Anti-Money Laundering and Counter-Financing of Terrorism Webinar 2021

December 2021

Agenda

I. Update on major AML/CFT regulatory developments

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(1) Revised AML/CFT Guidelines

(2) Mitigating ML/TF risks of virtual assets

(3) New Technologies for AML/CFT

Speaker:

Joyce Pang

Associate Director and Head of AML Unit
Intermediaries Supervision

Background and objectives

FATF Standards

To align with the FATF Standards as amplified by the FATF's Guidance for a Risk-Based Approach for the Securities Sector

Mutual Evaluation

To address some areas for improvement identified in the latest Mutual Evaluation Report of Hong Kong (MER) which are relevant to licensed corporations

Industry feedback

To provide practical guidance to facilitate the implementation of AML/CFT measures in a risk-sensitive manner

FATF Recommendation 13 - Cross-border correspondent banking and other similar relationships:

Requires financial institutions to perform ***additional due diligence and risk mitigating measures*** for cross-border correspondent banking and other similar relationships (in addition to normal customer due diligence measures)

Examples of similar relationships: those established for ***securitie28.3 (nd)-41.6 .3***

Scope of application

Illustrative diagram of an in-scope business relationship

Hong Kong broker
(LC)

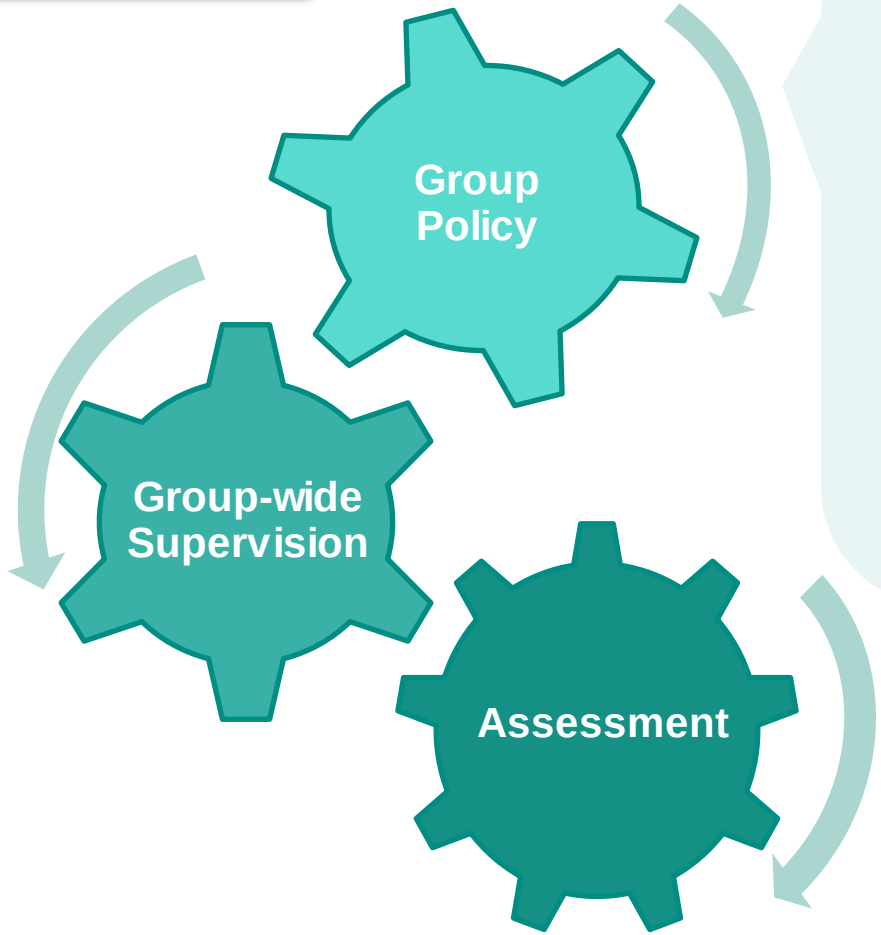
Scope of application

Illustrative diagram of an _____

Cross-

Streamlined approach

Effective implementation of the group policy and group-wide AML/CFT Systems is ***supervised*** at a group level by a ***competent authority***



Be satisfied that the ***group policy*** that applies to the respondent institution:

includes-

(i) CDD, ongoing monitoring and
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Assessment should be ***documented, and approved*** by an MIC of AML/CFT, MIC of Compliance or other appropriate senior management personnel

** Group-wide AML/CFT Systems include compliance and audit functions; provision of customer, account and transaction information to the group-level compliance, audit and AML/CFT functions and sharing of such information for CDD and group-wide ML/TF risk management purposes.*

