Additionally, when an FI suspects that the customer or the customer's account is involved in ML/TF or the FI doubts the veracity or adequacy of any information previously obtained for the purpose of identifying the customer for the purpose of verifying the customer's identity, CDD measures in relating to a pre-existing customer are also required (s. 6(1), Schedule 2, AMLO). A pre-existing customer, in relation to an FI means a customer with whom the FI has established a business relationship before the date of commencement of the AMLO (s.1 Schedule 2, AMLO). Para 5.13 and 5.14 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

#### ***Risk-Based Approach***

**Criterion 10.17** – FIs are required to conduct enhanced CDD when ML/TF risks are higher. The prescribed enhanced measures include measures to determine the customer's or beneficial owner's source of wealth and the source of funds; to obtain approval from senior management to establish or continue the business relationship; and take additional measures to mitigate the risk of money laundering or terrorist financing involved (s. 15 Schedule 2, AMLO). Para 5.24 to 5.44 of the RML AML/CFT Guideline provide for equivalent requirements for moneylenders.

**Criterion 10.18** – HKC allows for SDD measures as explained under criteria 1.8 and 1.12 on the basis that (i) the situation poses low ML/TF risk; (ii) customer and beneficial owner information is publicly available, and/or (iii) adequate checks and controls exist in other regulatory regime. The application of SDD measures by FIs should be supported by an adequate analysis of ML/TF risks.

Paras 5.20 to 5.23 of the RML AML/CFT Guideline provide for a list of customers for whom SDD may be applied. However, there is no indication that this list is based on an adequate risk assessment.

#### ***Failure to satisfactorily complete CDD***

**Criterion 10.19** – FIs must not establish a business relationship, or carry out an occasional transaction, where relevant CDD measures cannot be completed. If the FI already established a business relationship with that customer, the business relationship must be terminated as soon as reasonably practicable (s. 3(4) and s. 6(2) Schedule 2, AMLO). Sectoral AML/CFT Guidelines also require FIs to consider making a STR in relation to the customer (AIs AML/CFT Guideline: para 4.13.1; the SFC AML/CFT Guideline: para 4.17.1; IA AML/CFT Guideline: para 4.15.1; C&ED AML/CFT Guideline: para 4.13.1; and SVF licensee AML/CFT Guideline: 4.11.1). Para 5.9- and 5.10 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

#### ***CDD and tipping-off***

**Criterion 10.20** – The requirement to file STR under the OSCO, the DTROP and the UNATMO applies where an FI forms a reasonable suspicion at any time, including during the CDD process. Sectoral AML/CFT Guidelines require FIs not to pursue CDD and file an STR when they believe that performing the CDD process will tip off the customer (AIs AML/CFT Guideline: para 5.13; the SFC AML/CFT Guideline: para 5.16; IA AML/CFT Guideline: para 5.14; C&ED AML/CFT Guideline: para 5.13; and SVF AML/CFT Guideline: para 5.13). However, there is no equivalent requirement for moneylenders.

### ***Weighting and Conclusion***

There are some minor shortcomings identified under R.10 given that some stand-alone financial leasing companies and non-bank credit card companies are out of the scope of the CDD obligations, and given that the CDD principle for moneylenders is not set out in a law.

**Recommendation 10 is rated largely compliant.**

### **Recommendation 11 – Record-keeping**

In its 3<sup>rd</sup> MER, HKC was rated partially compliant with former R.10, which contained the previous requirements in this area. The main deficiencies were that only general record-keeping requirements were embedded in law or regulation. Furthermore, there were deficiencies with regard to the record-keeping requirements for the securities sector and remittance agents, and no formal risk assessment has been undertaken to justify exclusion of moneylenders, credit unions, the post office and financial leasing companies from the preventive measures and corresponding regulatory regime. Since then, HKC has addressed most of these deficiencies. However, no risk assessment was conducted to justify the exemption of the stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) from the AML/CFT framework and this constitute a minor deficiency in all the criteria in R.11.

**Criterion 11.1** – The AMLO (s. 20(1)(a) of Schedule 2) contains specific record-keeping requirements for FIs. In relation to each transaction carried out, the original or the copy of the documents and a record of CDD data and information obtained in connection with the transaction must be kept by the FI. Those documents must be kept for a period of at least five years, as of the date when the transaction is completed (s. 20(2) Schedule 2, of the AMLO). While the principle that moneylenders should maintain records on transaction and information obtained through CDD measures is not set out in law, para 9.2 and 9.3 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 11.2** – In relation to each customer, the FI must keep the original or a copy of the documents and a record of the data and information obtained in the course of identifying and verifying the identity of the customer or any beneficial owner of the customer, in relation to CDD requirements, as well as the original or a copy of the files relating to the customer’s account and business correspondence with the customer and any beneficial owner of the customer, and the results of any analysis undertaken (s. 20(1)(b) Schedule 2, AMLO and para 8.3 AIs AML/CFT Guideline; para 8.3 the SFC AML/CFT Guideline; para 8.3 IA AML/CFT Guideline; para 8.3 C&D AML/CFT Guideline; and para 8.3 SVF AML/CFT Guideline). Those documents must be kept throughout the continuance of the business relationship with the customer and for a period of at least five years beginning on the date on which the business relationship ends (s. 20(3) Schedule 2 of the AMLO). Para 9.2 and 9.3 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 11.3** – Section 20(1) Schedule 2, AMLO requires FIs to keep specific types of records in relation to each transaction (i.e., the original or a copy of the documents, and a record of the data and information, obtained in connection with the transaction) which would be sufficient to permit reconstruction of the transactions. Para. 9.2 and 9.3 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 11.4** – Section 12(2), AMLO requires FIs to produce any record or document within “the time specified” by the RAs upon request from the RAs; failure to comply is an offence under s.13, AMLO. Similarly, where LEAs seek to obtain any records from FIs through a production order, FIs must comply within “the time specified” in the order; failure to comply is an offence (s.3(5), OSCO; s. 20(2), DTROP; and s.12B(2), UNATMO). Furthermore, sectoral AML/CFT Guidelines (para 8.2) require FIs to ensure that the information is made available “swiftly” to the competent authorities (AIs AML/CFT Guideline: para 8.2; THE SFC AML/CFT Guideline: para 8.2; IA AML/CFT Guideline: para 8.2; C&ED AML/CFT Guideline: para 8.2; and SVF AML/CFT Guideline: para 8.2. Para 9.2(c) of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

### *Weighting and Conclusion*

There remain minor shortcomings with respect to some stand-alone financial leasing and non-bank credit card companies that are out of the scope of the requirements and with respect to the fact that the record keeping principle for moneylenders is not set out in a law.

**Recommendation 11 is rated largely compliant.**

### **Recommendation 12 – Politically exposed persons**

In its 3rd MER, HKC was rated partially compliant with former R.6, which contained the previous requirements in this area. The main deficiencies were that the banking and insurance guidelines did not specify explicitly that senior management approval was required to continue a business relationship with a PEP, there were no enforceable provisions regarding the identification and verification of PEPs for remittance agents and money changers and that no formal assessment had been undertaken to justify the exclusion of moneylenders, credit unions, the post office and financial leasing companies from CDD requirements. Since then, HKC has addressed some deficiencies. However, it did not conduct a risk assessment to justify the exemption of the stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) from the AML/CFT framework and this constitute a minor deficiency in most of the criteria in R.12.

**Criterion 12.1** – The foreign PEP regime provided for in the AMLO covers individuals who are or have been entrusted with a prominent public function in a place outside the PRC. This includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official. It also includes family members and close associates.

With respect to foreign PEPs, FIs are required to:

- a) establish and maintain effective procedures for determining whether a customer or a beneficial owner is a PEP (s. 19(1) Schedule 2, AMLO);
- b) obtain senior management approval before entering (or continuing, for existing customers) such business relationships (s. 10(1)(a) and 10(2)(a), Schedule 2, AMLO);
- c) take appropriate measures to establish the source of wealth and the source of funds that will be involved in the proposed or are involved in the business relationship of customer or beneficial owners identified as PEP's (s. 10(1)(b) and 10(2)(b), Schedule 2, AMLO);
- d) must, in monitoring the business relationship with the customer, take additional measures to compensate for any risk of ML or TF that may have caused by the fact that the customer or the beneficial owner is a PEP (s. 5(3), Schedule 2, AMLO).

Schedule 2 to the AMLO defines a PEP as an individual who is or has been entrusted with a prominent public function in a place outside the PRC (s. 1(1)). The application of the aforementioned enhanced due diligence requirements does not apply to “foreign PEPs” from the rest of China (e.g. from Mainland China and Macao, China). This is a significant shortcoming.

Paragraphs 5.29 to 5.36 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders with the same shortcomings.

**Criterion 12.2** – Sectoral AML/CFT Guidelines include a definition of domestic PEP and international organisation PEP, and provide for requirements for FIs to take reasonable measures to determine whether a customer or a beneficial owner of a customer is such a person and to adopt the EDD measures for foreign PEPs (c.12.1 (b) to (d)) in case there is a high risk business relationship (AIs AML/CFT Guideline: para 4.9.11-4.9.15; The SFC AML/CFT Guideline: para 4.11.18-4.11.22; the IA AML/CFT guideline: para 4.11.12-4.11.16; C&ED AML/CFT Guideline: para 4.9.11-4.9.15; and the SVF AML/CFT Guideline: para 4.8.11-4.8.15; and para 5.29 to 5.36 of the RML AML/CFT Guideline).

**Criterion 12.3** – The definitions of foreign PEP included in the AMLO (s. 1(1) Schedule 2) and the definition of domestic PEP included in sectoral AML/CFT Guidelines cover their family members and close associates. Therefore, the regime described in c. 12.1 and 12.2 applies to family members and close associates of foreign and domestic PEPs. Para 5.29 to 5.36 of the RML AML/CFT Guideline for moneylenders provides for equivalent requirements.

**Criterion 12.4** – Life insurance institutions must establish and maintain effective procedures for determining whether a customer or a beneficial owner of a customer is a PEP (s.19 (1) of Schedule 2, AMLO). IA AML/CFT Guideline (para. 4.6.5) extends this requirement to the beneficiary of a life insurance product: an insurance institution is required to take reasonable measures to determine whether a beneficiary or a beneficial

owner of a beneficiary for an insurance policy is a politically exposed person as described in para 4.11.7 (foreign PEPs), 4.11.12 (domestic PEPs) and 4.11.13 (international organisation PEPs). This should occur, at the latest, at the time of the payout. Where higher risks are identified, the II is required to:

- a) inform senior management before the payout of the policy proceeds;
- b) conduct enhanced scrutiny on the whole business relationship with the policy holder; and
- c) consider making a suspicious transaction report.

### *Weighting and Conclusion*

There are some deficiencies: HKC's framework considers PEPs from Mainland China and other parts of China as domestic PEPs, which is not in line with the requirements of R.12. This represents a moderate shortcoming in HKC's context. Furthermore, there remain shortcomings with respect to some stand-alone financial leasing and non-bank credit card companies that are out of the scope of the CDD requirements, which also have implications on the measures in relation to PEPs.

**Recommendation 12 is rated partially compliant.**

### **Recommendation 13 – Correspondent banking**

In its 3rd MER, HKC was rated compliant with former R.7, which contained the previous requirements in this area.

**Criterion 13.1** – Only authorised entities (AIs) can maintain cross-border correspondent banking relationship. Before establishing a correspondent banking relationship, AIs are required to (s. 14, Schedule 2, AMLO and para 11.6 AIs AML/CFT Guideline): (a) collect sufficient information about the proposed respondent bank to enable them to fully understand the nature of its business; determine from publicly available information the reputation of the proposed respondent bank and the quality of its supervision by competent authorities; (b) assess the AML/CFT controls of the proposed respondent bank and be satisfied that they are adequate and effective; (c) obtain approval from their senior management; and (d) document and understand the responsibilities, including AML/CFT responsibilities, of each institution involved. These requirements mirror those of R.13.

**Criterion 13.2** – With respect to payable through accounts, an AI must not establish a correspondent banking relationship unless it is satisfied that (s. 14, Schedule 2, AMLO): (a) in respect of the respondent bank's customers who will be able to directly operate the accounts, the respondent institution will verify the identities of those customers, and will continuously monitor its business relationships with those customers; and (b) the respondent institution will be able to provide, on request, the documents, data or information in relation to those customers in accordance with requirements similar to those imposed under Schedule 2 to the AMLO (s. 14(2)(d) Schedule 2, AMLO). These requirements mirror those of R.13.

**Criterion 13.3** – Section 17(1) of Schedule 2, AMLO prohibits AIs from entering into or from continuing correspondent banking relationships with shell bank. Paragraph 11.14 of AML/CFT Guideline for the banking sector requires AIs to satisfy themselves that respondent banks do not permit their accounts to be used by shell banks

## Weighting and Conclusion

**Recommendation 13 is rated compliant.**

### Recommendation 14 – Money or value transfer services

In its 3rd MER, HKC was rated partially compliant with former SR.VI, which contained the previous requirements in this area. The main deficiencies were that no system for monitoring remittance services was in place, only criminal sanctions were available and these were not effective, proportionate and dissuasive, and that general CDD deficiencies impacted the remittance sector.

**Criterion 14.1** – A natural and legal person is required to have a licence from the C&ED to operate a money service (s. 29(1), AMLO) which includes a remittance service or a money changing service. However, the definition of MSO (s. 1 Schedule 1, AMLO) is limited to sending money and receiving money to and respectively from a place outside HKC. This does not fully meet the definition of MVTs in the FATF Glossary, i.e. remittance within HKC.

**Criterion 14.2** – The AMLO contains a licensing regime for MSOs. Carrying out an unlicensed MVTs is a breach of the AMLO and makes it an offence punishable by a fine at level 6 (i.e. maximum of HKD 100 000 - approx. USD 12 750) and imprisonment for 6 months (Sec. 29(1) and (2), AMLO). If a person is convicted of an offence under section 29, AMLO, the magistrate may order that the person be disqualified from the holding of a licence (s. 29(3), AMLO).

The C&ED is empowered to appoint authorised officers for the purpose of supervising and regulating the operation of a money service (s. 46, AMLO). If there are reasonable grounds that an offence under section 29, AMLO has been committed, authorised officers, with a warrant issued by the magistrate, have the power to enter and search the premises and seize, remove or detain relevant evidence (s. 47(1), AMLO). HKC has taken actions, with a view to identifying natural or legal persons that carry out MSO activities without a license, and has imposed sanctions that range from fine to suspended sentence against these persons. However, the financial sanctions imposed by the Court are not proportionate nor dissuasive. The highest fine that has been imposed is HKD 60 000 (approx. USD 7 650) with an average fine of HKD 16 127 (approx. USD 2 060; 44 convictions in the period from 2012 to 2017).

**Criterion 14.3** – The C&ED is the authority responsible for monitoring compliance of MVTs with the AMLO AML/CFT obligations. The C&ED is empowered to enter the business premises of any MVTs to conduct onsite inspections, inspect any record or document and make inquiries of the MVTs or any other person (s. 9(1), AMLO).

**Criterion 14.4** – The AMLO provides that any person that operates money services is required to obtain a licence from the C&ED (s. 29(1) and 30(1), AMLO). No difference is made between a person who is providing money services as a principal or agent. The C&ED must maintain a register of licensees (s. 27(1), AMLO).

**Criterion 14.5** – No difference is made between a principal and agent. Consequently, agents are required to have their own AML/CFT programmes and fall directly under the supervision of the C&ED (see c.14.4).

### *Weighting and Conclusion*

There is a scope issue because “domestic remittance” is not included within the scope of the AMLO and HKC has not applied proportionate and dissuasive sanctions against MSOs that carry out activities without a licence.

**Recommendation 14 is rated largely compliant.**

### **Recommendation 15 – New technologies**

In its 3rd MER, HKC was rated largely compliant with former R.8, which contained the previous requirements in this area. The main deficiencies were that remittance agents were not required to have policies in place or take measures to prevent the misuse of technological developments in ML and TF schemes and for remittance agents and moneychangers to verify a customer’s identity or to take alternative measures when conducting non-face-to-face transactions. Since then, HKC has made some improvements but stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) are not included in the AML/CFT framework and this constitute a minor deficiency in R.15.

**Criterion 15.1** – HKC has taken steps to identify and assess the risks that may arise in relation to the development of new products and new business practices, including new delivery mechanisms, and the use of new or developing technologies for both new and pre-existing products. The HRA and other thematic risk assessments also included consideration of the risks posed by new payment methods, such as the risks posed by virtual commodities and multi-purpose SVFs<sup>63</sup>.

The relevant sectoral AML/CFT guidelines cover the aspect of risk assessment of new products and indicate that FIs should assess the risks of any new products and services before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks (AIs AML/CFT Guideline: para 2.10; the SFC AML/CFT Guideline: para 2.3, IA AML/CFT Guideline: para 2.10; C&ED AML/CFT Guideline: para 2.10; and SVF AML/CFT Guideline: para 2.10). Paragraph 4.4 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 15.2** – Sectoral AML/CFT Guidelines cover the aspect of risk assessment of new products and indicate that FIs should assess the risks of any new products, new business practices, or the use of new or developing technologies before they are introduced and ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks (AIs AML/CFT Guideline: para 2.11; the SFC AML/CFT Guideline: para 2.3; IA AML/CFT Guideline: para 2.11; C&ED AML/CFT Guideline: para 2.11; SVF AML/CFT Guideline: para 2.11 and RML Guideline: para 4.4).

<sup>63</sup> Multi-purpose SVFs can be used as a means of payment for goods or services provided by the issuer or third-party participating merchants at designated locations and points, or for person-to-person payments. Single-purpose SVFs are a means of payment for goods or services provided by the issuer of the SVF only.

### Weighting and Conclusion

There are minor deficiencies as some stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements.

**Recommendation 15 is rated largely compliant.**

### Recommendation 16 – Wire transfers

In its 3rd MER, HKC was rated partially compliant with former SR.VII, which contained the previous requirements in this area. The main deficiencies were that there were no requirements for remittance agents to transmit full originator information, there was no mechanism for monitoring compliance by remittance agents and that, for remittance of HKD 8 000 or more ordered by non-account holders, there was no requirements to verify the customer's identity when they don't appear in person.

#### Ordering financial institutions

**Criterion 16.1** – FIs, that are ordering institutions, are required to ensure that all cross-border wire transfers equal or above HKD 8 000 (approx. USD 1 000) or more are accompanied by the required originator and beneficiary information (s. 12(5)(a) Schedule 2, AMLO). This information must include all the elements listed in required by this criterion (AIs AML/CFT Guideline: para 10.5; the SVF AML/CFT Guideline: para 10.5; the C&ED AML/CFT Guideline: para 10.5) .As part of CDD, FIs are required to verify the accuracy of the customer (originator) information (s. 3(1)(a) and (c) Schedule 2, AMLO) and this requirement is further detailed in sectoral Guidelines (AIs AML/CFT Guideline: para 10.8; C&ED AML/CFT Guideline: para 10.8; and ; SVF AML/CFT Guideline: para 10.8).

**Criterion 16.2** – The requirements regarding batch files are consistent with the FATF requirements regarding originator and beneficiary information (s. 12(7) Schedule 2, AMLO).

**Criterion 16.3** – Transfers of below HKD 8 000 (approx. USD 1 000) are required to be accompanied by the required originator and beneficiary information (s.12(5)(b) Schedule 2, AMLO).

**Criterion 16.4** – In cases where there is suspicion of ML/TF, verification of the customer (originator) information by FIs is required as part of CDD (s.3(1)(d) Schedule 2, AMLO). In addition, FIs acting as an ordering institution are required to verify the identity of the originator, *inter alia*, when there is a suspicion of ML/TF (AIs AML/CFT Guideline: para. 10.9; SVF licensee AML/CFT Guideline: para. 10.9; and C&ED AML/CFT Guideline: para 10.9).

