

# HONG KONG

## MONEY LAUNDERING AND TERRORIST FINANCING RISK ASSESSMENT REPORT



April 2018



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# FOREWORD BY FINANCIAL SECRETARY

Like elsewhere in the world, Hong Kong is not immune from the threats of money laundering (“ML”) and terrorist financing (“TF”). As an international financial centre with a highly externally-oriented economy, we are alert to the fact that Hong Kong’s competitive advantages – orderly flows of capital, people, goods and information; well-established legal system; sophisticated market infrastructure; and advanced professional services – could also make it attractive for criminals seeking to hide or move funds. The fact that financial activities of criminal elements have become more sophisticated in the digital era and the prevalence of terrorist activities elsewhere call for additional vigilance.



Hong Kong is committed to combating ML and TF together with the international community. Over the years we have put in place a robust anti-money laundering and counter-financing of terrorism (“AML/CFT”) regime having regard to international standards set by the Financial Action Task Force. To stay ahead of the curve, we put the AML/CFT regime under continuous review to ensure that it can live up to challenges posed by the fast-changing financial-market and security landscapes.

As part of our ongoing efforts to strengthen the regime, we have conducted this risk assessment to examine the ML/TF threats and vulnerabilities facing various sectors, and the city as a whole. It also identifies areas for further work, so that more targeted responses can be formulated. Informed by the risk assessment, over the past year we have taken forward various enhancement measures. These include updating the legal and regulatory framework, reinforcing the adoption of a risk-based approach in preventive and supervisory measures, stepping up efforts to restrain and confiscate crime proceeds, and strengthening international cooperation. The risk assessment will be updated from time to time as we continue our work to enhance the AML/CFT regime.

As ever, the Government will spare no efforts and devote the necessary resources to ensure that Hong Kong stays as a safe and clean place for living, work and doing business.

A handwritten signature in black ink, appearing to be 'Paul Chan', written in a cursive style.

Paul MP Chan, GBM, GBS, MH, JP  
Financial Secretary



# HONG KONG'S AML/CFT POLICY

The Hong Kong Special Administrative Region (“HKSAR”) Government adopts a multi-agency approach in constructing its AML/CFT regime. A high-level Central Coordinating Committee on AML/CFT (“CCC”), chaired by the Financial Secretary, steers the formulation of policies and implementation of the AML/CFT regime. It comprises members from the relevant Government bureaux and departments, financial regulators and law enforcement agencies (“LEAs”), which work together to take forward AML/CFT initiatives.

The Government is committed to upholding a robust AML/CFT regime that:

- (a) Fulfills 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 Hong Kong;
- (e) Adopts a risk-based approach (“RBA”) in applying compliance obligations to businesses and individuals;
- (f) Fosters strong external and international collaboration to disrupt global ML/TF threats; and
- (g) Promotes the awareness and builds the capacity of private sector stakeholders in combatting ML/TF risks through engagements in AML/CFT efforts.

In line with the above principles, and in response to risks and gaps identified in this assessment, 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 cooperation/partnership.



# EXECUTIVE SUMMARY

As an international financial centre, Hong Kong attaches great importance to safeguarding the integrity of its financial systems by implementing international AML/CFT standards to deter and detect inward and outward flows of illicit funds. Hong Kong is an active member of international AML/CFT organisations, having been a member of the Financial Action Task Force (“FATF”) since 1991 and a founding member of the Asia/Pacific Group on Money Laundering (“APG”) since 1997.

Over the years, Hong Kong has built up a comprehensive AML/CFT regime comprising a robust legal framework, effective law enforcement, rigorous preventive measures, international cooperation, and public education and publicity. However, international standards have evolved quickly because of the changing global financial-market and security landscapes. Hong Kong therefore recognises the need to conduct the risk assessment in response to these developments.

Hong Kong has made reference to the *FATF Guidance on National Money Laundering and Terrorist Financing Risk Assessment* and adopted the World Bank Tool in conducting its first territory-wide risk assessment. The purpose of the assessment is to identify, understand and update the ML and TF risks to which Hong Kong is exposed, which would then form the basis for the formulation of more targeted responses.

This assessment draws on extensive consultation, quantitative and qualitative data examination and direct engagement with regulators, LEAs, government bodies and private sector entities. The aim is to canvas and consolidate collective knowledge to develop a list of specific threats or vulnerabilities that are the causes, sources or drivers of ML/TF risks in the context of Hong Kong. Action has been taken in the course of conducting the risk assessment to address these identified ML/TF risks.

## Key Findings

### Ability to combat ML

Hong Kong’s ability to combat ML is assessed as medium-high, characterised by its robust legal framework, high-level political commitment, close partnerships among Government agencies and between the public and private sectors, fair and efficient prosecution and judicial process, and good external and international cooperation.

