Anti-Money Laundering and Counter-Financing of Terrorism Webinar 2022

November / December 2022

Hong Kong ML/TF Risk Assessment

(1) Overview of the latest Hong Kong ML/TF risk assessment results

(2) ML threats of the securities sector

(3) ML vulnerabilities of the securities sector

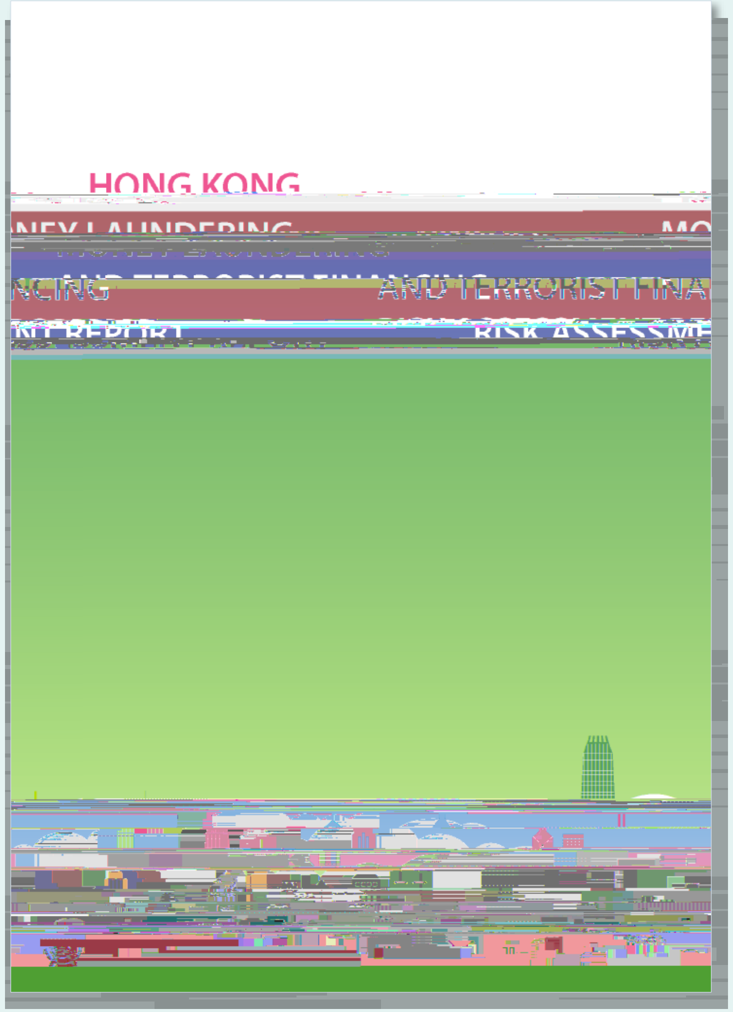
(4) ML threats and vulnerabilities of the virtual assets sector

Speaker:

Joyce Pang

Associate Director and Head of AML Unit
Intermediaries Supervision

Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report



Overall ML risk of Hong Kong

ML Threat

Threats arising from both internal and external predicate offences

Sectoral risk assessment financial institutions

Source: Figure 5.2, HRA Report (2022)

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Overall ML risk of the securities sector

ML Threat		ML Vulnerability		Overall ML Risk
Medium	+	Medium	=	Medium

Business sub-sector	*ML vulnerability*
Brokerages	**Medium**
Asset managers	**Medium-low**
Advisers on investments	**Medium-low**
Advisers on corporate finance	**Low**

Use of technology

Fact-finding Survey

ML threats of the securities sector

Securities-related offence

The securities market

Non-securities-related offence

ML threats from non-securities-related offence

Use of securities accounts to launder crime proceeds

A case in 2017

1

Crime proceeds from cannabis cultivation and trafficking

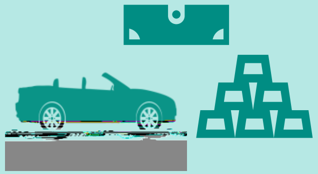
2

One of the suspects engaged his wife to launder crime proceeds

3

Some of the proceeds were layered into securities accounts

4



HK$7.2 million worth of assets, in the form of cash, gold, securities, credit balance of banks and luxury cars

ML threats from social media investment scams

Social media investment scams

In a typical scheme, the scammers:

1. Approach investors on social media platforms and establish relationships
2. Convince investors to buy typically a thinly-traded small-cap stock at an inflated price
3. Dump their own shares, causing the price to collapse

Ramp and dump schemes account for a **significant percentage** of the SFC market manipulation investigations

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Speaker:

Sharon Wong

Senior Manager
Intermediaries Supervision

ML vulnerabilities Nominee and dubious investment arrangements

arrangements

Transactions / arrangements incommensurate with the intended purpose and nature of business relationships