**Criterion 16.5 and 16.6** – Transfers within HKC are considered to be domestic transfers<sup>64</sup> for the purposes of R.16. Domestic transfers may be accompanied only by the account number (or unique identifier) of the originator. The FI must be able to provide complete information on the originator, if requested by the FI to which it passes on the transfer instruction or the relevant authority, within three working days which is consistent with the second part of c.16.5 and c.16.6 (s. 12(6) Schedule 2, AMLO). Such record must be produced

<sup>64</sup> Means a wire transfer in which the ordering institution and the beneficiary institution and, if one or more intermediary institutions are involved in the transfer, the intermediary institution or all the intermediary institutions are financial institutions located in HKC (s.12(11) Schedule 2, AMLO).

to LEAs within the “time specified” by the Court pursuant to the OSCO, the DTROP, or the UNATMO. Sectoral AML/CFT Guidelines require that such information be made available to LEAs immediately upon request (AIs AML/CFT Guideline and SVF AML/CFT Guideline: para 10.12; and the C&ED AML/CFT Guideline: para 10.12).

**Criterion 16.7** – For FIs there is the general obligation to keep the original or a copy of the documents, and a record of the data and information obtained in connection with the transaction (which include wire transfers) for five years beginning on the date on which the transaction is completed (s. 20(1)(a) and (2) Schedule 2, AMLO). This includes originator and beneficiary information (please see c.16.1).

**Criterion 16.8** – There is no explicit prohibition on executing wire transfers if c. 16.1 to 16.7 cannot be met. However, if an FI does not comply with the relevant legal requirements set out in line with the criteria, it will act in violation of the AMLO that can result in criminal sanctions (s. 5, AMLO) or disciplinary action (s. 21, AMLO).

#### ***Intermediary financial institutions***

**Criterion 16.9** – If an FI acts as an intermediary institution in a wire transfer, it must transmit all of the information that it receives with the transfer (s. 12(8) Schedule 2, AMLO). This includes the originator and beneficiary information required by section 12(3) Schedule 1, AMLO.

**Criterion 16.10** – Sectoral AML/CFT Guidelines require that, where technical limitations prevent the required originator or recipient information accompanying a cross-border wire transfer from remaining with a related domestic wire transfer, the intermediary institution should keep a record, for at least five years, of all the information received from the ordering institution or another intermediary institution (AIs, SVF and C&ED AML/CFT Guidelines: para 10.14). This also applies to a situation where technical limitations prevent the required originator or recipient information accompanying a domestic wire transfer from remaining with a related cross-border wire transfer.

**Criterion 16.11** – An FI that carries out wire transfers, including intermediary institutions, must establish and maintain “effective procedures” for identifying wire transfers that lack required originator or required beneficiary information (s. 19(2) of Schedule 2 of the AMLO). The requirement to take “reasonable measures”, as required by c.16.11, is further detailed in the sectoral AML/CFT guidelines (AIs, SVF and C&ED AML/CFT Guidelines: para 10.15).

**Criterion 16.12** – An FI that carries out wire transfers, including intermediary institutions, must establish and maintain “effective procedures” handling wire transfers that lack required originator or required beneficiary information (s.19(2) Schedule 2, AMLO). Sectoral AML/CFT Guidelines require these procedures to be risk-based. that FIs determine when to reject or suspend an incoming wire transfer for lack of information, and when to take the appropriate follow-up action (AIs, SVF and C&ED AML/CFT Guidelines: para 10.15).

#### ***Beneficiary financial institutions***

**Criterion 16.13** – An FI that carries out wire transfers, including beneficiary institutions, must establish and maintain “effective procedures” for identifying and handling wire transfers that lack required originator or required beneficiary information (s. 19(2) of Schedule 2 of the AMLO). The requirement to take “reasonable measures”, as required by c.16.13, is introduced in sectoral AML/CFT Guidelines (AIs, SVF and C&ED AML/CFT Guidelines: para 10.18)

**Criterion 16.14** – FIs are required to conduct CDD measures, including the verification of the identity of the customer, before an occasional transaction that is a wire transfer of an amount equal or above HKD 8 000 (approx. USD 1 000) is carried out for the customer (s. 3(1)(c) Schedule 2, AMLO). When the beneficiary of the transfer is already a customer of the FI, his identity was verified at the beginning of the business relationship (s. 3(1)(a) Schedule 2, AMLO). The record keeping requirements relating to CDD requirements also apply.

**Criterion 16.15** – An FI that carries out wire transfers, including beneficiary institutions, must establish and maintain “effective procedures” for identifying and handling wire transfers that lack required originator or required beneficiary information. Sectoral AML/CFT Guidelines require that these measures should be risk-based. They also require FIs to determine when to reject or suspend an incoming wire transfer for lack of information, and when to take the appropriate follow-up action. (AIs, SVF and C&ED AML/CFT Guidelines: para 10.18).

#### ***Money or value transfer service operators***

**Criterion 16.16** – The AMLO and the C&ED AML/CFT Guideline applies to MVTS. As mentioned in c.14.4, pursuant to the AMLO both the principal and agent require a licence to operate a money service. Section 22(1) and (2), Schedule 2, AMLO requires FIs, including MVTS, to comply with the requirements of Recommendation 16. Nevertheless, these requirements do not apply to the foreign agents of a MVTS, as required by c.16.16.

**Criterion 16.17** – An MVTS provider in HKC is required to report an STR where it suspects that a transaction is associated with proceeds of crime or terrorist property (s. 25A(1), DTRDP & OSCO; s. 12(1), UNATMO), together with any matter on which the knowledge or suspicion is based. When an MVTS provider controls both the ordering and beneficiary side of a wire transfer, there are no specific requirements relating to measures to be taken. Nevertheless, the OSCO, the DTRDP and the UNATMO require the STR to contain “any matter” on which the knowledge or suspicion is based. Where a MVTS holds information concerning both the originator and the beneficiary, it should take all of this information into account as part. Where an FI in HKC had information regarding ML, irrespective of location, it should consider seeking clarification with making a report to the JFIU in HKC (s. 25(4)) but not in any other country affected.

#### ***Implementation of Targeted Financial Sanctions***

**Criterion 16.18** – HKC ensures that FIs, when processing wire transfers, take freezing action as required by the targeted financial sanctions for terrorism and TF. The freezing obligations are implemented under sections 8 and 8A of the UNATMO, which prohibits making property available to or dealing with property of a terrorist or terrorist associate (i.e. a person or entity) designated under the sanction regimes, and section 6 of the UNATMO which empowers the S for S to issue a freezing notice to persons in respect of identified property held by the person in HKC. The obligations apply to all natural and legal persons.

### ***Weighting and Conclusion***

There is no requirement for the foreign agents of a MVTS to comply with all the relevant requirement of this recommendation. There is also no requirement for a MVTS provider that controls both the ordering and the beneficiary side of a wire transfer to file an STR in a foreign country affected by the suspicious wire transfer.

**Recommendation 16 is rated largely compliant.**

## Recommendation 17 – Reliance on third parties

In its 3rd MER, HKC was rated partially compliant with former R.9, which contained the previous requirements in this area. In the 4<sup>th</sup> follow-up report (2012), HKC was rated largely compliant. The main deficiencies were that, in the banking and securities sectors, reliance could be placed on introducers that were not regulated for AML/CFT, the FIs could rely on intermediaries incorporated in equivalent jurisdictions but the list of equivalent jurisdictions was not derived from an objective assessment, and that moneylenders, credit unions, the post office and financial leasing companies were excluded from the preventative measures. Since then, the FATF Recommendations have been strengthened to impose more detailed requirements. Nevertheless, HKC has still not included stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) in its AML/CFT framework and this constitute a minor deficiency in all of the criteria in R.17.

**Criterion 17.1** – FIs are allowed to rely on third parties to conduct CDD measures (s. 18(1) Schedule 2, AMLO). FIs that rely on a third party remain liable under the AMLO for a failure to carry out that CDD measure (s. 18(2) Schedule 2, AMLO). FIs must:

- obtain, immediately after the intermediary has carried out the CDD measures, the data or information that the intermediary has obtained (s. 18(4)(a) Schedule 2, AMLO);
- The FI must ensure that the intermediary will, if requested, provide a copy of any document, or a record of any data or information, obtained in the course of carrying out that measure “without delay” (s. 18(1) Schedule 2, AMLO); and
- FIs may rely only on certain categories of third party as permitted in s.18(3) Schedule 2, AMLO, which are subject to AML/CFT regulation and supervision, but needs to satisfy itself that the third party has adequate procedure in place for compliance with CDD and record-keeping requirements (Para 4.11.8 AIs AML/CFT Guideline; para 4.15.8 the SFC AML/CFT Guideline; Para 4.13.9 IAs AML/CFT Guideline; 4.11.8 C&ED AML/CFT Guideline; and Para 4.10.8 SVF licensees AML/CFT Guideline).

Paras 5.45 to 5.51 of the RML AML/CFT Guideline for moneylenders provides for similar requirements.

**Criterion 17.2** – Reliance is only permitted on entities from equivalent jurisdictions “Equivalent jurisdiction” is defined as (a) a jurisdiction that is a member of FATF, other than HKC; or (b) a jurisdiction that imposes similar CDD and record-keeping requirements (s.1, Schedule 2, AMLO). The sectoral AML/CFT Guidelines provide for further guidance on jurisdictional equivalence (AIs AML/CFT Guideline: para. 4.16; the SFC AML/CFT Guideline: para. 4.19; IA AML/CFT Guideline: para. 4.18; C&ED AML/CFT Guideline: para. 4.16; and SVF AML/CFT Guideline: para. 4.14). Para 5.45 to 5.51 of the RML AML/CFT Guideline for moneylenders provide for similar requirements.

**Criterion 17.3** – FIs are allowed to rely on a third-party FI that is part of the same financial group as an intermediary, provided that: (a) the related foreign FI is required under group policy to have measures in place to ensure compliance with similar CDD and record-keeping requirements and to implement programmes against ML/TF (Sec. 18(3A)(a) Schedule 2, AMLO); (b) the related foreign FI is supervised for compliance with the CDD and record-

keeping requirements at a group level by a competent authority; and any higher country risk is adequately mitigated by the AML/CFT policies (s. 18(3A)(b), Schedule 2, AMLO and para 4.10.13 AIs AML/CFT Guideline; para 4.15.13 the SFC AML/CFT Guideline; para 4.13.14 IAs AML/CFT Guideline; para 4.11.13 C&ED AML/CFT; and para 4.11.13 SVF AML/CFT Guideline). Moneylenders who rely on third-party FI that is part of the same financial group are subject to the same requirements under para 5.45 to 5.51 of the RML AML/CFT Guideline.

### *Weighting and Conclusion*

There are minor deficiencies as some stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements.

**Recommendation 17 is rated largely compliant.**

### **Recommendation 18 – Internal controls and foreign branches and subsidiaries**

In its 3rd MER, HKC was rated largely compliant with former R. 15 and R.22, which contained the previous requirements in this area.

HKC did not conduct a risk assessment to justify the exemption of the stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) from the AML/CFT framework and this constitute a minor deficiency in all of the criteria in R.18.

**Criterion 18.1** – The AMLO contains the requirement for FIs to take all reasonable measures to ensure that proper safeguards exist to prevent a contravention under part 2 (CDD requirements) or part 3 (record-keeping requirements) of Schedule 2, AMLO; and to mitigate ML/TF risks (s. 23 Schedule 2, AMLO).

To ensure compliance with these requirements, FIs pursuant to the sectoral AML/CFT Guidelines should implement appropriate internal AML/CFT policies, procedures and controls (AIs AML/CFT Guideline: para 3.4; THE SFC AML/CFT Guideline: para 2.9; IA AML/CFT Guideline: para 3.4; C&ED AML/CFT Guideline: para 3.4; and SVF AML/CFT Guideline: para 3.4)). FIs should take into account the following risk factors: product/service risk, delivery/distribution channel risk, customer risk and country risk FIs are required to ensure proper implementation of the aforementioned policies and procedures, to have effective controls covering: (a) senior management oversight, and appointment of a Compliance Officer and a Money Laundering Reporting Officer; (b)(c) staff screening and training; and (d) compliance and audit function. Paras. 3.3, 3.4, 3.8 and 10.1-10.6 of the RML AML/CFT Guideline for moneylenders provide for similar requirements in relation to compliance management arrangements, screening procedures when hiring employees and ongoing employee training programmes, but the RML AML/CFT Guideline for moneylenders does not contain specific provisions in relation to the independent audit function.

**Criterion 18.2** – An FI incorporated in HKC must ensure that: (a) its branches; and (b) its subsidiary undertakings that carry on the same business as an FI in a place outside HKC, have procedures in place to ensure compliance with, to the extent permitted by the law of that place, requirements similar to those imposed under Parts 2 (CDD requirements) and 3 (Record-Keeping requirements) of Schedule 2, AMLO that are applicable to the FI (s. 22(1) Schedule 2, AMLO).

Other elements regarding the sharing of information (c.18.2(a), (b) and (c)) are specifically set out under the sectoral AML/CFT Guidelines, subject to adequate safeguards on the protection of confidentiality and use of information being shared (AIs AML/CFT Guideline: para 3.17; the SFC AML/CFT Guideline: para 2.21; IA AML/CFT Guideline: para 3.17; C&ED AML/CFT Guideline: para 3.17; and SVF AML/CFT Guideline: para 3.17). This includes the sharing of information required for the purposes of CDD and ML/TF risk management; and the provision to the FI's group-level compliance, audit and/or AML/CFT functions, of customer, account, and transaction information from its overseas branches and subsidiary undertakings that carry on the same business as an FI as defined in the AMLO, when necessary for AML/CFT purposes. Equivalent requirements apply to moneylenders (RML AML/CFT Guideline: para. 3.7)

**Criterion 18.3** – In addition to what is already mentioned in c.18.2, FIs are required in the event the law of the place at which a branch or subsidiary undertaking of an FI carries on business does not permit the application of any procedures relating to any of the CDD and record-keeping requirements imposed under the AMLO to: (a) inform the relevant authority accordingly; and (b) take additional measures to effectively mitigate the risk of ML and TF faced by the branch or subsidiary undertaking as a result of its inability to comply with the requirement (s. 22(2) Schedule 2, AMLO). Moneylenders are subject to equivalent requirements (Para 3.7 of the RML AML/CFT Guideline)

### *Weighting and Conclusion*

There are minor deficiencies as some stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements. Furthermore, there are no specific provisions for moneylenders in relation to the independent audit function.

**Recommendation 18 is rated largely compliant.**

### **Recommendation 19 – Higher-risk countries**

In its 3rd MER, HKC was rated largely compliant with former R.21, which contained the previous requirements in this area. Stand-alone financial leasing companies and the credit card/charge card companies (operating independently from banks) are exempted from the preventive measures requirements from the AML/CFT framework and this constitute a minor deficiency in all of the criteria in R.19.

**Criterion 19.1** – FIs are required to perform enhanced CDD in a situation specified by the relevant authority in a notice in writing given to the FI and in any other situation that by its nature may present a high ML/TF risk (s.15 Schedule 2, AMLO). In addition to the requirements for FIs to EDD in a “situation that by its nature may present a high ML/TF risk”, the AML/CFT Guidelines specifically require FI to apply enhanced CDD, proportionate to the risks, to relationships and transactions from countries for which is called for by the FATF (AIs AML/CFT Guideline, 4.15.1; The SFC AML/CFT Guideline: para 4.14.1; IA AML/CFT Guideline: para 4.17.1; C&ED AML/CFT Guideline: para 4.15.1; and SVF AML/CFT Guideline; para 4.13.1). Para 5.44 of the RML AML/CFT Guideline provides for equivalent requirements for moneylenders.

**Criterion 19.2** – RAs have the power to notify FIs in writing to require them to apply countermeasures proportionate to the risks when called upon to do so by the FATF and independently (AIs AML/CFT Guideline: 4.15.2; The SFC AML/CFT Guideline: para 4.14.2; IA AML/CFT Guideline: para 4.17.2; C&ED AML/CFT Guideline: para 4.15.2; and SVF

AML/CFT Guideline: para 4.13.2). Para. 5.44 of the RML AML/CFT Guideline provides for similar requirements for moneylenders.

**Criterion 19.3 –**

RAs have the power to notify FIs in writing to require them to perform EDD measures thereunder or in any other situation that by its nature may present a higher ML/TF risk. The HKMA, the RML and the C&ED publish FATF’s public statements on their website, and the SFC’s and IA’s circulars on FATF’s public statements are also available on their website.

**Weighting and Conclusion**

There are minor deficiencies as some stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements.

**Recommendation 19 is rated largely compliant**

**Recommendation 20 – Reporting of Suspicious Transactions**

In its 3<sup>rd</sup> MER, HKC was rated LC with these requirements. The technical deficiencies identified were that the requirement to file suspicious transaction reports (STRs) did not extend to funds that were suspected to be linked to or related to terrorist organisations or individual terrorists in the absence of a link to a terrorist act and minor deficiencies in HKC’s list of predicate offences regarding environmental crime.

**Criterion 20.1 –** Any FI which knows or suspects any property in whole or in part directly or indirectly represents proceeds of drug trafficking or indictable offences or is terrorist property, is legally obliged to report the knowledge or suspicion to an authorised officer, or any other person authorised under writing by the Secretary for Justice (OSCO & DTROP, s.25A (1); UNATMO, s.12 (1).) In practice, this legal requirement is fulfilled by way of filing an STR to the Joint Financial Intelligence Unit (JFIU) of HKC.

Terrorist property, as defined under section 2 of the UNATMO, includes the property of a terrorist or terrorist associate as well as any property that is intended to be / was used to finance / assist a terrorist act.

FIs are required to file the disclosure of knowledge or suspicion “as soon as it is reasonable” (OSCO & DTROP, s. 25(A)(1)); or “as soon as is practicable” (UNATMO, s.12(1).) Assessors were satisfied that this meets the requirement for FIs to file promptly. There are minor deficiencies in relation to coverage of some designated categories of offences that would have an indirect impact on R. 20 (see R.3.)

**Criterion 20.2–** The reporting requirement applies regardless of the amount of the transaction as it is solely hinged on knowledge or suspicion and without regard to whether any transaction has actually taken place. The relevant offences are broad enough to cover attempted transactions. (OSCO & DTROP; s. 25A(1); UNATMO; s.12(1).)

**Weighting and Conclusion**

FIs have a legal obligation to file an STR if they know or suspect property to be proceeds of drug trafficking or indictable offences or is terrorist property. There are

minor deficiencies in relation to coverage of some designated categories of offences that would have an indirect impact on R. 20 (see R.3.)

**Recommendation 20 is rated largely compliant.**

### Recommendation 21 – Tipping-Off and Confidentiality

In its 3rd MER, HKC was rated largely compliant with these requirements. The main deficiency identified was that the prohibition against tipping-off did not apply in all cases where a suspicious transaction report was being considered but has not yet been filed to the JFIU.

**Criterion 21.1** – FIs and their staff members are immune from both criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision as long as they report STRs to the JFIU based on genuine suspicion and knowledge (OSCO & DTROP s.25A(3); UNATMO; s. 12(3).) The aforementioned protection does not require that the reporting entity has knowledge of what the underlying criminal activity was, nor that illegal activity actually occurred (OSCO & DTROP, s. 25A (4); UNATMO, s. 12(4).)