### ML threat

As an international finance, trade and transport hub with strong links to Mainland China, Hong Kong is exposed to ML threats arising from both internal and external predicate offences. Internally, fraud and drugs-related crimes pose high and medium-high ML threats to Hong Kong. Externally, fraud again poses a high ML threat while drugs, corruption and tax evasion pose medium-high threats.

Local and cross-border<sup>1</sup> money launderers have exploited the high degree of free trade and efficient financial and banking systems. Corporate bank accounts and money service operators (“MSOs”) are common conduits exploited by ML syndicates so that the banking sector faces a high ML risk and MSOs a medium-high risk.

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<sup>1</sup> In this report, the term “cross-border” shall be interpreted as “between different jurisdictions”.

ML syndicates also abuse the efficient and open business environment, which allows easy formation of shell companies, to launder proceeds of crime. The ML threat to trust or company service providers (“TCSPs”) has a noticeable cross-border element. It is not uncommon for shell companies incorporated in Hong Kong under the control of transnational syndicates to be used to launder proceeds of crimes committed outside Hong Kong.

To disguise the source of money, it is often converted into a form that makes it difficult to trace its origins. The threat analysis reveals that illicit gains are commonly placed in bank accounts, real estates and stocks.

With technological advancement, the global payment landscape has been developing rapidly. Stored value payment products, internet and mobile payment services are popular in Hong Kong, most of them linked to an underlying bank account. Virtual currencies (“VCs”) are virtual commodities not accepted for payment in Hong Kong and have only drawn speculative investment. While we have not found substantial risks in these newly developing payment methods or commodities, this is a rapidly developing area requiring continued monitoring.

## ML vulnerabilities

The number of suspicious transaction reports (“STRs”) received by the Joint Financial Intelligence Unit (“JFIU”) has risen significantly over the past five years. The rapid growth in STRs reflects a growing awareness of ML/TF, but presents challenges to the JFIU in terms of handling capacity. Meanwhile, certain gaps in AML/CFT legislation vis-à-vis the FATF recommendations were identified in the process of conducting the risk assessment, following which legislative exercises have been pursued to address the gaps.

Financial institutions (“FIs”) have been subject to the customer due diligence (“CDD”) and record-keeping requirements under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (“AMLO”)<sup>2</sup> since 2012. No equivalent statutory requirements had been mandated for designated non-financial businesses and professions (“DNFBPs”) until the Legislative Council (“LegCo”) enacted the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018 (“AML(AO”)<sup>3</sup> in January 2018. Under the AML(AO which commenced operation on 1 March 2018, legal professionals, accounting professionals, estate agents and TCSPs are subject to the same set of CDD and record-keeping requirements as FIs. TCSPs are further required to obtain a licence from the Companies Registry (“CR”), subject to the fulfilment of a fit-and-proper test, before they can provide the business in Hong Kong.

All companies are required by law to maintain legal ownership information by way of keeping registers of directors, members and company secretaries. In January 2018, LegCo passed the Companies (Amendment) Ordinance 2018<sup>4</sup> which requires companies incorporated in Hong Kong to maintain beneficial ownership information by way of keeping registers of significant controllers. Commencement of the new requirements from 1 March 2018 plugs a gap in the company legislation, and goes a long way towards enhancing the transparency of legal persons.

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2 Chapter 615 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap615>.

3 See footnote 2.

4 Chapter 622 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap622>.

Having regard to FATF Recommendation 32, the Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance (“the R32 Ordinance”)<sup>5</sup> was enacted in June 2017 to establish a declaration and disclosure system to detect the cross-boundary movement of large quantities of currency and bearer negotiable instruments (“CBNIs”) into or out of Hong Kong. Powers are vested in the Customs and Excise Department (“C&ED”) to restrain the movement of CBNIs suspected to be crime proceeds or terrorist property, to which asset recovery procedures may apply. The R32 Ordinance will commence operation on 16 July 2018.

## Overall ML risk

Overall, Hong Kong is exposed to a medium-high level of ML risk, comprising a medium-high level of threat and a medium level of vulnerability.

## TF threat

Hong Kong is assessed to have a “moderate” level of terrorism threat, and a medium-low level of TF threat. The threat of isolated incidents of financing extraterritorial terrorism may be greater, given Hong Kong’s advanced and open financial system, and the cultural and economic links between certain segments of the community and regions affected by terrorism. However, there has been no confirmed TF case in Hong Kong. High-risk patterns commonly associated with TF such as abuse of non-profit organisations (“NPOs”) or physical movement of large quantities of CBNIs across boundaries are not observed in Hong Kong.

## TF vulnerabilities

Hong Kong has a sound CFT framework in general. Hong Kong is fully aware of the constant need to update the relevant legislation to reflect the latest measures imposed by the United Nations Security Council (“UNSC”) against designated persons, entities and countries. Gaps have been identified in the fulfilment of the relevant United Nations Security Council Resolutions (“UNSCR”) and steps are being taken to address these gaps.