Definition of “third party”

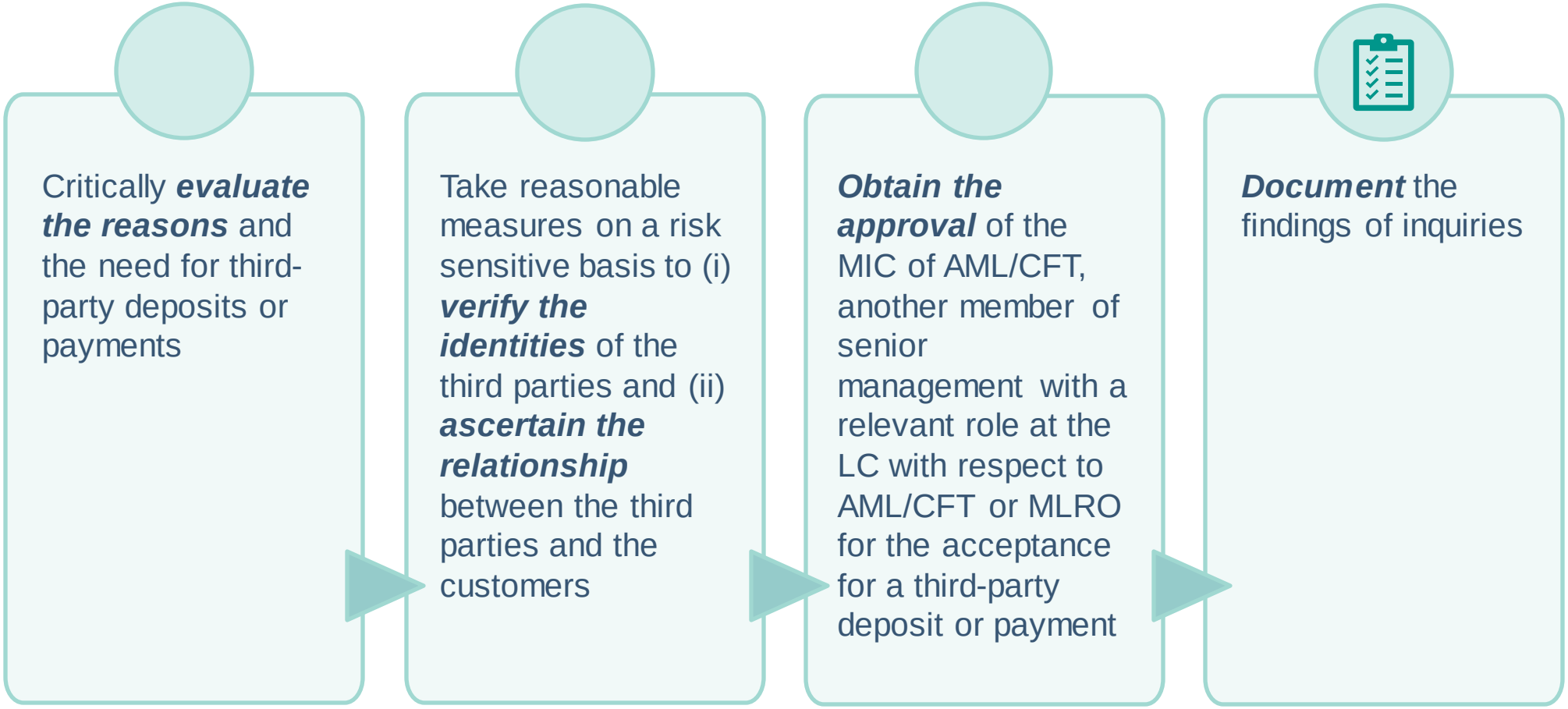
Who are the in-scope third parties for the purposes of the third-party deposits and payments provisions and whether fund transfers to or from a bank account jointly owned by a customer and a third party are in-scope?

“Third party” means any person other than the customer (see footnote to paragraph 11.1 of the AML/CFT Guideline)

Where an LC’s customer made a deposit or payment from or to a jointly owned bank account, the joint owner who is not the relevant customer is a third party for the purposes of these provisions. LCs should apply policies and procedures for handling third-party deposits and payments to transactions with such a jointly-owned bank account.

**For details, please refer to Q26 of AML/CFT FAQs*

Due diligence process for assessing third-party deposits and payments



Approval of third-party deposits and payments

Can the approval process for the acceptance of a third-party deposit or payment be delegated?