**Criterion 21.2** – A person commits an offence if, knowing or suspecting an STR has been filed, he discloses to any other person any matter which is likely to prejudice any investigation which might be conducted following the disclosure (s. 25A(5) of the DTROP and OSCO & s. 12(5) of the UNATMO). It is a defence under section 25A(6) to prove that the individual did not know or suspect that the disclosure concerned was likely to be prejudicial to an investigation.

Sections 25A(5) of the OSCO and the DTROP and section 12(5) of the UNATMO stipulates that the tipping-off offence covers both STRs made to the JFIU and STRs made internally to a compliance officer within the institution concerned.

### Weighting and Conclusion

**Recommendation 21 is rated compliant.**

### Recommendation 22 – DNFBPs: Customer due diligence

In its 3rd MER, HKC was rated non-compliant with these requirements. The main deficiency was that no relevant CDD or other obligations had been imposed on any of the DNFBP sectors with very limited exceptions. Since then, HKC has amended the AMLO and extended the statutory AML/CFT requirements to most of DNFBPs.

DPMS are not subject to the AMLO, although not being assessed as proven low risk by HKC to justify the exemption. This shortcoming affects compliance throughout c.22.1-5.

**Criterion 22.1** –

(a) There are no licenced casinos in HKC (including ship-based or internet-based casinos). See c.28.1 regarding ship-based casinos and internet-based casinos.

(b, d, e) Estate agents, legal professionals, accounting professionals and TCSPs are required to comply with the customer due diligence requirements set out in the AMLO in the situations specified in c.22.1(b), (d) or (e) respectively (s.5A, Part 2 of Schedule 2 to the AMLO). Notaries Public do not engage in any of the activities defined in c.22.1(d).

(c) DPMS are not subject to the AMLO.

**Criterion 22.2** – Estate agents, legal professionals, accounting professionals and TCSPs are required to comply with the record-keeping requirements set out in the AMLO (s.5A, Schedule 2 to the AMLO).

**Criterion 22.3** – Estate agents, legal professionals, accounting professionals and TCSPs are required to comply with the PEPs requirements set out in the AMLO (s.5A of the AMLO; s.10 of Schedule 2 to the AMLO).

The shortcoming in the application of EDD to foreign PEPs identified in c.12.1 applies. The requirements on a domestic PEP are set out in sector-specific AML/CFT guidelines, except for estate agents, which are issued under sec.7 of the AMLO. These are the Practice Direction P (PDP), the Guidelines on AML/CFT for Professional Accountants (The AML/CFT Guidelines for PAs) and the Guidelines on Compliance of AML/CFT Requirements for TCSPs (The AML/CFT Guidelines for TCSPs) which were issued by the LSHK, the HKICPA and the CR respectively (para.107 of the PDP; para.620.12.14-18 of the AML/CFT Guidelines for PAs; para.5.31, 5.33 and 5.35 of the AML/CFT Guidelines for TCSPs).

**Criterion 22.4** – The AMLO requires DNFBPs to take measures to prevent a contravention of CDD and record-keeping requirements, and most sector-specific guidelines also have general provisions to assess the risks in relation to customers. DNFBPs are required to take appropriate risk mitigating measures accordingly (s.23 of Schedule 2 to the AMLO, para.3.5-7 of the AML/CFT Guidelines for EAs; para.610.2 of the AML/CFT Guidelines for PAs; ch.4 of the AML/CFT Guidelines for TCSPs). However, there is no specific provision that requires DNFBPs to identify and assess the risks specifically in relation to the development of new products and new business practices and the use of new or developing technologies prior to launch or use of such products, practices and services. Meanwhile, any new service to be provided by legal professionals must be approved by the LSHK that takes into account the related ML/TF risks.

**Criterion 22.5** – Estate agents, legal professionals, accounting professionals and TCSPs are required by the AMLO to comply with the requirements corresponding to R.17 in case relying on a specified intermediary which is essentially a regulated FI or DNFBP including an intermediary located in an equivalent jurisdiction as prescribed in the AMLO to carry out CDD measures (s.18 of Schedule 2 to the AMLO).

### **Weighting and Conclusion**

There are moderate gaps in compliance with the requirements of R.12 and 15. The scope limitation in relation to DPMS also applies.

**Recommendation 22 is rated partially compliant.**

### **Recommendation 23 – DNFBPs: Other measures**

In its 3rd MER, HKC was rated non-compliant with these requirements. The main deficiencies were that scope limitations of predicate and TF offences for STR; the tipping-off prohibition does not apply when an STR is in the process of being submitted; and DNFBPs were not required to have internal control and pay special attention to transactions with high risk countries. Since then, HKC has amended Ordinances and extended the statutory AML/CFT requirements to most of DNFBPs.

DPMS are not subject to the AMLO although submitting of STRs is a universal obligation in HKC. This shortcoming affects c.23.2-3.

**Criterion 23.1** – The requirements to report suspicious transactions apply universally to all persons in HKC. There is neither threshold nor exemption for attempted transactions (s.25A(1), (4) of the DTROP; s.25A(1), (4) of the OSCO; s.12(1), (4) of the UNATMO). However, the minor shortcoming identified in R.20 applies.

**Criterion 23.2** – The AMLO contains the requirement for DNFBPs to take all reasonable measures to: ensure that proper safeguards exist to prevent a contravention under part 2 (CDD requirements) or part 3 (record-keeping requirements) of Schedule 2, the AMLO; and to mitigate ML/TF risks. To ensure compliance with these requirements, the sector-specific AML/CFT Guidelines require DNFBPs to implement appropriate internal controls requirements corresponding to c.18.1 and 18.3, with some exceptions for legal professionals related to c.18.1(a), (d) and for TCSPs related to c.18.1 (b), (d) (s.22(2A)-(2B) and 23 of Schedule 2 to the AMLO; para. 2.3-5, 2.11-14 and 9.2 of the AML/CFT Guidelines for EAs; sec.53 of the LPO; para.7, 27-28 of the PDP; para. 610.3.1-2, 610.3.6-8, 670.1.1, 670.1.3-4 of the AML/CFT Guideline for PAs; para.3.3-5, 10.1 of the AML/CFT Guidelines for TCSPs). The AMLO also requires DNFBPs to have procedures in place to ensure compliance of branches and subsidiary outside of HKC (see c.18.2, s.22(2A)-(2B) of Schedule 2 to the AMLO), but there is no requirement regarding c.18.2 (a)-(c) in the Guidelines. The requirements regarding c.18.2-3 do not apply to legal or accounting professionals as they are prohibited from setting up a separate business and having subsidiaries.

**Criterion 23.3** – Estate agents, legal professionals, accounting professionals and TCSPs are required to apply enhanced due diligence measures in high risk situations specified in a notice by respective SRBs and other DNFBP supervisors (i.e. they are empowered to issue such a notice), or in any other situation that by its nature may present a high risk, such as measures to establish the source of wealth and funds of the customer or beneficial owner (s.5A of the AMLO; s.15 of Schedule 2 to the AMLO). The EAA and the CR are empowered to issue a notice to require estate agents and TCSPs to apply countermeasures when called upon to do so by the FATF and independently while the LSHK and the HKICPA are not empowered. However, the notice itself does not specify concrete countermeasures to be applied (para.4.39 of the AML/CFT Guidelines for EAs; para.5.45 of the AML/CFT Guidelines for TCSPs).

**Criterion 23.4** – All persons who report suspicious transactions including internal reporting from an employee to the appropriate person in accordance with an internal procedures are legally protected in line with R.21 (s.25A(3) of the DTROP; s.25A(3) of the OSCO; s.12(3) of the UNATMO), and are prohibited from disclosing to any other person any matter which is likely to prejudice any investigation following aforementioned report (s.25A(5) of the DTROP; s.25A(5) of the OSCO; s.12(5) of the UNATMO).

### *Weighting and Conclusion*

There are minor gaps in compliance with the requirements of R.18, 19 and 20. The scope limitation in relation to DPMS also applies.

**Recommendation 23 is rated largely compliant.**

## Recommendation 24 – Transparency and beneficial ownership of legal persons

In its 3rd MER, HKC was rated partially compliant with these requirements. The main deficiencies were that: (i) measures are not adequate to ensure that there is sufficient accurate and timely information held on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities; (ii) information on the companies register pertains only to legal ownership and is not necessarily reliable; (iii) corporate and nominee directors are permitted; and (iv) there are limited measures in place to ensure that share warrants to bearer may be issued. Since then, additional measures, e.g. requiring companies to identify persons who have significant control over the company, have been taken by the authority and are discussed below.

**Criterion 24.1** – The main types of legal persons in HKC consist of local companies and foreign companies, and include: (i) a public company limited by shares; (ii) a private company limited by shares; (iii) a public unlimited company with a share capital; (iv) a private unlimited company with a share capital; and (v) a company limited by a guarantee without a share capital (section 66 CO). Other forms of legal entities (which would be considered legal persons in the FATF context) also exist in HKC, e.g. partnership (including limited liability partnership (LLP), which is only available for law firms in HKC), sole proprietorships, co-operative societies registered under the Co-operative Societies Ordinance and OFC under the SFO.

Information on the registration of legal persons is all publicly available on various government's department website. The process for obtaining and recording basic and beneficial ownership information of the above is also publicly available.

**Criterion 24.2** – The HRA noted that HKC is known for its low taxes and efficient company formation procedures and noted that a main concern is the misuse of front companies for transferring crime proceeds from one country to another, under the disguise of payments resulting from legitimate business activities such as imports and exports. The report also concludes that the risk of companies being abused for ML purposes is high, while the risk of them being abused for TF is low.

HKC considers that the risk for legal persons rests mainly with companies, but has not fully assessed the risks posed by other forms of legal persons, as the authorities consider that the possibility of these legal entities being abused for ML/TF is remote and does not warrant specific coverage<sup>65</sup>.

**Criterion 24.3** – Section 27 of the CO requires the CR to keep records of companies – this would include information contained in every document that is delivered to the Registrar of Companies (the Registrar) for registration and that the Registrar decides

<sup>65</sup> OFCs come under the securities sector and there are AML/CFT obligations imposed on its investment managers and intermediaries involved in sale of OFC shares. The various other types of legal persons were typically set up for limited and specific purposes, and not considered to be conducting business in the usual sense. Their funds must be spent on the specific causes and membership is restrictive. Their board must be elected in accordance with the relevant Ordinances.

to register; and information contained in every certificate that is issued by the Registrar under the CO. The public can obtain timely company information through the CR's Cyber Search Centre<sup>66</sup> and the Company Search Mobile Service<sup>67</sup>. Basic company information including the company number, company name, company type, date of incorporation, active status and the name history etc. are provided free of charge. Other particulars of the company including registered office address, particulars of current director(s) and reserve director(s) (if any), particulars of company secretary, particulars of liquidator(s), receiver(s), and manager(s) (if any), share capital structure, address of principal place of business and particulars of authorised representatives (for registered non-HKC companies), and image records of registered documents (including articles of association, annual return of a company containing shareholders information (list of members), etc.) can be obtained by the public for a fee.

Companies are also required to maintain the registers of members (s. 627), directors (s. 641), and Company Secretaries (s. 648), and have to make available for inspection by the public for a small fee (ss. 631, 642, 649).

The SFC is the principal regulator of OFC and is responsible for the registration and regulation of OFCs, i.e. OFCs will be formed by registering with the SFC and obtaining a certificate of incorporation issued by the Registrar of Companies (ss. 112C and 112D SFO). The CR will oversee the incorporation and statutory corporate filings of OFCs, and information with the CR, e.g. date of incorporation and directors can be searched and accessed by the public.

A co-operative society is established under the Co-operative Societies Ordinance (CSO) and is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. It is "another means for forming a legal entity to conduct business besides forming a company". The register of a co-operative society<sup>68</sup> would also have to be made available for inspection by a member of the public (Rule 5, Co-operative Societies Rules (CSR)) and the register of members would include information on the names, address, occupation of each member and statement of shares, if any (Rule 10, CSR). Other legal entities and businesses (which may have no separate legal personality but are still legal persons as defined by the FATF) could also be formed in HKC. For instance, partnerships (defined as the "relationship which subsists between persons carrying on a business in common with a view of profit") comes under the Partnership Ordinance, and are registered under the Business Registration Office of the IRD<sup>69</sup>. LLP is a form of general partnership (see s.7AB of the LPO) and can only be established under the Legal Practitioners

<sup>66</sup> [www.icris.cr.gov.hk](http://www.icris.cr.gov.hk)

<sup>67</sup> [www.mobile-cr.gov.hk](http://www.mobile-cr.gov.hk)

<sup>68</sup> A co-operative society needs to have at least 10 members and a committee of 5 unpaid members. In order to be qualified for membership of a co-operative society a person must be resident within or in occupation of land within the society's area of operations (section 21 CSO).

<sup>69</sup> See [www.gov.hk/br](http://www.gov.hk/br) for more information.

Ordinance. Partnerships need to submit Form 1(c) for the registration of a business, and this would include details on: (i) name of the business; (ii) its address; (iii) business activities; (iv) names, address and ID numbers of all its partners – a copy of the partners identity card must also be provided, and the information can be available upon application and payment of a fee<sup>70</sup>.

**Criterion 24.4** - As noted, companies must provide the CR with the information listed in c. 24.3 above (see also s. 662 CO which requires companies to file an annual return), and are required to maintain the registers of members (s. 627 CO), directors (s. 641, CO), and company secretaries (s. 648 CO). Section 627 CO requires the company to enter in the register of members the names and addresses of its members, the date on which each person is entered in the register as a member, the date on which any person ceases to be a member, the shares held by each member; and the amount paid or agreed to be considered as paid on the shares of each member. Section 179 of the CO further requires that if the company's share capital is divided into different classes of shares, this should be stated in the share certificate.

Section 628(1) of the CO provides that the register of members shall be kept at the company's registered office or a prescribed place (in HKC), and a company must notify the Registrar of Companies of the place at which the registers are kept and any change within 15 days.

There are similar requirements for OFC and co-operative societies etc. to maintain and keep up-to-date information on its directors, shareholders, and members (or equivalent).

**Criterion 24.5** – Information submitted to the CR is subject to system validation process which conducts a validity check of the particulars provided against pre-defined data validation rules. For some documents such as incorporation forms and annual returns, manual verification procedures (e.g. for completeness or consistency of information reported) will be conducted before registration. The CR also verifies the identities and residential addresses of natural persons (directors or company secretaries), if necessary, and companies must notify the CR within 15 days of any change of director. Follow-up actions will be taken in respect of any discrepancies or breaches noted from the documents, and under section 35, the Registrar may refuse to accept or register a document when it is unsatisfactory.

The CR has set up an inspection unit to carry out regular checks on registered office addresses of companies on the Companies Register, the publication of company names and the keeping of proper registers, etc.

To facilitate public scrutiny of information on the Companies Register, an e-Monitor Service has also been introduced at the e-Registry since December 2011, which provides instant electronic notification to company users and subscribers when a document is registered in the public records of a company as specified by the subscriber.

However, a company has two months to update changes in shareholding, especially for subsequent changes, in its register (s.627 CO), which means that shareholder information may not always be accurate and up-to-date even when the intention of

<sup>70</sup> See [www.gov.hk/en/business/registration/businesscompany/index.htm](http://www.gov.hk/en/business/registration/businesscompany/index.htm)

the underlying parties are. Further, companies only need to update the CR of any such changes as part of its annual returns.

**Criterion 24.6** – HKC relies upon a combination of mechanisms to ensure that information on beneficial ownership of a company is available or can otherwise be determined in a timely manner by competent authorities.

The CO requires companies to obtain and maintain up-to-date information on the companies' beneficial ownership through the significant controllers register (SCR) since 1 March 2018. Section 653H CO requires every company to obtain and maintain beneficial ownership information by way of SCR, which must contain the particulars of all individuals or legal entities that have significant control<sup>71</sup> over the company. Companies are required to take reasonable steps to ascertain whether there is any significant controller of the company, and if so, identify each of them. Pursuant to section 653P CO, companies are required to give notice to any person who the companies know or reasonably believe to be a significant controller, requiring the person to confirm the same within a prescribed timeframe. Companies must enter in the SCR the particulars of all registrable persons (being natural persons who exercise ultimate control over the company), and registrable legal entities (being the vehicle through which the natural persons exercise control).

The company has a positive duty to take reasonable steps to ascertain whether there is any significant controllers and to identify them (s. 653P CO), and if the company knows or reasonably believes that the status of a significant controller or their particulars have changed, it must give notice to such person requiring the person to confirm whether such change has occurred and provide the details of such change within a prescribed timeframe (s. 653T CO).

The SCR must be kept at the registered office of the company or a prescribed place (s. 653M, CO) and be made available for inspection by LEAs upon demand for the purpose of prevention, detection, or investigation of ML or TF under the law of HKC (s. 653X CO).

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- <sup>71</sup> Under sections 653C and 653D CO, a person or a legal entity is a registrable person or registrable entity if he or it has significant control over the company by virtue of any criteria under Schedule 5A, i.e.,
- (a) the person holds, directly or indirectly—
    - (i) if the company has a share capital—more than 25% of the issued shares in the company; and
    - (ii) if the company does not have a share capital—a right or rights to share in more than 25% of the capital or, as the case requires, profits of the company;
  - (b) the person holds, directly or indirectly, more than 25% of the voting rights in the company;
  - (c) the person holds, directly or indirectly, the right to appoint or remove a majority of the board of directors of the company;
  - (d) the person has the right to exercise, or actually exercises, significant influence or control over the company;
  - (e) the person has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm—
    - (i) that, under the law governing the trust or firm, is not a legal person; and
    - (ii) whose trustees or members meet one or more of the conditions (in their capacity as such) specified in paragraphs (a), (b), (c) and (d).

In addition, LEAs may also obtain information on beneficial ownership of customers that is required to be held by FIs and DNFBPs.

**Criterion 24.7** – As noted, the company has a positive duty to take reasonable steps to ascertain whether there is any significant controller and to identify them. If the company knows or reasonably believes that the status of a significant controller or their particulars have changed, it must give notice to such person to confirm the information (s. 653T CO) and the person then has one month to respond. The date and details of any change in the significant controllers or their particulars must be registered under the SCR within seven days after the change has been provided or confirmed (s.653J CO). The process for updating SCR information takes up to five weeks and this, for a relatively new regime, raises minor concerns on whether the information would be adequately up-to-date.

For the other types of legal persons, mentioned in c24.3, the beneficial owners would in practice usually be the partners/members. There are similar requirements for OFC, co-operative societies to maintain and keep up-to-date information on its directors, shareholders, and members (or equivalent).

**Criterion 24.8** – Under section 653ZC of the CO, a company is required to designate at least one representative to provide assistance relating to the SCR to LEAs and Registrar. A designated representative must be: (i) a director, employee or member of the company and is a natural person resident in HKC; or (ii) an accounting professional, a legal professional, or a TCSP licensee under AMLO. In addition, for information collected by FIs and DNFBPs, they would have officers/compliance officers who would be able to deal with requests from authorities.

**Criterion 24.9** – Companies (except listed companies which are subject to disclosure requirements under the SFO) are required to keep an SCR and all entries at its registered office or a prescribed place in HKC for at least six years from the date on which the natural or legal person ceases to be a beneficial owner of the company (s.653L CO). Entries in the register of members must be kept for a period of 10 years after a person ceased to be a member (s.627, CO.) Companies must also keep a register of directors and company secretaries (ss.641 and 648 CO), and books and papers<sup>72</sup> must be kept at all times until at least six years after the date of the dissolution (ss.758).

Pursuant to section 20(3) Schedule 2 AMLO, all FIs and DNFBPs are required to keep CDD records, including that of beneficial ownership information, for five years from the date on which the business relationship ends.