Amendments have been introduced to the United Nations (Anti-Terrorism Measures) Ordinance (“UNATMO”)<sup>6</sup> to prohibit any person from dealing with specified terrorist property and property of specified terrorists or terrorist associates, and to criminalise, among other things, the financing of travel between states for the purpose of perpetration, planning or preparation of, or participation in, terrorist acts or the provision or receiving of terrorist training. The amendments will come into operation on 31 May 2018 following the enactment of the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2018 by LegCo in March 2018.

Implementation of the R32 Ordinance, extension of CDD and record-keeping requirements to DNFBPs under the AMLO, requirements for companies to keep beneficial ownership information and introduction of prohibitions on financing the travel of foreign terrorist fighters and on dealing with terrorist property will help mitigate TF risks and complement ongoing CFT efforts by LEAs.

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5 Chapter 629 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap629>.

6 Chapter 575 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap575>.

## Overall TF risk

Hong Kong is exposed to a medium-low level of TF risk, with threat and vulnerability both rated as medium-low.

## Way Forward

In response to the risks identified in this assessment, five major areas of work are considered necessary: enhancing the AML/CFT legal framework, strengthening risk-based supervision and partnerships, sustaining outreach and awareness-raising, monitoring new and emerging risks, and strengthening law enforcement efforts and intelligence capability.

### Enhancing the AML/CFT legal framework

To address gaps identified in the AML/CFT legislation in the course of conducting the risk assessment, the Government has pursued the following legislative exercises, which will further strengthen the AML/CFT capability of Hong Kong:

- (a) Amend the AMLO to extend the CDD and record-keeping requirements therein to DNFBPs, and to introduce a licensing regime for TCSPs requiring them to apply for a licence from the Registrar of Companies and satisfy a “fit-and-proper” test before they can provide trust or company services as a business in Hong Kong;
- (b) Amend the Companies Ordinance (“CO”)<sup>7</sup> to require the keeping of beneficial ownership information by companies incorporated in Hong Kong;
- (c) Introduce the R32 Ordinance to implement a declaration/disclosure system for cross-boundary movement of CBNIs;
- (d) Amend the UNATMO to enhance the freezing mechanism of terrorist property and to prohibit the financing of travel of foreign terrorist fighters; and
- (e) Implement the latest UNSC sanctions against the Democratic People’s Republic of Korea (“DPRK”) by amending the United Nations Sanctions (Democratic People’s Republic of Korea) Regulation. Pending completion of the legislative exercise, the HKSAR Government implements the UNSC sanctions concerned by exercising appropriate powers available under the existing legislation. The Government has also alerted the relevant sectors to the sanction measures and reminded them not to engage in or facilitate related activities and to conduct necessary screening on an ongoing basis.

### Strengthening risk-based supervision and partnerships

Financial regulators work closely among themselves and with the LEAs and the JFIU to better identify, understand and mitigate existing and emerging risks, and focus their supervisory efforts on areas identified to be of higher risk. Financial regulators review and update their AML/CFT Guidelines<sup>8</sup> from time to time to ensure that the requirements are in line with the

<sup>7</sup> See footnote 4.

<sup>8</sup> <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/guideline/g33.pdf>  
<http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/guideline-on-anti-money-laundering-and-counter-terrorist-financing/guideline-on-anti-money-laundering-and-counter-terrorist-financing.pdf>  
[https://www.ia.org.hk/en/legislative\\_framework/files/GL3.pdf](https://www.ia.org.hk/en/legislative_framework/files/GL3.pdf)  
[https://eservices.customs.gov.hk/MSOS/download/guideline/AMLO\\_Guideline\\_en.pdf](https://eservices.customs.gov.hk/MSOS/download/guideline/AMLO_Guideline_en.pdf)

latest international standards. Ongoing supervisory efforts will be pursued to promote the implementation of risk-based AML/CFT systems that are critical for protecting the safety and soundness of FIs and the integrity of Hong Kong's financial system.

As regards DNFBPs, the relevant regulatory bodies have been developing targeted supervisory strategies and issued guidelines to facilitate practitioners to comply with the requirements under the AML(A)O which came into force on 1 March 2018. Capacity-building efforts will be strengthened to help with the migration of the concerned sectors to the new regulatory regime.

Engaging the private sector more prominently as partners in combatting significant ML threat is a relatively recent development, under the auspices of the Fraud and Money Laundering Intelligence Taskforce ("FMLIT"). The police-led platform brings together banks and the Hong Kong Monetary Authority ("HKMA") in the discussion of cases, trends and typologies and the sharing of intelligence, which contributes to a shared understanding of the ML/TF risks and formulation of risk-based interventions. Consideration will be given to expand the platform after more implementation experience has been accumulated.