Yes, so long as the third-party deposit or payment approvers remain responsible for the approval decision

Other areas of major amendments

Institutional risk assessments

Red-flag indicators of suspicious transactions and activities

Risk indicators for institutional and customer risk assessment

Person purporting to act on behalf of the customer (PPTA)

Simplified and enhanced measures under a risk-based approach

Update on major AML/CFT regulatory developments

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(3) New Technologies for AML/CFT

Speaker:

Irene Pou

Associate Director

Intermediaries Supervision

Mitigating ML/TF risks of virtual assets

FATF's updated guidance

In October 2021, the Financial Action Task Force (FATF), published the *Updated Guidance for a Risk-*

Mitigating ML/TF risks of virtual assets

There is general support for the proposed direction and framework of the VASP regulatory regime, and for the SFC to become the regulatory authority of the regime.

The Government targets to introduce the amendment bill into the Legislative Council in the beginning of 2022 legislative year.

Proposed licensing regime for VASPs

Scope of regulated activities

Operating a VA exchange

The Government will keep in view the need for regulation of a broader range of VA activities as the market evolves. Flexibility will be built in the licensing regime such that it may be expanded to cover forms of VA activities other than VA exchanges where the need arises in future

Definition of VA

Both securities and non-securities tokens will be covered

[***Carve out**: digital representations of fiat currencies (including digital currencies issued by central banks); financial assets (eg, securities and authorised structured products) and stored value facilities which are already subject to regulations; and closed-loop, limited purpose items (such as air miles, credit card rewards, etc.)*]

Flexibility will be built in the legislation by empowering the SFC to prescribe characteristics that constitute the definition of a VA, and the Secretary for Financial Services and the Treasury to determine whether any digital representation of value is to be regarded as a VA or not

Proposed licensing regime for VASPs

Eligibility

Locally incorporated companies with a permanent place of business in Hong Kong or companies incorporated elsewhere but registered in Hong Kong under the Companies

Proposed licensing regime for VASPs

Licence period and exemption

Licence will remain valid until revoked by the SFC, for example, due to misconduct or cessation of operation

No exemption is proposed except for VA exchanges that are already regulated as a

Update on major AML/CFT regulatory developments

New Technologies for AML/CFT

On 1 July 2021, the FATF published a report on *Opportunities and Challenges of New Technologies for AML/CFT*.

The report:

Identifies opportunities to leverage new technologies and emerging and available technology-based solutions

Examines the challenges and obstacles to implement new technologies and how to mitigate them

Opportunities of new technologies for AML/CFT

(Based on responses to digital transformation questionnaire disseminated to government authorities and public and private sector experts by FATF)

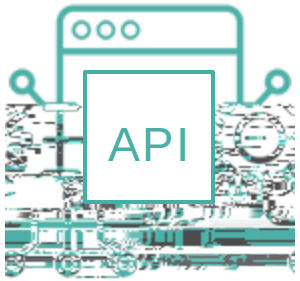
Opportunities of new technologies for AML/CFT

(Based on responses to digital transformation questionnaire disseminated to government authorities and public and private sector experts by FATF)

Which technologies offer the most potential to AML/CFT?

Respondents to FATF's digital transformation questionnaire cite machine learning and natural language processing (both are subsets of artificial intelligence) and Application Programming Interfaces as having the most potential for contributing to AML/CFT effectiveness.

However, it is essential to ensure that there is no over-reliance on new technologies. Human input and capacity building continue to be essential, in particular regarding elements that technology still cannot overcome, regional inequalities or expertise on emerging issues.



Challenges of implementation of new technologies for AML/CFT

Operational challenges such as complexities and costs involved in developing and implementing new technologies; difficulties with the explainability and interpretability of digital solutions, etc.

The unintended consequences of new technologies, such as ethical and legal issues, can arise from a misguided implementation of new technologies.

Inspection findings and other supervisory observations on AML/CFT

(1) Deficiencies and inadequacies found in LCs' AML/CFT systems and controls

(2) Guidance on the identification and reporting of suspected "ramp and dump" scams involving market manipulation activities

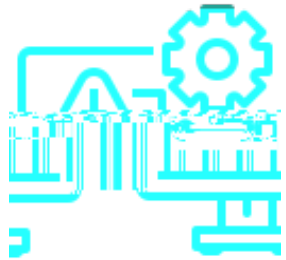
Management oversight and controls

Example 2: Documentation of AML/CFT control measures performed

Implementation of risk assessments

Example 3: Institutional risk assessment

On areas of controls identified in the assessment that require enhancements, no elaboration on the enhancements required or action plan developed for the enhancements.