**Criterion 24.10** – Basic and legal ownership information of a company is available through public search or from the companies directly, so authorities (including LEAs) would have timely access. Section 653X of the CO requires that a company must, on demand made by the CR (for the purpose of ascertaining compliance with the SCR requirements) and LEAs for the purpose of combating ML/TF (or the officer's performance under the laws of HKC), make its SCR (containing beneficial ownership

<sup>72</sup> “Book and paper” include accounts, deeds, writings and documents, and “Documents” include summons, notice, order, and other legal process and registers.

information) available at any reasonable time for inspection by the officer at the place where the information is kept.

As for beneficial ownership information, which are required to be kept by FIs and DNFBPs pursuant to AMLO, they may be obtained by LEAs by exercising their investigative powers (e.g. production order or search warrant) under applicable laws including the OSCO, the DTROP, the UNATMO, etc. Where LEAs seek to obtain any records from FIs through a production order, the FI must comply within the time specified in the order; failure to comply is an offence (section 3(5) of the OSCO, section 20(2) of the DTROP, section 12B(2) of UNATMO).

**Criterion 24.11** – Pursuant to section 139 of the CO, a company cannot issue a share warrant (defined as a warrant where the bearer is entitled to the shares specified in the warrant; and enabling the shares to be transferred by delivery of the warrant). The bearer of a share warrant issued before the commencement date of the amendment to CO in March 2014 is entitled to surrender it for cancellation, and to have the bearer’s name entered in the register of members of the public company. For private companies, there has been a restriction on members’ right of transferring shares since 1933 (s. 11 CO).

**Criterion 24.12** – Nominee shareholders and nominee directors are permitted, although there are various mechanisms to deal with them:

- i. Section 6, Division 2, Schedule 5A of the CO states that a share held by a nominee for another person is regarded as being held by “that other person”.
- ii. If the nominee holds more than 25% of the issued shares of the company, “that other person” should be identified by the company and be entered into the SCR. The company has to take reasonable steps to ascertain whether there is any significant controller<sup>73</sup> and identify each of them under section 653P CO. Further, a nominee that falsely claims that he or she is not a nominee, pursuant to a Notice issued by the company to comply with section 653P of the CO commits an offence under section 653ZE of the CO.
- iii. Anyone who by way of business acts or arranges for another person to act as a shareholder or a director of a company for another person would be considered to be providing trust or company service under the AMLO and is required to obtain a licence from the CR to do so; since March 2018, licensees are subject to statutory CDD and record-keeping requirements under the AMLO.

**Criterion 24.13** – There are various different penalty levels. If a company fails to comply with the requirement of keeping an SCR (s. 653H) or if a notice addressee fails to comply with the notice requirement (s.653ZA), they are liable upon conviction to a fine of up to HKD 25 000 (USD 3 125). Section 653H carries a further fine of HKD 700 per day for a continuing offence. There is a more serious offence for anyone who knowingly or recklessly makes in an SCR a statement which is misleading, false or deceptive in any material particular (s. 895), with a penalty of a fine of up to HKD 300

<sup>73</sup> Please refer to footnote 11 on definition of person with significant control.

000 (USD 37 500) and imprisonment of up to two years. The penalties appear generally dissuasive and proportionate.

**Criterion 24.14** – Basic information held by the CR is available to the public either free of charge or for a small fee. Foreign LEAs may thus access the same any time. Shareholder information of a company forms part of the basic information available through a public search of the annual returns and allotments.

The HKPF and the JFIU can also provide basic ownership and beneficial ownership information held by the CR, FIs, DNFBPs and companies upon an INTERPOL/Egmont Group FIU/ Non-Egmont Group FIU/MLA request made by the competent authorities as appropriate for the purpose of investigating a criminal offence.

IRD is able to provide basic and beneficial ownership information in accordance with the Exchange of Information Article under CDTAs, TIEAs or the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

**Criterion 24.15** – The Liaison Bureau (LB) of the HKPF co-ordinates police-related inquiries from overseas police organisations and local consular officials. It also maintains close liaison with the Mainland Public Security authorities, the Police Liaison Department of the Liaison Office of the CPG in the HKC and the Macao, China SAR Police. The LB used the HKPF wide Electronic Liaison Information Timely Enquiry System (ELITES) to monitor and processes requests received from or made to overseas / Mainland China LEAs. Should there be any prolonged response or any incomplete information in the reply from overseas jurisdiction, the LB will assist in sending a reminder to the overseas authority to trace a reply or sending a further request to seeking missing/ additional information. The JFIU has also put in place a feedback mechanism to monitor the quality of assistance it obtains from FIUs of other jurisdictions in response to requests from local LEAs and other agencies for basic and beneficial ownership information.

### *Weighting and Conclusion*

HKC has taken a number of steps to ensure and promote transparency of beneficial ownership, particularly through the recent CO amendments. Through the HRA, it has identified and assessed the risk of misuse of companies for ML/TF in HKC. However, minor concerns remain over the scope and depth of the risk assessment in relation to legal persons that are not companies. Minor gaps also exist in relation to whether basic and beneficial ownership information would be available in a timely manner.

**Recommendation 24 is rated largely compliant.**

### **Recommendation 25 – Transparency and beneficial ownership of legal arrangements**

In its 3rd MER, HKC was rated partially compliant with these requirements. The main deficiencies were: (i) no adequate measures in place to ensure that adequate, accurate and timely information on the beneficial ownership and control of legal arrangements can be obtained in a timely fashion by competent authorities; and (ii) providers of trust services, other than those that are financial institutions (FIs), are not subject to AML/CFT obligations. Since then, additional measures, e.g. putting in place AML/CFT

requirements for TCSPs, have been taken by the authorities which are discussed further below.

**Criterion 25.1** – Based on a 2013 industry report<sup>74</sup>, HKC authorities consider that the trust market is dominated by FIs and DNFBPs, which act as professional trustees. The report also noted that “the actual number of players/stakeholders in the HKC trust industry could be far more than what is suggested by official data”. As the report is slightly dated and based on a survey of the professional trustee sector only (including financial services firms), it is not possible to clearly conclude what is the number/proportion of trustees are not professional. Accurate appreciation of the size is made more challenging as it does not clearly cover express trust governed under HKC’s law (but have no other connection with HKC).

Professional trustees i.e. banks, insurers, financial services firms, lawyers, accountants and trust companies have obligations (including CDD and record keeping obligations) under the AMLO (see s.1(1) and s.2(1) Schedule 2) to identify and hold accurate information on the identity of the settlor, an individual who is entitled to a vested interest in more than 25% of the capital of the trust property, a protector/enforcer, and any individual who has ultimate control over the trust.

Outside the express obligations imposed on professional trustees under the AMLO, there is a general duty of care that would apply to all trustees under the Trustee Ordinance (Cap. 29) as well as under common law rules of trust and equity. Under the Trustee Ordinance, a trustee owes a statutory duty of care to exercise the care and skill that is reasonable in the circumstances in relation to certain functions that the trustee carries out, including investment, delegation, appointing nominees and custodians, taking out insurance and powers in relation to accepting property and valuation and audit (TO, s. 3A).

The common law also imposes a duty of care on the trustee to execute the trust with reasonable diligence and conduct its affairs as a prudent man of business. A higher standard of care applies to a trust corporation or similar body that carries on a specialised business of trust management. Under the common law, trustees are required to obtain and ascertain facts material to the trusteeship, including all documents concerning the trust (*Hallows v Lloyd* (1888) 39 Ch D 686). The duty extends to all information including trust deeds, records of meetings, legal advice and financial information relevant to the trust that may be ordered to be disclosed by the Court.

Nonetheless, based on the case law provided to the assessment team, it could not be clearly concluded that there is a duty of care, express or implied, that requires the trustee of an express trust to obtain and hold adequate, accurate and current information on the identity of settlors, the trustees, protectors (if any), beneficiaries or class of beneficiaries, and any other natural persons exercising ultimate effective control over those trusts. HKC referred to the case of *Jones v Firkin-Flood* [2008] All

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<sup>74</sup> See [Hong Kong Trust Industry: A Cross-Sector Perspective](#)” published by the Hong Kong Trustee Association in June 2013. This surveys banks and subsidiaries of a financial institution, law firms or other professional services firms, trust companies, and individual professionals.

ER (D) 175, but this speaks in much more general terms about trustee obligations and not about the much more specific obligations noted above.

As regards holding basic information on service providers and/or regulated agents (e.g. investment advisors, accountants etc.) to the trust, HKC refers to the Trustee Ordinance, which regulates the trustees' interaction with persons acting as his agent, with obligations to evidence such an agency in writing and to keep it under review. However, this is not relevant to persons such as investment advisors or accountants, who provide a contractual service to the trust and are not agents of the trustee. No other law has been provided that demonstrates trustees are required to hold basic information in relation to service providers to the trust.

**Criterion 25.2** In cases where the trustee is an FI or a professional providing trust services as a business (e.g. a TCSP), he or she is subject to the requirements under the AMLO to continuously monitor the business relationship and update any CDD information. For other trustees, the statutory and common law duty of care would apply, but there are no specific obligations as required by this criterion.

**Criterion 25.3** – There is no direct requirement for trustees to disclose their status to FIs or DNFBPs. There are however obligation on the FIs and DNFBPs as part of their CDD obligations to collect the information, with applicable sanctions for non-compliance. In certain cases, it may be possible to prosecute a trustee who acts with deceit and with intent to defraud an FI or professional trust service provider for an offence of fraud under section 16A of the Theft Ordinance, but this is a limited scenario.

**Criterion 25.4** – There is no statutory provision or common law rule preventing trustees from providing competent authorities with any information relating to the trust. Competent authorities, and in particular LEAs, are empowered to gain access to information relating to trust for investigation purpose under regular investigatory powers.

**Criterion 25.5** – To the extent that the information is available and collected, LEAs have a wide range of powers under the OSCO, the DTROP and the UNATMO to obtain and/or compel trustees, FIs and/or DNFBPs to provide the relevant information. This would normally not be an issue for professional trustees, but for non-professional trustees, only the normal investigation powers exist, and it is not clear that timely access to the information would exist in all cases, especially when the trustee cannot be clearly identified.

**Criterion 25.6** – Competent authorities are able to assist foreign counterparts in obtaining information held by other domestic authorities through established channels such as MLA or other forms of co-operation. Further, they may obtain beneficial ownership information of trusts from trustees (to the extent that the information is available and collected), FIs or DNFBPs using their investigative powers under the PFO, the OSCO, the DTROP or the UNATMO for the purpose of investigating a criminal offence in HKC. The HKPF may provide information as intelligence to foreign counterparts through Egmont Group, INTERPOL and the JFIU, including information obtained through coercive powers if a statutory gateway for the exchange exists or the dominant purpose of the exchange is to advance investigation in HKC. Other competent authorities may also provide information through other established channels; the IRD can also assist foreign counterparts in

obtaining information upon receipt of exchange of information requests from bilateral agreement partners and also under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. However, due to limitations concerning non-professional trustee, minor concerns remain.

**Criterion 25.7** – For trustees who are FIs or professional service providers, they would be held liable and subject to a range of sanctions under the AMLO if they fail to perform the statutory CDD and record keeping measures when providing trust services. This would include a public reprimand, a remedial order, a pecuniary fine, and a suspension or revocation of the licence (ss. 5(5) to 5(8) and s. 21 AMLO). More generally, trustees are also liable to be sued by an adversely affected party e.g. a beneficiary, in a civil suit at law for breach of their duty of care in conducting the affairs of the trust. However, as noted, the general duty of care does not clearly cover the range of obligations as required under R.25.

**Criterion 25.8** – The failure to comply with a production order under section 4(13) of the OSCO and section 14 of the UNATMO is an offence with a maximum penalty of imprisonment for one year and a fine of HKD100 000 (USD 12 500). RAs and RBs are also empowered under section 9(1) of the AMLO to inspect and make copies of CDD records (including beneficial ownership information) and the failure to comply is an offence punishable by imprisonment for one year and a fine of HKD200,000 (USD 25,000) (s. 10, AMLO). An offence of obstruction of an officer in the exercise of his duty may be applied to a person who fails to grant competent authorities timely access to this information when the officer is authorised.

### *Weighting and Conclusion*

While professional trustees, such as banks, lawyers and TCSPs, have specific obligations to obtain and hold adequate, accurate and up-to-date information on the settlor, trustee, and beneficiaries, and face sanctions for failure to comply with the identification requirements, this does not apply to non-professional trustees (e.g. private individuals) or other trustees of trust governed under HKC's laws. While there are general duty of care requirements placed on trustees under the Trustee Ordinance and the common law, these are not specific enough to be in line with R.25. There are other gaps, i.e. (i) no specific requirements for trustees to hold basic information on service providers to the trust, (ii) no explicit requirement for non-professional trustees to keep the information held accurate and up-to-date; and (iii) no obligation for trustees to disclose their status to regulated entities.

**Recommendation 25 is rated partially compliant.**

### **Recommendation 26 – Regulation and supervision of financial institutions**

In its 3rd MER, HKC was rated largely compliant with these requirements mainly because of the scope limitation to exclude some financial sectors from the AML/CFT regime. Since then, HKC has conducted risk assessment and brought most of necessary sectors under the regulatory regime.

Stand-alone financial leasing companies and credit card companies are not subject to AML/CFT supervision, despite no risk assessment to justify the exemption. This minor shortcoming affects compliance throughout c.26.1-6.

**Criterion 26.1** – The following supervisors are designated for AML/CFT regulation and supervision; the HKMA for AIs and SVFs, the SFC for LCs, the IA for IIs, and the C&ED for MSOs and the Postmaster General (s.1 of Part 2 of Schedule 1 to the AMLO). While moneylenders are not subject to statutory AML/CFT requirements under the AMLO, the RML supervises moneylenders for their compliance with AML/CFT requirements under the AML/CFT Guideline issued by the RML as part of their licensing conditions (Condition 14 of the Moneylenders Licence).

**Criterion 26.2** – Most FIs are required to be licensed except for insurance intermediaries which are subject to a registration regime (ss.11, 12, 16 and 97A of the BO; s.8B and 8F of the PSSVFO; s.114(1), (8), 116 and 120 of the SFO; s.6, 8, 65, 66, 67, 69, 70 and 73 of the IO; ss.29 and 30 of the AMLO; ss.7, 10 and 11 of the MLO). While there is no provision in the BO to prohibit the establishment or continued operation of a shell bank, the HKMA requires every AI to maintain a physical presence in HKC as a licensing condition and AIs are subject to ongoing supervision. In practice, this prevents a shell bank from being established or continuing operation in HKC.

**Criterion 26.3** – Most FIs are subject to necessary measures by respective supervisors to prevent criminals or their associates from holding a significant or controlling interest, or holding a management function as follows, and authorities are empowered to withdraw the approval that they gave (s.40(2)(c) of the IGCO):

- AI - an indirect or shareholder controller, a chief executive or a director is required to obtain the HKMA's consent to hold their positions, and the HKMA can withdraw such a consent. The HKMA must be satisfied that a controller, a chief executive or a director is fit and proper for the position. The criteria of fit-and-properness include criminal record (ss.70, 70A and 71 of the BO);
- SVF licensee - similar control by the HKMA applies to an indirect or shareholder controller, a chief executive or a director (ss.8ZZF, 8ZZI(2)(a), 8ZZJ, 8ZZV, 8ZZW(1), (4) of the PSSVFO);
- LC - every executive director who is an individual needs to be approved as a responsible officer for the regulated activities by the SFC, and a substantial shareholder also needs to be approved by the SFC. The SFC must be satisfied that a responsible officer or a substantial shareholder is fit and proper for the position. The criteria of fit-and-properness include criminal record pursuant to the Fit and Proper Guidelines issued by the SFC under s.399 of the SFO (s.125, 126, 129, 131 and 132 of the SFO);
- II - a managing director, a chief executive, a director or a key person in control function of an authorised insurer needs to be approved by, and a shareholder controller of an authorised insurer is subject to a notice of objection from the IA. The IA can revoke such approval. The IA must be satisfied that a managing director, a chief executive, a director, a key person in control function or a shareholder controller is fit and proper for the position. The criteria of fit-and-properness include criminal record pursuant to the Guideline on Fit and Proper Criteria issued by the IA under sec.133 of the IO. Furthermore, the IA has powers to direct an authorised insurer to de-register an appointed agent and withdraw the authorisation of an authorised broker or the approval given to a body of insurance brokers (ss.8(2), 13A, 13AC, 13AE, 13B, 14, 14A, 66 and 75 of the IO);

- MSO - an individual applicant, an ultimate owner, a partner or a director needs to be approved by the C&ED as a fit and proper person in applying for a new licence or renewal of licence. The criteria of fit-and-properness include criminal record (ss.30(3), (4), 31(4) and 35-37 of the AMLO);
- Moneylender - in the licensing process and licence renewal process, the Licensing Court will have regard to objections made by the HKPF or the RML on the fit-and-properness of the applicant including a person who controls the applying company or is responsible for the management of the business (it is possible to appeal to the CFI if any person aggrieved by the Licensing Court's decision), and this contributes to prevent criminals or their associates from controlling a moneylender, although it is ultimately up to the Court's decision. The HKPF or the RML may apply to the Licensing Court for the suspension or revocation of the licence as well (s.9, 11, 14, and 16 of the MLO).

**Criterion 26.4** – (a) The IMF conducted the Financial Sector Assessment Programme (FSAP) of HKC in 2014. Regarding Basel Committee on Banking Supervision (BCBS) principles, HKC was compliant with 14 of the relevant AML/CFT principles and largely compliant with the remaining one. All of the four relevant International Organisation of Securities Commission (IOSCO) principles were Fully Implemented. Regarding the International Association of Insurance Supervisors (IAIS) Principles, seven relevant principles were rated as Observed and seven others as Largely Observed. Only Principle 23 on Group-wide supervision was found Partly Observed. The IMF also assessed the compliance of HKC with the Principles for Financial Market Infrastructures (PFMIs) in the 2014 FSAP and updated the assessment in the 2016 Article 4 Consultation where the FMIs under the HKMA's purview were considered to be generally observant of PFMI and the FMIs under the SFC's purview were on track to be observant.

(b) SVF licensees, MSOs, and moneylenders are regulated and subject to supervision or monitoring including their compliance with AML/CFT requirements.

**Criterion 26.5** – All RAs and the RML adopt the RBA to AML/CFT supervision on the basis of factors (a) to (c) in this criterion to varying degrees.

The HKMA adopts RBA in supervising AIs and SVF licensees, although the methodology for SVF licensees is at a relatively recent phase of development as the AML/CFT regime for the sector came into effect only in 2016. It assesses periodically (every two years) an AI's inherent risks and the adequacy of the AI's ML/TF risk management and control based on a range of factors from various internal and external sources to come to a rating of High, Medium High, Medium Low or Low (Risk rating). Each AI is also assessed in terms of its impact on HKC's financial system and the role of IFC, and given a rating of High, Medium or Low (Impact rating). Combining a Risk rating and an Impact rating, each AI is classified into one of four categories (Category 1-4) and is subject to a different degree of supervisory engagements (e.g. Category 1, which is the highest risk, is subject to an on-site review at least once in two years and annual review meeting.). For SVF licensees, the HKMA completed the first ML/TF risk profiling exercise in September 2018, and takes the risk profiling, a licensee's complexity and size into account to determine the frequency and intensity of on-site examination.

The SFC adopts similar approach with the HKMA's supervision for AIs. It assesses an LC's inherent risk and the quality of ML/TF risk management and control to come to a rating of Significant, Moderate or Low, and assess potential negative impact of an LC on HKC's market

to come to a rating of High, Medium or Low. Combining these two ratings, each LC is classified into one of three categories (High, Medium or Low Priority) and is subject to a different cycle of the inspection.