Conceal the actual beneficial ownership for other illegal activity

Give instructions

Nominee clients

- Execute trade instructions

Broker / Asset manager

Regulatory responses

ML vulnerabilities Remote office arrangements

Remote office arrangements

Regulatory responses

1

2

Increased use of remote office arrangements

Increased opportunities for criminals to derive illicit gains from **online fraud /**

ML vulnerabilities Third-party deposits and payments

Third-party deposits (TPDs) and payments (TPPs)

Broker

Third parties

Obscure the true beneficial owner / source of funds

Regulatory responses

1. **Issued circular in May 2019 to**:
   - reiterate the importance of mitigating the risks associated with TPDs and TPPs
   - provide guidance on the policies, procedures and controls to mitigate these risks (eg, due diligence process for assessing TPDs and TPPs)

2. **Incorporated** the guidance on TPDs and TPPs **into the revised AML/CFT Guideline published in September 2021**

Hong Kong ML/TF Risk Assessment

(1) Overview of the latest Hong Kong ML/TF risk assessment results

Overall ML risk of the virtual asset (VA) sector

ML threats of the VA sector

Major ML threats

Fraud

Investment in non-existing lucrative crypto investment plan

Theft

Robbery during face-to-face VA transactions

Statistics on VA-related crimes

155%

Number of VA-related cases registered in the first eight months of 2021 compared to the same period in 2020

472%

Financial losses related to VA-related cases registered in the first eight months of 2021 compared to the same period in 2020

52%

Number of VA-related crimes increased from 324 in 2018 to 494 in 2020

$324M

Financial losses related to VA-related crimes in the first eight months of 2021

ML vulnerabilities of VA trading platform

VA trading platform

Ease of accessibility, **anonymity-enhanced feature** and **global reach** without audit trail

Use of third parties as a **mule investor** to conduct VA transaction

ML vulnerabilities of VA trading platform

Update on major AML/CFT regulatory developments

AML/CFT regime for VASPs

Licensing regime for VASPs

Miscellaneous amendments

Politically exposed person (PEP)

Amend the definition of PEP (ie, from one in a place outside the People's Republic of China to one in a place **outside Hong Kong**)

Allow more **flexibility in the treatment of former PEPs*** by enabling the adoption of a risk-sensitive approach in determining the degree of CDD for such persons

Beneficial owner in relation to a trust

Amend the definition of "beneficial owner" of a trust **to include trustees, beneficiaries and class(es) of beneficiaries**, for better aligning with the definition of "controlling person" under the Inland Revenue Ordinance (Cap. 112)

Digital identification system

Allow a financial institution not to carry out additional measures for a customer who is not physically present for identification purposes if the financial institution verifies the customer's identity on the basis of data or information provided by a **recognized digital identification system**

** A former PEP refers to a PEP who is no longer entrusted with a prominent public function*

Inspection findings and other supervisory observations on AML/CFT

(1) Review of online brokerage, distribution and advisory services

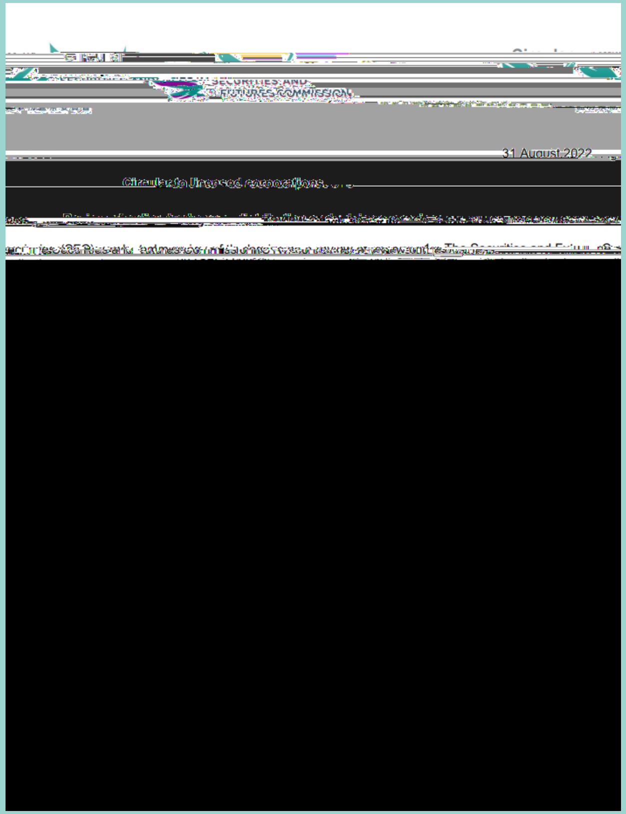
(2) Case examples

Speaker:

Calvin Pang

Manager
Intermediaries Supervision

Review of online brokerage, distribution and advisory services



- On 31 August 2022, the SFC issued a circular summarising key observations and compliance issues identified from the review of LCs which provided online brokerage, distribution and advisory services in respect of their:

  business models

  compliance with regulatory requirements when onboarding clients and distributing or advising on investment products via their online platforms

50 LCs

were surveyed

The period of

Jul 2020 – Jun 2021

was covered

In particular, the review found that:

96%

of the new accounts were opened by the surveyed LCs through non-face-to-face client onboarding approaches

Review of online brokerage, distribution and advisory services

Deficiencies relating to client onboarding

Use of certification services

Use of certification authorities (CA) that were not recognised

- an LC employed a certification service that was **not provided by CA recognised under the Electronic Transactions Ordinance (Cap. 553) nor by overseas CA** whose electronic signature certificates have obtained mutual recognition status accepted by the Government for client identity verification

Review of online brokerage, distribution and advisory services

Deficiencies relating to client onboarding

Designated bank account approach

Failure to obtain bank account details for client identity verification

- an LC failed to obtain bank account details from its clients to **confirm the ownership of the bank accounts** from which the clients' initial transfers were made

Failure to conduct deposits and withdrawals through a designated bank account in Hong Kong

- an LC **failed to identify** some clients' initial fund transfers were from their **bank accounts outside Hong Kong**

Review of online brokerage, distribution and advisory services

Review of online brokerage, distribution and advisory services

Deficiencies relating to cybersecurity

Monitoring and surveillance

Failure to implement effective monitoring and surveillance mechanism

- an LC failed to implement any monitoring and surveillance

Inspection findings and other supervisory observations on AML/CFT

(1) Review of online brokerage, distribution and advisory services

(2) Case examples

Case example 1

Background information

> 170 of ~230

sampled deposits were identified as

Case example 1

Failure to detect suspicious client fund deposits

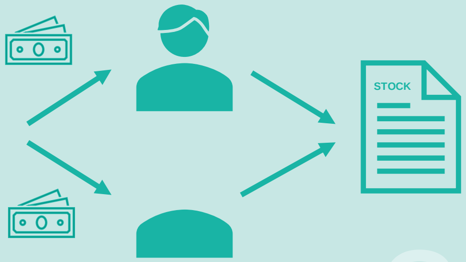
The LC did not detect the suspicious client fund deposits and make appropriate enquiries despite the presence of the below red flags:

1

Clients received deposits from **multiple third parties**, whose relationships with the clients were unknown

2

The amount of net deposits received by clients were **not commensurate** with their estimated net assets



3

Multiple clients received deposits from the **same third party**; and used the funds to trade in the same stock

Case example 2

Background information

During the period

2016 DEC → 2017 DEC

Processed

> 760

third-party fund transfers without sufficient due diligence

Aggregate amount of

> $1 billion

Case example 2

Transfers with unverified relationship

All the transfers were made to/from third parties whose relationships with the clients were **unverified or difficult to verify**, including:

Spouse and relatives

Director, shareholder, business partner and money lender

Friend and colleague

Case example 2

Case example 2

Transfers which raised red flags

Some of the transfers appeared to be **unusual and involve frequent transfers to/from the same third party**. For example:

Client A

third party

Case example 2

Inadequate measures to mitigate ML/TF risk associated with third-party fund transfers

- Adoption of **box-ticking approach** and routine processing of third-party fund transfers in **reliance on the information provided by clients**
- **Failure to properly scrutinise** the reasonableness of these transfers. In particular:

Did not require clients to provide documents to **support their relationship with third parties**, where applicable

Lack of proper understanding of the requirement for clients to provide justifiable reason for the transfers

Did not require staff to **make further enquiries** or require clients to provide any **supporting documents for verifying the reasons** provided by the clients

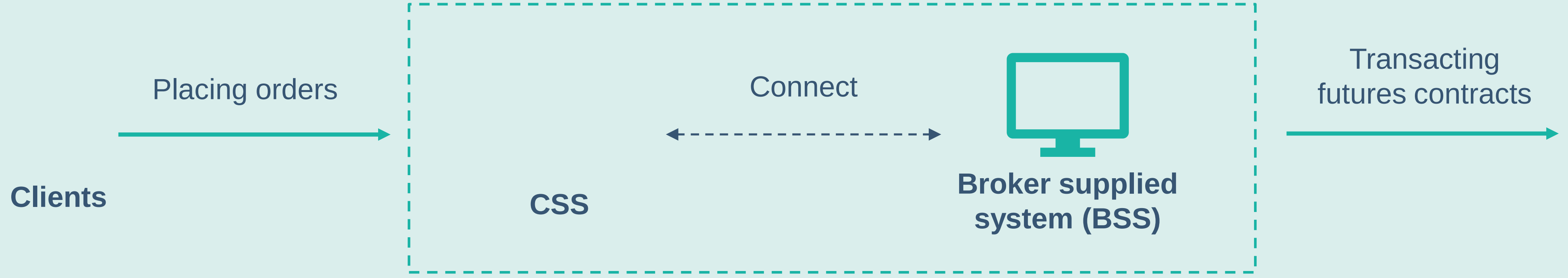
Case example 3

Background information

During the period

Case example 3

Failure to perform adequate due diligence on the CSSs, and assess and manage the associated ML/TF and other risks