Example 4: Customer risk assessment (CRA)

Failure to institute appropriate and effective measures to ensure that the High Risk Countries List used in the assessment of country risk associated with a customer during the CRA process, is complete and timely updated for proper categorisation of ML/TF risks of the customer.

Identification and evaluation of third-party deposits

Example 5: Identification of third-party deposits

Only deposits with amount exceeding the predetermined threshold would be subject to review to ascertain whether they originated from third-party payors.

Example 6: Evaluation of third-party deposits

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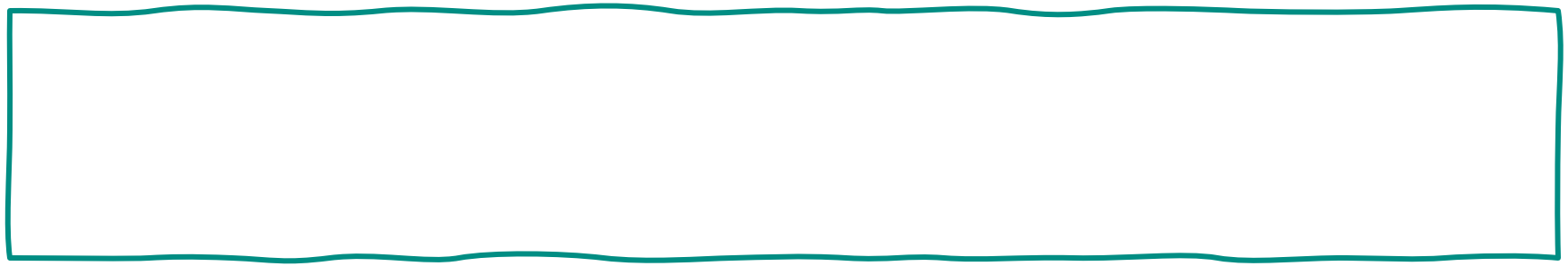
Sanctions screening



Ongoing monitoring

Example 8: Keeping customer information up-to-date and relevant

An LC reviewed customer due diligence (CDD) records of its customers on a periodic basis and upon the occurrence of trigger events.

The review process was limited to negative news screening of the customers, without reviewing the veracity and adequacy of the CDD information previously obtained and taking appropriate follow-up steps.

Inspection findings and other supervisory observations on AML/CFT

(1) Deficiencies and inadequacies found in LCs' AML/CFT measures and controls

Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

On 29 June 2021, the SFC issued a circular highlighting the concerns about the rising number of suspected ramp and dump scams.

The circular serves to:

- Encourage intermediaries to provide information or documents which may facilitate the SFC's immediate assessment of the impact of potential market misconduct, in particu (s)-8,i1 ()14.(r se)14hs-8
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Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

The circular also provides guidance on red flags which may arouse the reasonable suspicion of intermediaries or their staff about suspected ramp and dump scams. The following is a list of non-exhaustive illustrative red flags set out in the circular:

- Clients whose transaction amounts are generally incommensurate with their reported profiles.
- Clients who regularly acquire shares through bought and sold notes or on a free-of-payment basis or who receive large third-party deposits in their accounts.
- Clients who bought shares on a delayed settlement basis, following which the share price rose substantially during the delayed settlement period, and then gave instructions before the payment date to sell these shares.
- Clients who bought shares in a particular stock towards the end of the trading day in a way that had the effect of substantially raising the closing price on a number of days.

Suspected ramp and dump scams involving market manipulation in the shares of companies listed on the SEHK

Clients who sold a large volume of shares in a particular company shortly before a collapse of the share price which cannot be explained by any corporate or sector-specific news.

A group of clients, some of whom are identified from the trading behaviour set out above, traded in the same stock in the same direction, at more or less the same price or at the same time, and exhibit any of the following characteristics:

- they have authorised the same third party to operate their accounts;
- they have effected fund transfers amongst themselves;
- they opened accounts on or around the same day, were served by the same account executive or referred to the intermediary by the same person at account opening; or
- they share the same personal particulars such as telephone numbers or email addresses.

Paragraph 7.12 of AML/CFT Guideline requires LCs to “have reasonable policies and procedures to identify and anal(i)-546.0esaesepeat and enhanced (i)-1.12(c)-8.8 (i)-1.1 (eo)47.2 (c)-8.8 (u)0.7 (an)

Thank you

AML/CFT section of the SFC website:
https://www.sfc.hk/en/Rules-and-standards/Anti-money-laundering-and-counter-financing-of-terrorism