The IA adopts RBA to determine the intensity of its supervision. By assessing various risk factors and the quality of AML/CFT system and control of an II, the IA comes to a rating of High, Medium or Low. IIs with High or Medium rating are subject to routine inspections while IIs with Low rating are subject to off-site review.

The C&ED adopts RBA in deciding the priority of MSOs for inspection focused on AML/CFT compliance. By taking several risk factors on an MSO into consideration, the C&ED calculates a risk score and comes to a rating of High, Medium or Low. MSOs with High rating are subject to on-site inspections focused on AML/CFT compliance, while other MSOs are subject to off-site inspections. Although the C&ED does not indicate the specific inspection cycle linked to the rating, more inspections are conducted for MSOs belonging to higher risk category.

The RML adopts RBA in selecting the targets of inspections for moneylenders. However, the information collected and used to identify and assess the ML/TF risks of individual moneylenders fall short of the elements (a) to (c). In addition, there is no clear link between identified ML/TF risks and the frequency and intensity of the AML/CFT supervision.

**Criterion 26.6** – The HKMA reviews AIs’ ML/TF risk profile on a biennial basis and in response to trigger events, and plans to take similar approach to SVF licensees with the first risk-profiling exercise is just completed in September 2018. The SFC reviews LCs’ ML/TF risk profile on a quarterly basis, and if there are major events or developments that have an adverse impact on a LC’s AML/CFT systems, the information will be utilised for updating the ML/TF risk profile. The IA reviews authorised insurers’ ML/TF risk profile annually and intermediaries (brokers and agencies) every two years, and on an event-driven basis in response to certain trigger events. The C&ED reviews MSOs’ ML/TF risk profile on a biennial basis during the licence renewal and on an event-driven basis. The RML assesses moneylenders’ ML/TF risks periodically, particularly during licence renewal (every 12 months), and on an event-driven basis.

### *Weighting and Conclusion*

There is a minor scope issue with respect to stand-alone financial leasing companies and credit card companies.

**Recommendation 26 is rated largely compliant.**

### **Recommendation 27 – Powers of supervisors**

In its 3rd MER, HKC was rated partially compliant with these requirements. The main deficiencies were that limitations of the OCI’s authority to routinely monitor AML/CFT issues and the powers to monitor and sanction remittance and money changing businesses, in addition to the same scope limitation as R.26. Since then, HKC has amended relevant Ordinances aiming at empowering relevant authorities.

There is no designated AML/CFT supervisor for stand-alone financial leasing companies and credit card companies, despite no risk assessment to justify the exemption. This minor shortcoming affects compliance throughout c.27.1-4.

**Criterion 27.1** – The HKMA, the SFC, the IA, the C&ED, the RML and the HKPF have powers to supervise or monitor the compliance of respective supervising FIs with AML/CFT requirements including powers to enter an FI’s business premises, require production of records or documents, and impose sanctions (Part 3 and 4 of the AMLO; s.11(6) and 28 of the MLO; Conditions 11 and 14 of the Moneylenders Licence Conditions).

**Criterion 27.2** – The HKMA, the SFC, the IA, the C&ED, the RML and the HKPF have the authority to conduct inspections of respective supervising FIs (s.9 of the AMLO; s.28 of the MLO).

**Criterion 27.3** – The HKMA, the SFC, the IA, the C&ED, the RML and the HKPF have the authority to compel production of any information relevant to monitoring compliance with the AML/CFT requirements (s.9(5) and 12 of the AMLO; s.11(6) of the MLO; Condition 11 of the Moneylenders Licence) Conditions.

**Criterion 27.4** – The HKMA, the SFC, the IA and the C&ED are authorised to impose a range of disciplinary and financial sanctions, including public reprimand, order to take a specific action by FIs and pecuniary penalty and pursue criminal prosecution, for an FI’s and its employee’s failure to comply with the AML/CFT requirements (ss.5, 21, 43 and 79 of the AMLO; Guidelines issued by the HKMA, the SFC, the IA and the C&ED pursuant to the s.23 and 45 of the AMLO). Other than these sanctions, aforementioned supervisors can impose sector-specific sanctions including withdrawing, restricting or suspending an FI’s licence and withdrawing the consent with the senior managements such as the chief executive of an FI for holding their positions to remove them (ss.16(5), 22, 24, 25 and 71(4) of the BO; s.8I, 8V, 8Z, 8ZA and 8ZZW(4) of the PSSVFO; s.194 and 196 of the SFO; s.13A(7), 13AC(7), 13AE(7), 66(7) and 75 of the IO; s.34 of the AMLO). The RML is not empowered to impose a range of proportionate sanctions. What it can do is either referring the breach of a licensing condition (which includes compliance with the AML/CFT Guideline issued by the RML) to the HKPF for prosecution or applying to the Licensing Court for suspension or revocation of a moneylender licence for AML/CFT contraventions on the ground of cessation to become fit and proper and/or contravention of licensing condition, although it is ultimately up to the Court’s decision (ss.14, 29(1) and 32(1)(2) of the MLO).

### **Weighting and Conclusion**

There is a shortcoming in the RML’s capability to sanction and a minor scope issue with respect to stand-alone financial leasing and credit card companies.

**Recommendation 27 is rated largely compliant.**

### **Recommendation 28 – Regulation and supervision of DNFBPs**

In its 3rd MER, HKC was rated non-compliant with these requirements. The main deficiencies were that there were no designated competent authorities or formal structures in place to monitor DNFBPs’ AML/CFT compliance except for estate agents. Since then, HKC has amended relevant Ordinances aiming at strengthening the regulatory and supervisory framework for DNFBPs.

DPMS are not subject to the AMLO, although not being assessed as proven low risk by HKC to justify the exemption.

**Criterion 28.1** – *[Not applicable]* There is no licensed casino in HKC, including ship-based or internet-based casino. It is an offence to operate, manage or otherwise have control of, a

gambling establishment in HKC (s.5 of the Gambling Ordinance). Internet-based betting is prohibited in HKC and an internet-based casino cannot be established in HKC (s.8 of the Gambling Ordinance). For ship-based casinos operating in international waters on a ship registered or owned in HKC, please see para.684, 700, 716 and 727 in the 3<sup>rd</sup> MER of HKC.

**Criterion 28.2 & 28.3** – There is a designated competent authority or SRB for monitoring and ensuring compliance of DNFBPs with AML/CFT requirements as follows; the EAA for estate agents, the LSHK for legal professionals, the HKICPA for accounting professionals and the CR for TCSPs (Part 2 of Schedule 1 to the AMLO). DPMS are not subject to full suite of AML/CFT requirements or supervision.

**Criterion 28.4** –

(a) The EAA has powers to monitor compliance of a licensed estate agent or licensed salesperson with AML/CFT requirements and investigate them when necessary (s.5(a)(b), 6(1) and 28 of the EAO); the LSHK can appoint an inspector to verify compliance by a solicitor, a foreign lawyer, a trainee solicitor or an employee of a solicitor or foreign lawyer with the LPO or any LSHK’s practice direction which includes the AML/CFT requirements, and the documents required by the inspector must be produced and delivered (ss.8AA and 8B of the LPO); the HKICPA has powers to monitor compliance of accounting professionals with professional standards including AML/CFT matters issued or specified by the HKICPA through the Practice Review Committee (s.32A-32E of the PAO); the CR has powers to monitor compliance of TCSPs with AML/CFT requirements including powers to enter TCSPs’ business premises, require production of records or documents, and take disciplinary actions (Part 3 and 4 of the AMLO).

(b) An estate agent or a salesperson who works for an estate agent to do estate agency work must hold a licence from the EAA. An applicant must be a fit and proper person and the criteria to determine fitness-and-properness include the conviction record of any offence for an individual applicant. However, for an applicant who is a company, only each director is subject to the conviction record check. A person who holds a significant or controlling interest in the applying company is not subject to this check (ss.15, 16, 17, 19, 20 and 21 of the EAO). Regarding legal professionals, the Court admits as a solicitor a person who it considers is a fit and proper person, and elaborated in the recent case that a past conviction is an element of fitness-and-properness (s.4 of the LPO; *Re A* [2018] HKCA 272). Regarding accounting professionals, a person shall be qualified to be registered with the HKICPA as a certified public accountant. The HKICPA must be satisfied an applicant is fit and proper, and the HKICPA’s criteria include criminal records (s.24 and 29 of the PAO; the HKICPA Membership – Fit and Proper). Regarding TCSPs, a person must hold a licence from the CR to carry on a trust or company service. An applicant must be a fit and proper person and the criteria to determine fitness-and-properness include the conviction record of any offence for an individual applicant, each partner and an ultimate owner of an applicant who is a partnership, and each director and an ultimate owner of an applicant who is a corporation (ss.53F, 53H and 53I of the AMLO).

(c) The EAA can impose sanctions on a licensed estate agent (including a director engaged in business) or licensed salesperson for failure to comply with AML/CFT requirements, including suspending and revoking the licence, and financial penalty (ss.27(2)(h), 29(1)(e) and 30 of the EAO). The LSHK, when it considers necessary as a result of an inspection mentioned in c.28.4(a) or upon receiving a complaint about the conduct of a solicitor, a foreign lawyer, a trainee solicitor or an employee of a solicitor or foreign lawyer including an alleged failure for compliance with AML/CFT requirements, shall submit the matter to its

Tribunal Convenor of the Solicitors Disciplinary Tribunal Panel. A Solicitors Disciplinary Tribunal has the power to make such orders as striking off the roll of solicitors the name of a solicitor, suspending a solicitor from practice, and financial penalty (ss.8A(3), 9A and 10 of the LPO). The HKICPA, when it considers necessary as a result of a review mentioned in c.28.4(a) or upon receiving a complaint about the conduct of a certified public accountant or a practice unit including an alleged failure of compliance with AML/CFT requirements, will begin an investigation. Depending upon the seriousness, the case is referred to a disciplinary committee which has the power to order the removal of the name of the certified public accountant from the register temporarily or permanently, and financial penalty (ss.32D(5)-(7), 34(1)(a)(xiii)-(xv), 34(1)(b)(vi) and 35 of the PAO). The CR is authorised to impose a range of disciplinary and financial sanctions, including public reprimand, order to take specific action by TCSPs, pecuniary penalty and revoking or suspending the licence, and pursue criminal prosecution, for a TCSP's and its director's failure to comply with the AML/CFT requirements (ss.53Q, 53Z, 53ZD and 79 of the AMLO).

**Criterion 28.5** – The EAA has started the ML/TF risk profiling of estate agents and categorised them into two categories essentially based on the difference of the size of business, and allocates more supervisory resources to larger size estate agents. While there is a difference in the intensity of its AML/CFT supervision depending on the size, there is no clear difference in the frequency of its supervision; No concrete information is provided on how the LSHK performs its AML/CFT supervision on a risk-sensitive basis. The HKICPA started its AML/CFT compliance programme in October 2018 and has not yet performed AML/CFT supervision on a risk-sensitive basis as of the end of the on-site visit. The CR prioritises the licensing screening of higher-risk applicants based on its preliminary ML/TF risk analysis developed in tandem with the HKPF as it is still processing the applications under the recently introduced TCSP licence regime. However, it has not yet developed its supervisory plan including the frequency and intensity of supervision on a risk-sensitive basis due to the recent introduction of the licensing regime and corresponding supervision.

### *Weighting and Conclusion*

Risk-based AML/CFT supervision is not established in most of DNFBP sectors. There is a minor gap to prevent criminals or their associates from abusing estate agents. The scope gap in relation to DPMS also applies.

**Recommendation 28 is rated partially compliant.**

### **Recommendation 29 – Financial Intelligence Units (FIUs)**

In its 3rd MER, HKC was rated compliant with these requirements. Effectiveness issues were considered as part of the previous assessment but under the 4th round are no longer included in this technical compliance assessment, but are assessed separately under IO.6. Since the last evaluation, the FATF standards in this area were strengthened.

**Criterion 29.1** – The JFIU, as a law-enforcement-type FIU, is jointly run by the HKPF and the C&ED. It is the sole agency in HKC designated to receive, analyse and disseminate STRs and other information relevant to ML, associated predicate offences and TF.

**Criterion 29.2** – The JFIU is the central agency for receiving, analysing and maintaining STRs filed.

**(a)** for all STRs, reporting entities should report to an “authorised officer”, which includes, any police officer, any member of the C&ED, and any other person authorised in writing by the SJ (OSCO & DTROP, s.25A(1); UNATMO, s.12.)

**(b)** declarations and disclosures of cross boundary currency and bearer negotiable instruments (BNIs) which are reported to C&ED are made available to the FIU via C&ED’s information system (see c.32.6). The JFIU has access to such declaration and disclosure information via STREAMS which receives the data from the C&ED’s System CDS on a daily basis through a data matching process. Cash transaction reports (CTRs) or wire transfer reports are not required under HKC legislation.

**Criterion 29.3** - In relation to obtaining and accessing information:

**(a)** in relation to an STR that has already been filed, the JFIU can request information on “any matter on which that knowledge or suspicion is based” from reporting entities regardless of whether an investigation has been opened (DTROP & OSCO, s.25A(1); UNATMO, s.12(1).)

In addition, for entities that have not yet filed an STR, the JFIU may alert the private sector under justified grounds or consent as required when some information/intelligence comes into the JFIU’s attention in the course of financial intelligence exchange with worldwide counterparts or management of the STR regime. This may trigger those entities (e.g. FIs) to file STRs. The JFIU may also apply for a production order or a search warrant from the Court or Magistrate respectively by satisfying the Court that the article or document is relevant to the investigation for the purpose of which the application is made (DTROP, s.20; OSCO, s.4; Magistrates Ordinance (Cap. 227), s.22.) HKC authorities report that a search warrant/production order may be obtained within hours (both within and outside office hours).

**(b)** The JFIU has access to a wide range of databases e.g. the HKPF’s and the C&ED’s intelligence and criminal record databases as well as the databases maintained by the Transport Department, the CR, the IRD and the Land Registry. Without obtaining a court order, the JFIU can request information from several agencies/departments such as the HKMA, the Hong Kong Federation of Insurers, the SFC, the ImmD and the SWD. Production orders are generally used to obtain information which LEAs or the JFIU do not have ready access to, such as tax returns filed with the IRD.

**Criterion 29.4** –

**(a)** The JFIU uses its IT-tool STREAMS to automatically prioritise STRs based on their inherent ML/TF risk to categorise them as either high or low risk STRs. The JFIU analyses all STRs received, with senior analysts examining high-priority STRs and junior analysts examining low-priority STRs. Analysed STRs are assigned a risk level, either high risk or low risk. A growing number of high-risk STRs are further analysed and disseminated to operational partners as Financial Intelligence Reports (FIRs), while most low-risk STRs are kept in the database for later use. Specific targets and suspected proceeds of crime are identified and trails of activities or transactions are followed in the course of value-added intelligence development on some STRs, FIU-to-FIU exchanged information and other sources of information.

**(b)** the recently established Strategic Analysis and Research Team within the JFIU conducts more in-depth thematic analyses and holistic reviews on selected STRs, FIU to FIU exchanged information and other information from various sources on

prevalent crime trends with reference to the overall ML/TF threat and vulnerability in HKC. The JFIU also publishes a STR Quarterly Analysis Report to provide STR reporting sectors with recent ML/TF trends, patterns, case examples and typologies of interest.

**Criterion 29.5** – The JFIU is empowered to disseminate information obtained under, or intelligence derived from, STRs to other local LEAs and the DOJ, as well as competent authorities in other jurisdictions for the purpose of combating crime by using confidential emails or fax/registered mail (for local authorities), and the Egmont Secure Web (for international counterparts) (DTROP and OSCO, s.25A (9); UNATMO, s.12 (6).) HKC authorities have internal orders to manage the types and criteria of disseminations.

**Criterion 29.6** –

**(a)** To protect the information that it processes and analyses, the JFIU has set up its own secure IT system STREAMS that may only be accessed and used from secure designated terminals within the HKPF's headquarters. STREAMS is compartmentalised into different security levels in accordance with the confidentiality and sensitivity of the STR content, and information at a particular security level can only be accessed by users with the required level of clearance. The JFIU has an internal security order for STREAMS that sets out the rules of receiving, storing, accessing, and disseminating information. STRs filed non-electronically will be entered into STREAMS by the JFIU staff. Audit logs are examined monthly to detect and deter unauthorised access to STREAMS. Requests for information from other agencies will be considered only if the JFIU is satisfied that the receiving entity is responsible for investigating or preventing crime, or handling the disclosure of knowledge or suspicion on property relating to crime (25A(9) of OSCO and DTROP and s.12(6) of UNATMO.)

**(b)** All personnel must undergo an internal security clearance process before assuming his or her post in the JFIU, which is subject to review every three years. All JFIU staff receive training/ briefing on their responsibilities in handling or disseminating sensitive and confidential information (e.g. attendance at official training days on information security and integrity matters). Supervisory officers receiving integrity management and information security training will ensure strict compliance by their subordinates in this regard.

**(c)** The JFIU is located at the HKPF Headquarters that is subject to strict access control. Additionally the office areas of the JFIU are regarded as restricted areas with limited access to JFIU personnel only.

**Criterion 29.7** –

**(a)** The JFIU is located at the HKPF Headquarters, and is jointly staffed by officers of the HKPF and the C&ED. It has been an independent division established under the NB of the HKPF since 2009. The Head of the JFIU can make final autonomous decision on matters regarding analysis of financial intelligence, and handling of request for and dissemination of information.

**(b)** The JFIU is empowered to share information with other domestic competent authorities for the purpose of combating crime (DTROP and OSCO, s.25A(9); UNATMO, s.12(6)). JFIU may enter into an MoU or similar instrument with an FIU or

LEA of another jurisdiction, which is either a full member of the Egmont Group or its parent jurisdiction being a full member of the FATF or the APG. As of December 2018, the JFIU has signed co-operation agreements with 14 international counterparts.

**(c)** The JFIU is housed in the NB within the HKPF. The JFIU is the designated agency to perform its unique role and function as a law-enforcement-type FIU of HKC.

**(d)** The JFIU's resources are guaranteed under the annual estimates and it may obtain additional resources where justified through the Government's established mechanisms, or through internal redeployment within the HKPF or the C&ED. The Head of the JFIU specifically can raise requests for additional staff independently under the established mechanism of the HKC Government.

**Criterion 29.8** – The JFIU became a member of Egmont Group in 1996.

### *Weighting and Conclusion*

**Recommendation 29 is rated compliant.**

### **Recommendation 30 – Responsibilities of law enforcement and investigative authorities**

In its 3rd MER, HKC was rated compliant with under the old requirements. The 2012 standards contain much more detailed requirements in this area.

**Criterion 30.1** – The HKPF, the C&ED, the ImmD, and the ICAC are the main LEAs for investigating ML, TF and predicate offences in accordance with the applicable laws implementing HKC's AML/CFT policies (OSCO (Cap. 455), s.2; DTROP (Cap. 405), s.2; Police Force Ordinance (PFO) (Cap. 232), s.10(b); Immigration Ordinance (Cap. 115), s.56; Immigration Service Ordinance (Cap.331), s.12 and s.13; Customs and Excise Service Ordinance (Cap. 342), s.17, s.17A; Independent Commission Against Corruption Ordinance, s.10).

Generally speaking, the HKPF is responsible for investigating ML, associated predicate offences and TF offences; whereas the relevant divisions under relevant LEAs would be responsible for investigating predicate offences under their remit as well as ML offences arising therefrom.