Without thorough knowledge of the features and functions of the CSSs, the LC was **not in a position to properly assess the**

Case example 3

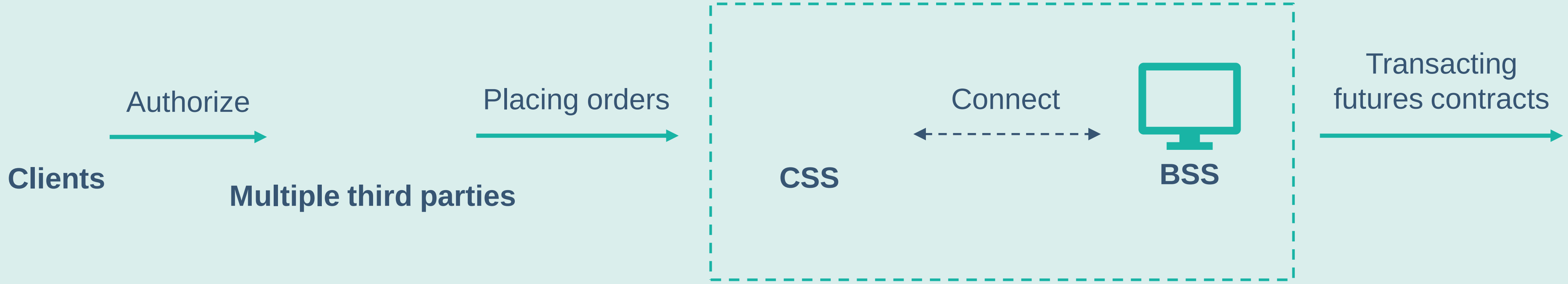
Failure to perform adequate due diligence on the CSSs, and assess and manage the associated ML/TF and other risks

Transacting
futures contracts

CSS

Case example 3

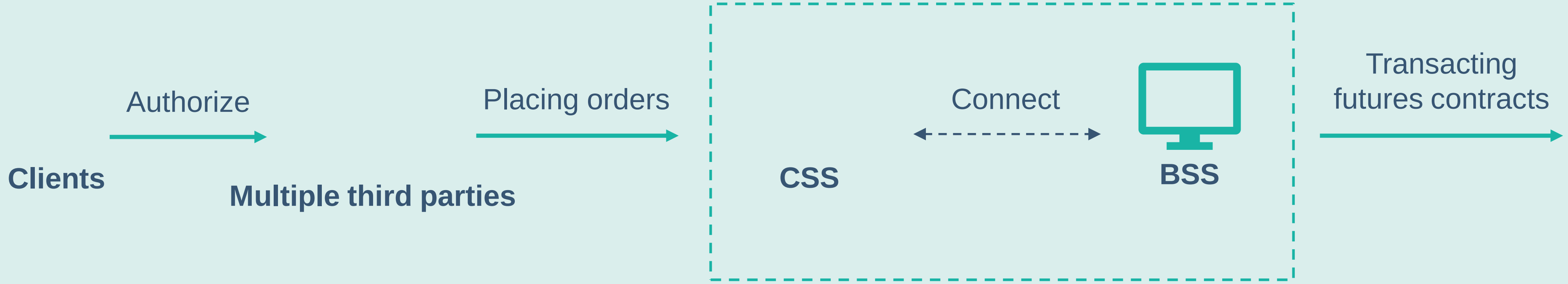
Failure to take reasonable steps to establish the true and full identity of clients and their ultimate party operated accounts



Such third-party authorisation arrangements **cast doubt on whether the client accounts might have been operated as nominee accounts** to conceal the true beneficial ownership or to facilitate other illegitimate activities.

Case example 3

Failure to take reasonable steps to establish the true and full identity of clients and their ultimate party operated accounts



Despite the risks associated with these third party operated accounts, the LC **failed to take reasonable steps to establish the true and full identity of its clients and their ultimate beneficial owners**, and **make proper enquiries** before approving the clients' requests to set up the third party operated accounts.

Case example 3

Failure to establish effective ongoing monitoring system to detect suspicious money movements and trading patterns in client accounts

The LC did not detect the following suspicious transactions at the material time:

1

Unusual money movements in three client accounts where the clients' **accumulated net deposit exceeded their declared net worth**

2

> 1,000 instances of self-matched trades in two client accounts

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