**Criterion 30.2** – Investigators within the different departments are authorised to conduct parallel financial investigations related to all associated predicate offences investigations, under the respective laws (the C&ED Standing Order; HKPF's Criminal Investigation Manual Chapter 9; Code of Practice on the Disclosure of Information; the Force Procedural Manual 21-49 and 27-19 and the Criminal Investigation Manual Chapters 9 and 10).

As provided under the DTROP and the OSCO, this extends to predicate offences that occurred outside HKC. Where ML cases are complex in nature and investigative units do not have the expertise or resources to handle such type of cases, they may, in accordance with the HKPF's Criminal Investigation Manual Chapter 9, consider referring the case to the FID (Financial Investigative Division of the Narcotics Bureau), regardless of where the predicate offence occurred.

**Criterion 30.3** – LEAs in charge of investigating ML/TF cases and associated predicate offence investigations have the authority to expeditiously identify, trace,

and initiate freezing and confiscation of crime proceeds and terrorist property as empowered under the OSCO, the DTRDP, the UNATMO (s.8 of OSCO; DTRDP, s.3; s.13 of UNATMO), and the POBO, s.14C.

**Criterion 30.4** – R. 30 applies to all relevant authorities responsible for investigating predicate offences. The SFC may conduct financial investigations related to securities crimes and misconduct, and is authorised to disclose non-public information to other LEAs (s. 378 of the SFO.)

**Criterion 30.5** – The ICAC investigates corruption in HKC and related ML and TF if it is facilitated by or connected with corruption or if a TF offence is revealed during the course of a corruption investigation. The ICAC is empowered to identify, trace and, subject to a restraint order from the CFI, provisionally freeze property of a person under investigation (Prevention of Bribery Ordinance (POBO) (Cap. 201), ss.13, 14, 14C and 17, OSCO, s.15; UNATMO, s.6; Independent Commission Against Corruption Ordinance (ICACO) (Cap. 204), s.10B.)

### *Weighting and Conclusion*

**Recommendation 30 is rated Compliant.**

### **Recommendation 31 - Powers of law enforcement and investigative authorities**

In its 3rd MER, HKC was rated compliant with these requirements.

**Criterion 31.1** – Competent authorities conducting investigating ML, associated offences and TF, including the HKPF, the C&ED, the ImmD, the ICAC and the SFC, have the power to:

**(a)** compel production of records held in FIs, DNFBPs, and other natural or legal persons (DTRDP s.20; OSCO, s.4; UNATMO, s.12B; ImmO, s.56 (1) (e); POBO, s.13; IRO, s.51 (4)(a). Similarly, non LEAs responsible for investigating ML and associated offences have similar powers (SFO; s.183.)

**(b)** Search person and premises subject to a search warrant from the Court (OSCO, s.5; DTRDP, s.21; UNATMO, s.12C; POBO, s.17; ImmO, s.12; IRO, s.51B; SFO, s.191.) **(c)** Witness statements can be taken voluntarily by a constable or can be compelled by a court (OSCO, s.3; UNATMO, s.3 (14); IRO, s. 51(4)(b); POBO, s.14(1)(d); Rules and Directions for the Questioning of Suspects and the Taking of Statements.) Pursuant to section 183 of the SFO, the SFC has the power to compel attendance at interviews. **(d)** Seize and obtain evidence (PFO, s.50 (6); IEO, s.21(2), s.21 (2); ImmO, s. 56(1A) (e); IRO, s.51B; ICACO, s.10C.)

**Criterion 31.2** – Depending on the nature of individual cases, the law enforcement authorities can use the following investigative techniques for investigating ML offences, associated predicate offences and TF offences:

**(a)** Undercover operations may be used to investigate serious offences in accordance with internal authorisation procedures.

**(b)** Interception of communication powers under the Interception of Communications and Surveillance Ordinance (ICSO) may be exercised by the HKPF, the C&ED, and the ICAC (ICSO; s.2, s.4, s.8-13, s.20-24, s.59 and s.61), while that for

covert surveillance may be exercised by the HKPF, the C&ED, the ICAC, and the ImmD (ICSO, Parts 1 and 2 of Schedule).

**(c)** Computer systems may be accessed by the HKPF, C&ED and ICAC to retrieve any data stored electronically with the owners' consent, or by a search warrant under the s.50 of the PFO, s.5 of the OSCO, s.21 of the DTROP, s.56(AA)(2) of the ImmO, s.191 of the SFO, s.10B of the ICACO or s.12C of the UNATMO.

**(d)** Controlled delivery may be used to investigate serious offences in accordance with internal authorisation procedures.

#### **Criterion 31.3 –**

**(a)** Authorities conducting an ML or TF investigation can apply to a judge for a customer information order that allows them to identify whether natural or legal persons hold or control accounts without prior notification to the owner (DTROP s.20; OSCO, s.4; UNATMO.) Mechanisms to identify assets include going through the HKCAB and the Deposit Taking Company Association that on average identifies the needed information within one week; and/or gathering information through the JFIU. In addition, where it appears to the Commissioner of Police, that it is expedient for the purpose of investigating an indictable offence, the Commissioner may require the bank to notify him within a specific time of any person holding an account (PFO, s.67).

**(b)** LEAs may also make use of other sources of information, e.g., the Companies Register and land records kept by the Land Registry, to identify other assets of a natural or legal person, such as companies or properties they held.

**Criterion 31.4 –** Competent authorities of the HKPF and the C&ED have direct access to FIU information via the JFIUs online database, STREAMS. Other authorities conducting investigations of ML, associated predicate offences and TF may obtain additional information on request (OSCO & DTROP, 25A(9); UNATMO, s.12(6)).

### **Weighting and Conclusion**

**Recommendation 31 is rated compliant.**

### **Recommendation 32 – Cash Couriers**

In its 3rd MER, HKC was rated non-compliant with these requirements due to the lack of a declaration or disclosure system for the detection, seizure or confiscation of cross-boundary movement of currency or bearer negotiable instruments (CBNIs) that are related to ML or TF. Since then, HKC has implemented a declaration or disclosure system by enacting the Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance (Cap. 629) (the R.32 Ordinance) in June 2017. The R.32 Ordinance has commenced operation on 16 July 2018.

**Criterion 32.1 –** For a person arriving in HKC at a specified control point (*cf*, schedule 1 of the R.32 Ordinance), all travellers are required to make a written declaration if they are in possession of CBNIs of more than HKD 120 000 (USD 15 290<sup>75</sup>) (R.32

<sup>75</sup> As of Nov 2018

Ordinance, Part 2, Division 1, s.4). HKC authorities report that in practice all 15 control points in HKC are specified.

For natural persons leaving HKC or arriving in HKC not via a specified control point, the person must make a disclosure upon request by the C&ED if he/she is in possession of CBNIs with total value of over HKD 120 000 (USD 15 290) (R.32 Ordinance, Part 2, Division 1, s.5.) "CBNIs" are defined as a note, or coin, that is legal tender in or outside HKC; or a bearer negotiable instrument. The declaration system extends to transportation via cargo carried out by both natural and legal persons (R.32 Ordinance, s.9 & 11.). CBNIs in postal packets are prohibited articles in HKC and which, unless tendered for transmission in insured or registered letters, will be refused or detained and disposed. Postal declarations of CBNIs transmitted in insured or registered letters are required. If the C&ED has reason to suspect that CBNIs in postal packets are crime proceeds or terrorist property, it will liaise with the Hong Kong Post which in accordance with section 12 of the Post Office Ordinance (Cap. 98), has the power to open the packets to facilitate the C&ED's necessary investigation.

**Criterion 32.2** – As mentioned above, HKC has a written declaration system for all travellers entering the territory carrying amounts of over HKD 120 000 (USD 15 290).

**Criterion 32.3** – As mentioned above, for natural persons leaving HKC or entering not via a control point, HKC has a disclosure system and travellers are required to provide truthful and appropriate information upon request.

**Criterion 32.4** – The C&ED officers have the powers to require a traveller arriving in or about to leave HKC or any person (including crew or staff member) on a cross-boundary conveyance to answer questions to ascertain whether there is a breach of declaration or disclosure requirements (R.32 Ordinance, Part 3, s.16(1)(c)). To ascertain if a case of failure to declare or disclose or false declaration may involve ML/TF activities, C&ED officers have the powers to question the person concerned to facilitate further detection and investigation of any ML/TF activities (R.32 Ordinance, s.25.).

**Criterion 32.5** – The maximum penalty for failure to comply with the declaration or disclosure requirements under the R.32 Ordinance is imprisonment for two years and a fine of HKD 500 000 (USD 63 700; EUR 54 200) (R.32 Ordinance, Part 2, Division 1, ss. 4(8), 5(6) and 6(6)). The Ordinance provides for a discretion for the Commissioner of the C&E to allow a first-time offending traveller to discharge the liability of a breach of a declaration or disclosure requirement (with exceptions as specified under section 13(2)), upon the payment of HKD 2 000 (USD 254; EUR 216) (R.32 Ordinance, Part 2, Division 3, s.13). HKC authorities report that the aforementioned discretion, which the Commissioner is not obliged to apply, is intended for handling cases of *bona fide* travellers having inadvertently failed to observe the declaration or disclosure requirements for the first time. Section 13(2) specifies that the procedure is not applicable to travellers convicted previously of ML/TF offences, or whose CBNIs are reasonably suspected to be crime proceeds or terrorist property. In any case, under section 13(1) of the R.32 Ordinance, the C&ED may choose to withhold the application of this mechanism of discharging a traveller's liability and bring the case to the court to decide on the appropriate level of penalty should the circumstances so require.

**Criterion 32.6** – The JFIU does receive information of declarations of CBNIs in respect of travellers and cargo, through the joint HKPF and the C&ED computerised

interface. Cargo declarations are filed electronically to the C&ED's CDS. Paper-form declarations made by travellers are delivered to the C&ED headquarters on a daily basis and entered manually into the CDS as soon as practicable. CBNIs in postal packets are prohibited articles unless transmitted in insured or registered letters for which postal declarations are required (see c.32.1).

**Criterion 32.7** – At the domestic level, HKC has set up regular co-ordination channels between the C&ED and other LEAs such as the JFIU, or the HKPF. When there is reasonable ground to believe that a traveller is in connection with an offence having been or likely to be committed under the R32 Ordinance, the C&ED will co-ordinate with the ImmD timely under the mechanism to monitor or intercept the traveller as per standing operational procedures.

**Criterion 32.8 – (a)** The C&ED may seize and detain any CBNIs reasonably suspected to be crime proceeds or terrorist property for a period of not more than 10 working days (R.32 Ordinance, Part 3, s.17.) This detention may be extended by up to two years subject to a Magistrate's order (R.32 Ordinance, Part 3, s.18).

**(b)** CBNIs seized on the ground of false declaration or false disclosure can be seized for such a reasonable period as required for the relevant criminal proceedings (R.32 Ordinance, Part, s.16 (2)).

**Criterion 32.9** – All information obtained and retained under the R32 system are available to facilitate international co-operation and assistance through all applicable mechanisms. CBNIs seized and detained can be dealt with under the external confiscation orders issued in accordance with the MLAO (MLAO, s.27). To facilitate such co-operation, the C&ED retains information from declarations, false declarations or disclosures (R.32 Ordinance, s.14) in a central database, and any suspicion of ML/TF is registered in the C&ED's database (see c.32.6).

**Criterion 32.10** – The C&ED has put in place departmental procedures to set out the policies and detailed practices in relation to personal data privacy to ensure that adequate and appropriate protection measures are applied in accordance with the Personal Data (Privacy) Ordinance (Cap. 486). The R32 Ordinance does not affect the legitimate flow of funds across boundaries in any way nor does it place any restriction on trade payments or movement of capital.

**Criterion 32.11** – In addition to the penalties set out in c.32.5 above for false disclosures/declarations, persons transporting funds or BNIs in relation to ML or TF may be subject to penalties for these offences, i.e. natural persons convicted of TF are subject to a maximum imprisonment of 14 years', or an unlimited fine, or both (UNATMO, ss.7, 8,8A) For ML, the maximum penalty under section 25(3) of both the OSCO and the DTROP is 14 years' imprisonment and a fine of HKD 5,000,000 (USD 637 000) (see c.3.9 and c.5.6).

CBNIs would be subject to civil and criminal forfeiture as set out in R. 4 (OSCO, s.8; UNATMO, s.13; CPO, s.102.)

### *Weighting and Conclusion*

**Recommendation 32 is rated compliant.**

### Recommendation 33 – Statistics

In its 3rd MER, HKC was rated largely compliant with these requirements. The main deficiency relates to the requirement under former R.32 for jurisdictions to review the effectiveness of their AML/CFT system

**Criterion 33.1** – Competent authorities maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of HKC’s AML/CFT systems. They are required to report assorted statistics to the FSTB biannually which are tabled for discussion at the regular meetings of the CCC.

*(a) STRs, received and disseminated;*

The JFIU has comprehensive statistics on STRs received (broken down by reporting sector) and disseminated (broken down by receiving agency), which are captured by its secure web-based platform STREAMS. Statistics on STRs received are kept up-to-date monthly on the official website of the JFIU, while more detailed statistics on STRs received and disseminated are published via the Quarterly STR Analyses and the JFIU Annual Reports.

*(b) ML/TF investigations, prosecutions and convictions;*

ML/TF investigation statistics are maintained by individual LEAs. The HKPF maintains statistics on the annual number of ML investigations, prosecutions and convictions (broken down by sentences), and TF investigations. ML/TF prosecution statistics are maintained by the Judiciary and input into the Integrated Law and Order Statistical System maintained by the SB. All ML/TF conviction statistics are maintained under HKPF’s Crime Record Database.

*(c) Property frozen; seized and confiscated;*

The DOJ collects and maintains statistics on the values of property frozen, seized and confiscated. The PD of the DOJ cross-checks the monthly collected figures with the JFIU for verification. The JFIU collates and maintains statistics on the number of annual restraint orders/confiscation orders/amount restrained or confiscated that are related to the Letter-of-No-Consent regime.

*(d) Mutual legal assistance or other international requests for co-operation made and received.*

Statistics on MLA and surrender requests made and received are collected and maintained by the DOJ under the Work Management System.

The LB of the HKPF has statistics on INTERPOL or other international investigative requests made to and received from worldwide police counterparts. The JFIU has statistics on FIU-FIU requests and spontaneous sharing made to, and received from, worldwide FIU or other counterparts. The FIG of the C&ED maintains statistics on all requests received or sent between the C&ED and overseas enforcement agencies in connection to ML investigations.

The IRD maintains statistics on the Exchange of Information on Request made and received as well as the status of the requests.

RAs also maintain statistics on requests for information or assistance made by or received from overseas counterparts. Regulatory bodies of DNFBPs, namely the EAA, the HKICPA and the LSHK, as well as the CR, are required to maintain statistics on

requests for information or assistance from overseas counterparts. Nevertheless, as the amended AMLO became effective from March 2018, HKC reports that no such requests have been received.

### *Weighting and Conclusion*

**Recommendation 33 is rated compliant.**

### **Recommendation 34 – Guidance and feedback**

In its 3rd MER, HKC was rated compliant with these requirements.

#### **Criterion 34.1 –**

##### *Supervisors' guidance and feedback to FIs*

The HKMA, the SFC and the IA respectively issue various sector-specific AML/CFT guidelines which are updated as necessary, circulars and other documents/information to assist compliance of AIs, LCs and IIs with AML/CFT requirements including STR filing, provide timely updates on such issues as common shortcomings of FIs, the latest ML/TF risk and trend, and holds various seminars and meetings with AIs, LCs and IIs; the HKMA issues a guideline for SVF licensees that is broadly similar to one for AIs, while other circulars, feedback seminars and so on are provided to a lesser extent as the licensing regime for the sector was introduced only in November 2016. The C&ED issues the AML/CFT guidelines which are updated as necessary, as well as circulars and other documents/information for MSOs to assist them to comply with AML/CFT requirements including STR filing, and organises seminars and meetings to keep them abreast of AML/CFT regulatory development including issues related to STR filing.

##### *Supervisors' guidance and feedback to DNFBPs*

The EAA, the LSHK, the HKICPA and the CR respectively issue sector-specific AML/CFT guidelines which contain the requirements on AML/CFT measures including CDD and record-keeping, in accordance with the recently amended AMLO coming into force in March 2018, and STR filing. Even prior to such guidelines, there were other circulars or documents containing guidance on AML/CFT measures issued by SRBs and other DNFBP supervisors or trade/professional bodies, and seminars regularly organised by the Narcotics Division of the SB and SRBs and other DNFBP supervisors or trade/professional bodies.

##### *FIU's guidance and feedback*

The JFIU provides feedbacks on STRs such as providing red-flag indicators on its website, its STR Quarterly Analysis and seminars to FIs and DNFBPs (including DPMS).

##### *Other competent authorities*

Although there is no designated competent authority for DPMS, the Narcotics Division of the SB issued a sector-specific AML/CFT guideline including examples of red flag scenario for STR, which was updated and published in October 2018, and holds meetings/seminars for awareness-raising and capacity-building with the sector. However, the activities targeted for the sector are minimal. Separately, the FSTB

organises annual AML/CFT seminar for financial sectors (banking, securities and futures, insurance, MSOs services, and moneylenders).

### *Weighting and Conclusion*

There are gaps with respect to DPMS, stand-alone financial leasing and credit card companies.

**Recommendation 34 is rated largely compliant.**

### **Recommendation 35 – Sanctions**

In its 3rd MER, HKC was rated partially compliant with these requirements. The main deficiencies were that there were limitations in a range of available sanctions with respect to the insurance, remittance and money changing sectors, and lack of financial sanctions for the institutions supervised by the HKMA. Since then, HKC has amended the AMLO aiming at strengthening the powers of relevant authorities to sanction non-compliance.

**Criterion 35.1** – Regarding the requirements of R.6, any person who contravenes the provisions related to TFS under the UNATMO and the UNSAR commits an offence and is liable on conviction to criminal sanctions. The maximum sanctions under the UNATMO is an unlimited fine and imprisonment for 14 years and under the UNSAR is an unlimited fine and imprisonment for seven years (ss.7, 8, 8A and 14 of the UNATMO; s.6 of the UNSAR).

Regarding the requirements of R.8, there is a range of proportionate and dissuasive sanctions. An NPO formed as a society, a company or a trust is subject to reporting and accountability requirements including the source of income and the expenditure, and is liable on conviction to a criminal sanction for non-compliance (ss.15, 16 of the Societies Ordinance; s.662(1), (3), (6) of the CO; s.98 of the Trustee Ordinance). The IRD reviews an NPO which enjoys the benefit of tax exemption and if conditions are not met, such a tax benefit would be deprived. Making a false statement to gain or retain tax exemption is also an offence (s.82 of the IRO). Further, an NPO must apply for permits or licences in such cases as fund raising at public places and selling lottery, and liable on conviction to fine and imprisonment for non-compliance (s.4(17)(i) of the Summary Offence Ordinance; s.9 of the Gambling Ordinance; ss.83B, 150 and Schedule 9 of the Public Health and Municipal Services Ordinance).

Regarding the requirements of R.9-19, the HKMA, the SFC, the IA, and the C&ED are authorised to impose a range of proportionate and dissuasive administrative sanction and pursue criminal prosecution if an FI or an employee of an FI fails to comply with the AML/CFT requirements depending on the materiality (see c.27.4). However, the RML is not empowered to impose a range of proportionate sanctions (see c.27.4). In addition, there is a scope issue in relation to stand-alone financial leasing companies and credit card companies.

Regarding the requirements of R.20-21, any person who contravenes the reporting requirements and the prohibition on tipping-off is subject to criminal sanctions, which are imprisonment for maximum three months and a fine up to HKD 50 000 (USD 6400) if the person contravenes the reporting requirement, and imprisonment for maximum three years if the person contravenes the tipping-off requirement

(s.25A(7), (8) of the OSCO and the DTROP; s.14(5), (6) of the UNATMO). While the sanction against non-reporting does not appear to be sufficiently dissuasive, FIs and DNFBPs that are subject to the enforceable sector-specific AML/CFT Guidelines could be subject to proportionate and dissuasive administrative sanctions (see c.27.4 and 28.4(c)), if they contravene the STR requirements prescribed in the Guidelines.

Regarding the requirements of R.22-23, the LSHK, the HKICPA, the EAA and the CR are authorised to impose a range of proportionate and dissuasive administrative sanctions, or a fine if a DNFBP or a natural person working for a DNFBP fails to comply with the AML/CFT requirements (see c.28.4(c)). However, the scope limitation with respect to DPMS applies.

**Criterion 35.2** – Sanctions are applicable not only to FIs and DNFBPs but also to responsible natural person including their directors and senior management (c.27.4 and 28.4(c)).

### *Weighting and Conclusion*

There is a shortcoming with respect to the range of sanctions applicable to moneylenders.

**Recommendation 35 is rated largely compliant.**

### **Recommendation 36 – International instruments**

In its 3rd MER, HKC was rated largely compliant and partially compliant respectively with these requirements. The main deficiencies identified were related to HKC's implementation of the TF Convention. Notably, the TF offence did not extend to 'funds' as broadly defined by the Convention; the definition of 'terrorist act' did not extend to acts or threats directed at international organisations; the civil 'protest' exemptions to certain classes of 'terrorist acts' were of potentially broad application; and not all customer due diligence requirements had been implemented. The UNATMO has been amended since to address the identified deficiencies.

**Criterion 36.1** – All four conventions are applicable to HKC by virtue of Article 153 of the Basic Law whereby the People's Republic of China's membership of these conventions means they have become part of HKC's legal order. China ratified the Vienna Convention on October 25, 1989, the Palermo Convention on September 23, 2003, the Merida Convention on January 13, 2006, and the Terrorist Financing Convention on April 19, 2006.

**Criterion 36.2** – HKC has fully implemented the relevant articles of the Vienna Convention, the Palermo Convention and the Merida Convention. HKC has also implemented the TF Convention and corrected the majority of the deficiencies highlighted in the 3<sup>rd</sup> MER (though the "civil protest exemption" remains under the law). Minor deficiencies still exist in the coverage of the trafficking in persons offence Gaps with the coverage of these predicate offences may impede HKC's ability to fulfil international co-operation, in particular to the Palermo Convention.

### *Weighting and Conclusion*

There are minor gaps under the TF convention (see R.5), as well as minor deficiencies observed in the coverage of human trafficking (see R.3).

**Recommendation 36 is rated largely compliant.**

## Recommendation 37 - Mutual legal assistance

In the 3<sup>rd</sup> MER, HKC was rated largely compliant with these requirements. The main deficiencies were that limited coercive measures existed with other parts of the PRC and the limitations with regards the TF offence impacted on the extent to which HKC could provide MLA. These deficiencies have been remedied in part through the enactment of the UNATMO (Amendment) Ordinance 2012, which has expanded the TF offence.

**Criterion 37.1** – HKC has a legal basis for the rapid provision of a wide range of MLA under the MLAO, the EO (which covers court to court letters of request which extend to the examination of witnesses and production of documents and applies to other parts of China<sup>76</sup>), and bilateral MLA agreements as well as a number of multilateral conventions which have been applied to HKC.<sup>77</sup> HKC's MLAO has a wide range of application, applying to ancillary criminal matters as well as investigation and prosecution of offences. Where no agreement or convention exists between HKC and the requesting jurisdiction, the MLAO allows for assistance to be rendered on the basis of reciprocity, except for assistance in relation to investigation of an offence relating to taxation referred to in Criterion 37.4.

**Criterion 37.2** – HKC's Central Authority for MLA is the MLA Unit (MLAU) of the International Law Division of the DOJ. An electronic case repository and management system is used to monitor progress of MLA requests. Priority is given to urgent cases as specified in the requests (e.g. cases with court hearings) and requests from jurisdictions with which HKC has a bilateral or multilateral arrangement. The time required to process a request varies depending on a number of factors, including the quality of a request, the complexity of a case, the time taken to obtain supplemental information, the type of assistance sought and the amount of evidence required. Requests under the EO are also included in the case management system.

**Criterion 37.3** – HKC accedes to the majority of MLA requests and does not subject requests to unreasonable or unduly restrictive conditions. The grounds for denying a request depend on the assistance sought, and may include: double jeopardy; the granting of such requests would impair the sovereignty or security of the PRC; reciprocity; dual criminality (see 37.7); cases of a political character; offences that would fall under only military law applicable in HKC; prejudice based on race, religion or nationality; and imposition of the death penalty (MLAO, s.5 (1) and (3)). All MLA requests will have to receive clearance from the CPG of the PRC before it can be executed (MLAO, s.34)

**Criterion 37.4** –

**(a)** An MLA request to HKC can be refused if it relates to an *investigation* into an offence relating to taxation if the requesting jurisdiction is neither a party to an MLA

<sup>76</sup> Section 3 of the IGCO stipulates that “People's Republic of China includes Taiwan, the Hong Kong Special Administrative Region and Macau”.

<sup>77</sup> As of December 2018, HKC has MLA agreements with the following 30 countries: Australia; Belgium; Canada; Czech Republic; Denmark; Finland; France; Germany; India; Indonesia; Ireland; Israel; Italy; Japan; Korea; Malaysia; Netherlands; New Zealand; Philippines; Poland; Portugal; Singapore; South Africa; Spain; Sri Lanka; Sweden; Switzerland; Ukraine; United Kingdom; United States of America.

agreement with HKC nor a party to an international convention that is applicable to HKC (MLAO, s.5 (2) (a)). There is no bar to seeking assistance under the MLAO where the request relates to a *prosecution* of a taxation offence. Alternatively, assistance to a tax investigation may also be provided under the EO. HKC authorities have further advised that in view of the wide network on mutual legal assistance underpinned by bilateral and multilateral conventions, the section 5(2)(a) restriction is rarely invoked. In the past five years from 2013 to 2017, there have been no instances of a request being refused pursuant to the provision. The possible refusal of requests on the basis that it relates to investigation into taxation offences unless there is an agreement represents a minor gap.

**(b)** There are no provisions in the legislation that allow an MLA to be refused on the grounds of secrecy or confidentiality requirements on FIs or DNFBNPs, except where legal professional privilege applies (MLAO, s.15(9)).

**Criterion 37.5** – MLA requests in HKC are executed under the auspices of confidentiality. Confidentiality is maintained when there is an explicit request by countries for it under the MLAO (MLAO, s.8 (2) (e)), and is a feature in most bilateral agreements that HKC has agreed to with foreign jurisdictions concerning MLA. There also exists jurisprudence from the HKC Courts that rule where MLA requests are concerned, confidentiality should be maintained (*Chan Mei Yiu Paddy & Anor v Secretary for Justice & Ors [2007] 4 HKC 227*).

**Criterion 37.6** – The lack of dual criminality is a mandatory ground for refusal under the MLAO (MLAO, s.5(1)). HKC authorities however report that the provision of assistance for non-coercive measures (or the non-coercive actions under a formal request), such as public record searches, voluntary interview of witnesses, or release of information on a consensual basis, can operate under other forms of international co-operation. The deficiency is therefore considered minor as a lack of dual criminality will not result in automatic refusal and the HKC authorities will endeavour to execute the request through informal co-operation where possible (i.e. LEA co-operation).

**Criterion 37.7** – HKC determines dual criminality based on the underlying conduct of the offence. Dual criminality is not predicated on the categorisation of the offence, the description of the offence by the same terminology or the need for the offence to have similar constituent elements. A decision by the HKC courts establishes this principle within HKC Legal Jurisprudence, *Re Rafat Ali Rizvi & Ors [2014] HKCU 280 at paragraphs 66 to 68*.

**Criterion 37.8** –

**(a)** Domestic competent authorities can exercise their powers under the MLAO in order to respond to MLA requests for production, search and seizure and taking of statements.

**(b)** For investigative techniques under c31.2, undercover operations and controlled delivery are administrative investigative techniques that may be provided to foreign counterparts through co-operation where the circumstances warrant. Accessing computer systems (without consent) requires a search warrant which may be obtained under the MLAO. Interception or covert surveillance can be provided where the purpose is to prevent a serious crime in or protect public security of HKC.

### *Weighting and Conclusion*

HKC possesses a comprehensive MLA regime with clear processes in receiving and responding to MLA requests. Minor gaps continue to exist in the request of MLA for information for the investigation of an offence relating to taxation, and the dual criminality requirements for non-coercive measures under the MLAO.

**Recommendation 37 is rated largely compliant.**

### **Recommendation 38 – Mutual legal assistance: freezing and confiscation**

In its 3rd MER, HKC was rated largely compliant with these requirements. The main deficiencies were that there were limited statutory mechanisms for asset recovery actions with other parts of the People’s Republic of China as well as lack of information provided by authorities on the establishment of an asset forfeiture fund.

**Criterion 38.1** – MLA in the restraint and confiscation of proceeds, instrumentalities of crime, and property of a corresponding value is available in HKC by virtue of the MLAO, the DTROP and the Drug Trafficking (Recovery of Proceeds) Order (DTROPOr).

The MLAO’s ambit extends to proceeds and instrumentalities of all criminal offences punishable with imprisonment for at least two years, and includes property of a corresponding value. Under the MLAO, a foreign jurisdiction can seek assistance for the purpose of investigations into an “ancillary criminal matter” which would include the restraint and forfeiture proceedings. HKC authorities are able to render assistance in investigations as discussed under R37 where identification of property is concerned. When proceedings have commenced in a place outside HKC, the MLAO may be used to restrain property pending the conclusion of those proceedings. If a confiscation or forfeiture order is obtained, such order may be enforced under the MLAO.

The DTROPOr allows for HKC to recognise external confiscation orders whereby the terms of recognition of such orders are contained in Schedule 2. Schedule 2 of the DTROPOr, s. 3 defines an external confiscation order as one relating to a drug trafficking offence including pecuniary penalty orders and orders for the recovery of proceeds (direct and indirect) as well as instrumentalities. The law also extends to covering orders for the recovery of amounts corresponding to the value of benefits. The DTROPOr is wide enough in scope to cover both civil and criminal orders. Schedule 1 of the DTROPOr contains a list of countries that have been designated for the application of the DTROPOr. Section 3(1)(b) of the DTROPOr extends the scope of the order to cover all countries to which the Vienna Convention applies.

Whilst the MLAO and the DTROPOr allow foreign jurisdictions to request the restraint of forfeiture of proceeds of crime and instrumentalities as well as property of corresponding value, HKC’s asset recovery regime under the MLAO does not have any application to other parts of the People’s Republic of China. Whilst the DTROP/DTROPOr has no such limitations, this confines HKC’s assistance in asset recovery to other parts of China to only Court-to-Court assistance under the EO, registration and enforcement of restraints and confiscation orders related solely to drug trafficking and any other forms of non-coercive assistance only.

**Criterion 38.2** – HKC can provide assistance to requests for co-operation made on the basis of non-conviction-based confiscation proceedings and related provisional

measures. Section 2 of the MLAO and s. 3 of Schedule 2 of the DTROP provide for the definition of “external confiscation order” to extend such orders to include both civil and criminal orders. Section 28 of the MLAO and section 29 of the DTROP meanwhile allow for the fact that where a perpetrator is unavailable, an external confiscation order can be made against him or specified property.

**Criterion 38.3** – Where arrangements for co-ordinating seizure and confiscation actions with other countries are concerned, arrangements in HKC are largely administrative and done on the basis of LEA-LEA co-operation.

HKC has in place mechanisms for managing and disposing of property frozen, seized or confiscated at different stages of proceedings. Sections 7 (7) and 9 (2) of Schedule 2 of the MLAO provide that the CFI may appoint a receiver to manage property at the restraint stage or to take possession and realise property at the confiscation stage. The DTROP also contains similar provisions for the management and realisation of instrumentalities (see R.4).

**Criterion 38.4** – HKC is able to share confiscated property with other countries. Section 10 (7) of Schedule 2 of the MLAO and s. 13 (8) of Schedule 2 of the DTROP provides that an application made by the requesting jurisdiction within five years from the deposit of the confiscated proceeds with the Registrar of the High Court, the SJ may direct the Registrar to pay to the requesting jurisdiction such specified proportion of proceeds.

### *Weighting and Conclusion*

While HKC fulfils most of the requirements of R.38, there remains limited statutory mechanisms for asset recovery actions with other parts of the People’s Republic of China.

**Recommendation 38 is rated largely compliant.**

### **Recommendation 39 – Extradition**

Extradition is known as surrender of fugitive offenders in HKC. In its 3rd MER, HKC was rated largely compliant with these requirements. The identified deficiency related to the absence of a mechanism to extradite to other parts of the People’s Republic of China (PRC).

**Criterion 39.1** – – HKC’s legal framework allows for surrender of fugitive offenders through the Fugitive Offenders Ordinance (FOO) (Cap. 503). These international arrangements are implemented by way of subsidiary legislation in the form of orders passed under section 3 of the FOO. HKC currently has 20 bilateral agreements for surrender of fugitive offenders of which 19 are in force. Surrender of Fugitive Offenders arrangements between HKC and other parts of the PRC remain absent and are subject to the discretion of LEA authorities of Mainland China.

**(a)** An extraditable offence in HKC is defined as (i) offences punishable in both HKC and the requesting jurisdiction by more than 12 months of imprisonment; and (ii) comes within the descriptions listed in Schedule 1 of FOO (FOO, s.2). ML and TF are both encompassed within the descriptions under items 41 and 43 of Schedule 1 of the FOO respectively.

**(b)** The MLAU has a case management system, which is electronic in nature and has in place a system to prioritise urgent and complex cases. For urgent and complex cases, the Deputy Law Officer of the MLAU) will make a remark of the urgency and complexity of those cases to alert handling counsel when a file is opened.

**(c)** The FOO contains a number of possible restrictions on surrender of fugitives, including freedom from persecution on political or other grounds, double jeopardy, dual criminality, and non-refoulement (FOO, ss.5 and 13.) These restrictions reflect well-established principles, and do not appear unreasonable or restrictive.

**Criterion 39.2** – Section 3 of the IGCO stipulates that “People’s Republic of China includes Taiwan, the Hong Kong Special Administrative Region and Macao, China”. While section 13(4) of the FOO gives the CE discretion not to surrender a person who is a national of the PRC, there are no legal provisions that provide HKC will submit these cases without undue delay to its competent authorities for prosecution at the request of a country seeking extradition.

**Criterion 39.3** – Dual criminality is a requirement that must be adhered to for the surrender of a fugitive to take place under HKC’s legal framework (FOO, s. 2(2)(b)). Case law is present which holds that dual criminality is based on the underlying conduct and not on technical differences in the elements or taxonomy of the offences: *Cosby v Chief Executive HKC [2000]3 HKC 662*.

**Criterion 39.4** A simplified surrender mechanism is provided under section 10(6)(a) of the FOO. The fugitive may inform the court of committal at any time that he consents to his surrender. In which case, he would be committed forthwith awaiting the CE’s decision to surrender under section 13 of the FOO. The requesting party is not required to provide any supporting evidence, nor will a full committal hearing be held pursuant to section 10(6)(b) of the FOO.

### **Weighting and Conclusion**

There are no legal provisions for HKC to submit cases, where a national is not surrendered on the grounds of nationality, without undue delay for prosecution. The absence of a mechanism enabling HKC to surrender to and seek surrender from other parts of China remain as impediments to HKC’s surrender regime.

**Recommendation 39 is rated largely compliant.**

### **Recommendation 40 – Other forms of international co-operation**

In its 3rd MER, HKC was rated compliant with these requirements.

**Criterion 40.1** – Competent authorities can provide a wide range of international co-operation in relation to ML, associated predicate offences and TF. The HKPF, through its LB, is able to spontaneously or by request, exchange information through international channels such as INTERPOL as well as through the network of liaison officers based in HKC and surrounding jurisdictions.

The C&ED is able to exchange information or intelligence through its network of Regional Intelligence Liaison Offices as well as through the World Customs Organization. The C&ED has a number of Customs Co-operative Agreements/Arrangements signed with overseas counterparts to facilitate bilateral

information exchange. Within the C&ED, the office has established a number of liaison contact points for various purposes such as intelligence, drug trafficking, financial investigation, and intellectual property matters.

The JFIU is able to exchange information spontaneously via the Egmont Channel as well as formalised channels with certain non-Egmont group countries. It is able to exchange information as well on the basis of reciprocity.

The ICAC is able to exchange information spontaneously or on request if the information in the possession of the ICAC indicates a crime has been committed and can do so with agencies in other jurisdictions on an agency-to-agency basis without the need of bilateral agreements. The ICAC can exchange and disseminate information through the Economic Crime Agencies Network of which it is a member and has in place an arrangement with Anti-Corruption authorities in the PRC known as the Mutual Case Assistance Scheme to render assistance in investigating corruption offences. The ICAC can also extend assistance through Article 48 of the United Nations Convention Against Corruption as a basis for mutual law enforcement co-operation.

The IRD is able to exchange information through the exchange of information articles under CDTA and TIEA to which it has become a signatory. It is also now able to exchange information on the basis of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters following amendments to the IRO. Similarly, supervisory authorities can spontaneously exchange and disseminate information to foreign counterparts.

The HKMA can exchange information with overseas regulatory authorities under section 121 of the BO even in the absence of MOUs. Pursuant to section 53ZK of the AMLO, the CR may exchange information with an authority or regulatory organisation outside HKC that performs functions of the CR under the AMLO or regulates, supervises or investigates banking, insurance or other financial services, or legal or accounting services.

HKC's position has not changed since the previous MER where in the absence of any prohibition by law, there is nothing to preclude an LEA from disclosing information which has lawfully come in to its possession to any appropriate authority for purposes that could be fairly regarded as incidental to or consequential to its statutory or common law duties. Furthermore, under the PDPO, there are exemptions to personal data protection for the purposes of law enforcement and agencies may release such information to their overseas counterparts for the purposes of investigation.

#### **Criterion 40.2 –**

**(a)** LEAs such as the HKPF, the C&ED and the ICAC possess the lawful basis to provide co-operation to international counterparts (see c.40.1). There are provisions in the OSCO and the UNATMO that allow for the SJ to authorise information exchange with LEAs.

Under the DTROP, the OSCO and UNATMO, there exist provisions to exchange information contained in STRs to foreign LEAs.

The BO and PSSVFO provides the statutory basis for the HKMA to render international co-operation assistance. Similar provisions exist in the SFO and IO for the SFC and the IA to do the same.

The C&ED can also disclose information to overseas financial regulators on the basis of provisions under the AMLO.

**(b)** There are no legal impediments to competent authorities using the most efficient means possible to extend co-operation. Exchange of information and intelligence is carried out where possible through electronic means such as ELITES where the HKPF is concerned and the Egmont system utilised by the JFIU. Competent authorities in HKC possess the necessary case management and prioritisation systems to expedite urgent and critical requests.

**(c)** Competent authorities in HKC demonstrate the use of clear and secure gateways to transmit information. Examples of this include the use of the INTERPOL I 24/7 system by the HKPF and Egmont secure web by the JFIU.

**(d)** The competent authorities in HKC possess guidelines, procedures and instructions where the prioritisation and execution of international co-operation requests are concerned.

**(e)** All competent authorities are subject to local laws protecting the confidentiality of information exchanged such as the PDPO as well as government wide regulations, policies and standing orders. Secrecy requirements are present in the BO, the PSSVFO, the SFO and the IO to protect the integrity of such information from being disclosed to other parties as well as to lay down the disclosure of such information in prescribed circumstances.

**Criterion 40.3** – HKC competent authorities have negotiated and signed in a timely way a multitude of bilateral agreements with their respective overseas counterparts as well as belong to various international organisations for the purposes of information exchange. Further to this, provisions in laws within HKC’s legal framework allow for information to be exchanged for the investigative and regulatory purpose in the absence of any formal agreements.

**Criterion 40.4** – HKC authorities state that feedback is provided in a timely manner if requested for by foreign counterparts where assistance has been received. This is done in a variety of ways through regular liaison or contact points or during meetings or other communications with foreign counterparts.

**Criterion 40.5** – HKC does not place unreasonable or unduly restrictive conditions on the provision of information or assistance on all the grounds under c. 40.5. Whilst certain laws such as the BO, the SFO, the IO and the AMLO regulate the conditions whereby which information can be shared to foreign counterparts, these do not appear to be unreasonable or unduly restrictive.

**Criterion 40.6** – Agencies in HKC appear to control and safeguard the use of information obtained exchanged with international counterparts to ensure that information received is used only for the intended purpose, and by the authorities for whom the information was sought. This is done through the use of various Standing Orders and Standard Operating Procedures. Laws such as the PDPO and the BO also provide for provisions that stipulate as to when such information can be disclosed.

**Criterion 40.7** – HKC possesses the requisite laws to protect the confidentiality of information exchanged through requests of co-operation. This can be found in the Official Secrets Ordinance, the PSSVFO, the SFO and the IO. All agencies also have their

standard operating procedures as to how to deal with confidential information as well as the necessary security measures to govern the provision of such information.

**Criterion 40.8** – Provisions exist under the HKC Legal Framework for competent authorities to conduct inquiries on behalf of their foreign counterparts. The IRO, the IO, the SFO, the PSSVFO and the BO provide for this. The JFIU can make inquiries on behalf of their foreign counterparts so long as it is for the purpose of combating ML, TF and associate predicate crimes. LEAs are also allowed to do so based on established case law under the HKC system. Also, bilateral agreements such as CDTAs and TIEAs as well as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters oblige HKC as well to share tax information and as such make the necessary inquiries to assist its overseas counterparts.

#### Exchange of information between FIUs

**Criterion 40.9** – The JFIU has adequate legal powers to exchange information with foreign FIUs (sections 25A(1) and 25A(9)(b) of the Drug Trafficking (Recovery of Proceeds) Ordinance (DTRPO) (Cap. 405) and the Organized and Serious Crimes Ordinance (OSCO) (Cap. 455), and sections 12(1) and 12(6)(b) of the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO) (Cap. 575)

**Criterion 40.10** – Upon request and whenever possible, the JFIU would provide written feedback to their worldwide counterparts on the use of the information/intelligence provided, as well as on the outcome of the analysis of such information/intelligence conducted.

**Criterion 40.11** – The JFIU generally co-operates with foreign counterparts on requests for information exchange. The JFIU may obtain information from all available sources including FIs when being requested by worldwide counterparts regardless of whether an STR has been filed.

#### Exchange of information between financial supervisors

**Criterion 40.12** – The HKMA, the SFC, the IA and the C&ED have legal basis for providing co-operation including the exchange of supervisory information with foreign counterparts (s.7(2)(e) and 121 of the BO; s.9(2)(c) and 50(4)(b) of the PSSVFO; s.5(1)(h), 186 and 378(3)(g)(i) of the SFO; s.4A(2)(f) and 53B of the IO; s.49(3)(d) of the AMLO). The RML may only exchange supervisory information with foreign counterparts if such an exchange is necessary to perform its function pursuant to s.5(1) or for the purpose of criminal proceedings pursuant to s.5(2)(b) of the MLO.

**Criterion 40.13** – The HKMA, the SFC, the IA, the C&ED and the RML are able to obtain information domestically, including information held by their supervised FIs (s.55, 56, and 63 of the BO; s.12, 12A and 33C of the PSSVFO; s.186 and 378(3)(g)(i) of the SFO; s.16(5), 34, 41B, 41D, 41N and 74 of the IO; s.9 and 12 of the AMLO; s.11(6) of the MLO; Condition 11 of Moneylenders Licensing Conditions). All of them have legal basis to exchange obtained information with foreign counterparts as mentioned in c.40.12.

**Criterion 40.14** – The HKMA, the SFC, the IA, the C&ED and the RML are able to exchange information including (a) regulatory information, (b) prudential information and (c) AML/CFT information. There is no provision to limit the scope of exchangeable information.

**Criterion 40.15** – The HKMA, the SFC and the IA are empowered by statutory provisions to conduct inquiries on behalf of foreign counterparts (s.7(2)(e), 55 and 63 of the BO; s.9(2)(c), 12, 12A and 33C of the PSSVFO; s.186(2A) and 180(4A) of the SFO; s.4A(2)(f) and 34 of the IO). The C&ED and the RML are able to conduct inquiries for their own purposes and have legal basis to exchange obtained information as mentioned in c.40.12, although there is no explicit provision to conduct inquiries on behalf of foreign counterparts (s.9, 12 and c.49(3)(d) of the AMLO; s.5(1), 11(6) and 28 of the MLO; Condition 11 of Moneylenders Licence Licensing Conditions). While only the HKMA in the capacity of AIs' supervisor and the IA are empowered by explicit provisions to authorise or facilitate foreign counterparts to conduct their own inquiries in HKC as appropriate, the SFC informed that it is able to facilitate such inquiries where there is an MOU with a foreign counterpart (s.68 of the BO; s.53C of the IO). No information was provided on the C&ED and the RML in this regard.

**Criterion 40.16** – The HKMA, the SFC, the IA and the C&ED are required to have the consent of the requested financial supervisor to disclose information exchanged except in a civil proceedings or other cases specified under the relevant Ordinances (s.120(5)(h), (5D) of the BO; s.50(3)(h) of the PSSVFO; s.378(3)(k) of the SFO; s.53A(3)(g), (3A) of the IO; s.49(3)(e) of the AMLO), and is required to promptly inform the requested authority of such an exceptional disclosure pursuant to the terms of the relevant MOUs with the requested authority or under multilateral instruments. The aforementioned authorities informed that they would do so even where there are no MOUs or multilateral instruments. No information was provided on the RML.

#### Exchange of information between law enforcement authorities

**Criterion 40.17** – All LEAs are able to exchange domestically available information with foreign counterparts in the manner set out under criterion 40.1. In the absence of an express prohibition by law, there is nothing to preclude LEAs (the HKPF, the C&ED, and the ICAC) from disclosing information which has lawfully come into its possession to an appropriate authority for those purposes that could be fairly regarded as incidental to or consequential to its statutory and common law duties.

**Criterion 40.18** – As set out under criteria 40.3 and 40.8, LEAs are able to conduct inquiries on behalf of requesting authorities and obtain information and provide the same to foreign counterparts.

**Criterion 40.19** – LEAs are able to form joint investigative teams with foreign counterparts where the need arises.

#### Exchange of information between non-counterparts

**Criterion 40.20** – Absent any prohibition, there are no legal impediments for LEAs to share information to an appropriate authority for purposes that could be fairly regarded as incidental to or consequential to statutory and common law duties as shown in case law from the Courts. Further to this, information can be exchanged with non-counterparts through the JFIU via the FIU-FIU channel where such information will be provided subject to the conditions determined such as the use of such information for specified purposes only and only for the knowledge and information of specific disseminated parties of competent authorities within a particular jurisdiction.

***Weighting and Conclusion***

The JFIU and LEAs have adequate powers to exchange information with its foreign counterparts and provides feedback if requested. Minor shortcomings exist in the international co-operation of financial supervisors (the C&ED and the RML).

**Recommendation 40 is rated largely compliant.**

## Summary of Technical Compliance – Key Deficiencies

Compliance with FATF Recommendations		
Recommendations	Rating	Factor(s) underlying the rating
1. Assessing risks & applying a risk-based approach	LC	<ul style="list-style-type: none"> <li>Full risk assessment of legal persons was not conducted.</li> <li>Exemptions for the DPMS sector, the stand-alone financial leasing companies and non-bank credit cards are not based on a proven low risk.</li> </ul>
2. National co-operation and co-ordination	LC	<ul style="list-style-type: none"> <li>It is not clear if the policies are fully informed by risks.</li> <li>Operational co-ordination and co-operation among LEAs and RAs can be enhanced further.</li> </ul>
3. Money laundering offences	LC	<ul style="list-style-type: none"> <li>There are minor gaps in the coverage of crimes for trafficking in human beings.</li> </ul>
4. Confiscation and provisional measures	LC	<ul style="list-style-type: none"> <li>OSCO restraint and forfeiture is limited to cases where benefits exceed HKD 100 000.</li> </ul>
5. Terrorist financing offence	LC	<ul style="list-style-type: none"> <li>There is a “civil protest” exemption to certain classes of terrorist acts, which is inconsistent with the TF Convention.</li> </ul>
6. Targeted financial sanctions related to terrorism & TF	C	<ul style="list-style-type: none"> <li></li> </ul>
7. Targeted financial sanctions related to proliferation	C	<ul style="list-style-type: none"> <li></li> </ul>
8. Non-profit organisations	C	<ul style="list-style-type: none"> <li></li> </ul>
9. Financial institution secrecy laws	C	<ul style="list-style-type: none"> <li></li> </ul>
10. Customer due diligence	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing companies and non-bank credit card companies are not required to comply with CDD requirements.</li> <li>CDD principle for moneylenders is not set out in a law.</li> </ul>
11. Record keeping	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing companies and non-bank credit card companies are not required to comply with record-keeping requirements.</li> <li>Record-keeping principle for moneylenders is not set out in a law.</li> </ul>
12. Politically exposed persons	PC	<ul style="list-style-type: none"> <li>PEPs from Mainland China and other parts of China are considered domestic PEPs.</li> <li>Stand-alone financial leasing companies and non-bank credit card companies are not required to comply with PEP requirements.</li> </ul>
13. Correspondent banking	C	<ul style="list-style-type: none"> <li></li> </ul>
14. Money or value transfer services	LC	<ul style="list-style-type: none"> <li>Domestic remittances are not covered within the scope of the AMLO</li> <li>HKC has not applied proportionate and dissuasive sanctions against MSOs that carry out activities without a licence.</li> </ul>
15. New technologies	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing and non-bank credit card companies are not required to comply with this obligation.</li> </ul>
16. Wire transfers	LC	<ul style="list-style-type: none"> <li>Foreign agents of MVTs are not required to comply with all the relevant requirement of this recommendation.</li> <li>There is no requirement for MVTs provider that controls both the ordering and the beneficiary side of a wire transfer to file an STR in a foreign country affected by the suspicious wire transfer.</li> </ul>
17. Reliance on third parties	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing and non-bank credit card companies are not required to comply with this recommendation.</li> </ul>
18. Internal controls and foreign branches and subsidiaries	LC	<ul style="list-style-type: none"> <li>There are no specific provisions for moneylenders in relation to the independent audit function.</li> <li>Stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements.</li> </ul>
19. Higher-risk countries	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing and non-bank credit card companies are out of the scope of the requirements.</li> </ul>

20. Reporting of suspicious transaction	LC	<ul style="list-style-type: none"> <li>There are minor deficiencies in the coverage of some designated categories of offences that have an impact on R.20.</li> </ul>
21. Tipping-off and confidentiality	C	<ul style="list-style-type: none"> <li></li> </ul>
22. DNFBPs: Customer due diligence	PC	<ul style="list-style-type: none"> <li>DPMS are not subject to CDD, record keeping, PEP, new technologies and third parties requirements.</li> <li>Deficiencies in R.12 apply.</li> </ul>
23. DNFBPs: Other measures	LC	<ul style="list-style-type: none"> <li>DPMS are not subject to requirements of R.18 and 19.</li> <li>Deficiencies in R.18-20 apply.</li> </ul>
24. Transparency and beneficial ownership of legal persons	LC	<ul style="list-style-type: none"> <li>Scope and depth of the risk assessment on legal persons, which are not companies, are insufficient.</li> <li>Companies have two months to update changes in shareholding in the register, which means that shareholder information is not always accurate and up-to-date.</li> </ul>
25. Transparency and beneficial ownership of legal arrangements	PC	<ul style="list-style-type: none"> <li>Non-professional trustees (e.g. private individuals) and other trustees of trust other than professional trustees do not have specific obligation to obtain and hold adequate, accurate and up-to-date information on the settlor, trustee, and beneficiaries.</li> <li>General duty of care requirements placed on trustees under the Trustee Ordinance and the common law are not specific enough to be in line with R.25.</li> <li>There is no specific requirement for trustees to hold basic information on service providers to the trust.</li> <li>There is no explicit requirement for non-professional trustees to keep the information held accurate and up-to-date.</li> <li>There is no obligation for trustees to disclose their status to regulated entities.</li> </ul>
26. Regulation and supervision of financial institutions	LC	<ul style="list-style-type: none"> <li>Stand-alone financial leasing companies and non-bank credit card companies are not regulated or supervised for AML/CFT purposes.</li> </ul>
27. Powers of supervisors	LC	<ul style="list-style-type: none"> <li>The RML is not empowered to impose a range of proportionate sanctions.</li> <li>No supervisor has powers with respect to stand-alone financial leasing companies and non-bank credit card companies.</li> </ul>
28. Regulation and supervision of DNFBPs	PC	<ul style="list-style-type: none"> <li>Risk-based AML/CFT supervision is not established in DNFBP sectors.</li> <li>A person who holds a significant or controlling interest in an estate agent is not subject to the conviction record check.</li> <li>DPMS are not regulated nor supervised.</li> </ul>
29. Financial intelligence units	C	<ul style="list-style-type: none"> <li></li> </ul>
30. Responsibilities of law enforcement and investigative authorities	C	<ul style="list-style-type: none"> <li></li> </ul>
31. Powers of law enforcement and investigative authorities	C	<ul style="list-style-type: none"> <li></li> </ul>
32. Cash couriers	C	<ul style="list-style-type: none"> <li></li> </ul>
33. Statistics	C	<ul style="list-style-type: none"> <li></li> </ul>
34. Guidance and feedback	LC	<ul style="list-style-type: none"> <li>Outreach activities for DPMS sector are minimal.</li> <li>No guidance and feedback to stand-alone financial leasing companies and non-bank credit card companies.</li> </ul>
35. Sanctions	LC	<ul style="list-style-type: none"> <li>RML is not empowered to impose a range of proportionate sanctions.</li> </ul>
36. International instruments	LC	<ul style="list-style-type: none"> <li>Gaps in relation to the TF convention and the coverage of human trafficking.</li> </ul>
37. Mutual legal assistance	LC	<ul style="list-style-type: none"> <li>MLA request to HKC can be refused if it relates to taxation when the requesting jurisdiction is neither a party to an MLAA with HKC nor a party to an international convention that is applicable to HKC.</li> <li>Dual criminality is a mandatory ground for refusal under the MLAO.</li> </ul>
38. Mutual legal assistance: freezing and confiscation	LC	<ul style="list-style-type: none"> <li>There are limited statutory mechanisms for asset recovery actions with other parts of the People's Republic of China.</li> </ul>
39. Extradition	LC	<ul style="list-style-type: none"> <li>No legal provisions for HKC to submit cases where a national is not surrendered on the grounds of nationality without undue delay for prosecution.</li> <li>No mechanism enabling Hong Kong to surrender to and seek surrender from other parts of China.</li> </ul>
40. Other forms of international co-operation	LC	<ul style="list-style-type: none"> <li>C&amp;ED and RML do not have adequate powers to exchange information with their foreign counterparts.</li> </ul>

## Glossary of Acronyms

ADCC	Anti-Deception Co-ordination Centre
Als	Authorised institutions
AMLO	Anti-Money Laundering and Counter-Terrorist Financing Ordinance
AMLRECG	Anti-Money Laundering Regulatory Enforcement Co-ordination Group
AMLRSCG	Anti-Money Laundering Regulation and Supervision Co-ordination Group
BO	Banking Ordinance
CCB	Commercial Crime Bureau
CEDB	Commerce and Economic Development Bureau
C&ED	Customs and Excise Department
CFA	Court of Final Appeal
CO	Companies Ordinance
CPO	Criminal Procedure Ordinance
CR	Companies Registry
CSO	Co-operative Societies Ordinance
CSR	Co-operative Societies Rules
DOJ	Department of Justice
DTROP	Drug Trafficking (Recovery of Proceeds) Ordinance
EAA	Estate Agent Authority
EAO	Estate Agent Ordinance
FDH	Foreign Domestic helpers
FID	Financial Investigations Division (HKPF)
FIG	Financial Investigation Group (C&ED)
FIRs	Financial Intelligence Reports
FMLIT	Fraud and Money Laundering Intelligence Task Force
FOO	Fugitive Offenders Ordinance
FSCCT	Force Steering Group Committee on Counter Terrorism
FSTB	Financial Services and the Treasury Bureau
HKC	Hong Kong, China
HKICPA	Hong Kong Institute of Certified Public Accountants
HKMA	Hong Kong Monetary Authority
HKPF	Hong Kong Police Force
HRA	Hong Kong ML/TF Risk Assessment Report
IA	Insurance Authority
ICAC	Independent Commission Against Corruption
ICACO	Independent Commission Against Corruption Ordinance
ICSO	Interception of Communications and Surveillance Ordinance
ICTU	Inter-departmental Counter Terrorism Unit
IEO	Import and Export Ordinance
IGCO	Interpretation and General Clauses Ordinance
IIs	Insurance institutions
ImmD	Immigration Department
ImmO	Immigration Ordinance
IO	Insurance Ordinance
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance

JFIU	Joint Financial Intelligence Unit
LB	Liaison Bureau of HKPF
LCs	Licensed corporations
LegCo	Legislative Council
LLPs	Limited liability partnerships
LNC	Letter of No Consent
LPO	Legal Practitioners Ordinance
LSHK	Law Society of Hong Kong
MLAO	Mutual Legal Assistance in Criminal Matters Ordinance
MLAU	Mutual Legal Assistance Unit of the Department of Justice
MLO	Moneylenders Ordinance
MSOs	Money service operator
MSSB	Money Service Supervision Bureau
NB	Narcotic Bureau
OFC	Open-ended fund companies
OSCO	Organized and Serious Crimes Ordinance
PAO	Professional Accountants Ordinance
PFO	Police Force Ordinance
PD	Prosecution Division of the Department of Justice
PDP	Practice Direction P
POBO	Prevention of Bribery Ordinance
PRC	People's Republic of China
PSSVFO	Payment Systems and Stored Value Facilities Ordinance
RA	Regulatory authorities
RAU	Risk Assessment Unit
RMB	Renminbi
RML	Registrar of Moneylenders
SB	Security Bureau
SCR	Significant controllers register
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
SVF	Stored value facilities
UNATMO	United Nations (Anti-Terrorism Measures) Ordinance
UNSO	United Nations Sanctions Ordinance
WBT	World Bank National Risk Assessment Tool





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## **Anti-money laundering and counter-terrorist financing measures - Hong Kong, China.**

### ***Fourth Round Mutual Evaluation Report***

In this report: a summary of the anti-money laundering (AML) / counter-terrorist financing (CTF) measures in place in Hong Kong, China as at the time of the on-site visit from 31 October-15 November 2018.

The report analyses the level of effectiveness of Hong Kong's, China AML/CTF system, the level of compliance with the FATF 40 Recommendations and provides recommendations on how their AML/CFT system could be strengthened.