### Sustaining outreach and raising awareness

Outreach and awareness-raising efforts by the Government, regulators and the businesses and professions concerned will continue. It is important to ensure adequate awareness and understanding by FIs and DNFBPs of the ML/TF threats and the high-risk patterns pertinent to them. This will facilitate more efficient and targeted detection of suspicious activities and better focus of AML/CFT systems on genuine risks.

The typologies, methods and trends of ML/TF identified in this assessment, as updated from time to time, will provide useful references for the industries. They will be disseminated in the Government's and regulators' outreach efforts.

### Monitoring new and emerging risks

Risks may evolve with changes in patterns of predicate offences or terrorism and the related modes of ML/TF, as well as the development of new technologies creating new opportunities for unlawful activities. Hong Kong will continue to monitor risks and keep abreast of new and emerging typologies to ensure it responds appropriately and proportionately.

### Strengthening law enforcement efforts

LEAs will continue to step up ML/TF investigation, leverage the use and exchange of financial intelligence and multi-agency collaboration to secure prosecution, restraint and confiscation of illicit proceeds, ensuring that efforts and resources are effectively expended in response to the evolving landscape of crime. Furthermore, LEAs will continue to strengthen international cooperation with overseas competent authorities, to identify and combat cross-border and transnational ML syndicates and their activities.



# CHAPTER 1

## INTRODUCTION TO HONG KONG

1.1 Hong Kong 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 Hong Kong on 1 July 1997 under the "One Country, Two Systems" principle.

### Geographical Position

1.2 On the south-eastern coast of China, the HKSAR has an area of about 1,106 square kilometres, covering Hong Kong Island, Kowloon, the New Territories and 262 outlying islands. The Macao Special Administrative Region is about 60 kilometres west of Hong Kong and is linked by high speed ferries and a helicopter service as well as the Hong Kong – Zhuhai – Macao Bridge which will be commissioned in 2018. Hong Kong has a 35-kilometre land boundary and a 191-kilometre sea boundary with Mainland China. The HKSAR Government exercises immigration control and there are 12 control points by air, land and sea<sup>9</sup>.

### Population

1.3 In end-2017, Hong Kong had a population of almost 7.41 million<sup>10</sup>. In 2016, locally born residents made up about 60.6% of the population, while another 31% were born in Mainland China, Macao or Taiwan, and the remaining 8.4% originated from elsewhere<sup>11</sup>. Among the last group, there were approximately 184,000 Filipinos and 153,000 Indonesians<sup>12</sup>, the majority of both groups being women employed as foreign domestic helpers ("FDHs").

1.4 Hong Kong has one of the highest population densities in the world, standing at 6,777 persons per km<sup>2</sup> in 2016.

### Language

1.5 Chinese and English are the official languages of Hong Kong. Cantonese, a southern dialect of Chinese from the Guangdong region, is the primary spoken language. With greater economic and business integration with Mainland China, Putonghua (Mandarin Chinese) is also widely spoken. With Hong Kong's status as an international financial centre and its externally-oriented economy, English is widely used in the Government and other public institutions as well as by the professional and business sectors.

### Government Structure

1.6 The Basic Law is a national law of the PRC and Hong Kong's constitutional document. It provides, *inter alia*, that the HKSAR 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 Hong Kong and defence are the responsibility of Central People's Government of the PRC.

1.7 The HKSAR 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.

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9 Hong Kong International Airport, Hung Hom, Lo Wu, Lok Ma Chau, Man Kam To, Sha Tau Kok, Lok Ma Chau Spur Line, China Ferry Terminal, Macau Ferry Terminal, Tuen Mun Ferry Terminal, Shenzhen Bay and Kai Tak Cruise Terminal.

10 Year-end population for 2017, Census and Statistics Department.

11 2016 Population By-census, Census and Statistics Department.

12 2016 Population By-census, Census and Statistics Department.

Bureaux in the Government Secretariat formulate policies and initiate legislative proposals. Departments implement laws and policies and provide direct services to the community.

1.8 The HKSAR has a two-tier system of representative government. At the central level 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.

1.9 The HKSAR has an independent Judiciary responsible for the administration of justice and the adjudication of cases in accordance with laws.

## Legal System and the Judiciary

1.10 The legal system of Hong Kong is based on the rule of law and the independence of the Judiciary. Under the “One Country, Two Systems” policy, Hong Kong has its own legal system based on the common law, and local legislation codified in the Laws of Hong Kong. Laws in force in Hong Kong include: (a) the Basic Law; (b) PRC national laws listed in Annex III to the Basic Law as applied to Hong Kong; (c) the laws previously in force in Hong Kong 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. Legislation in force in Hong Kong is accessible on the Internet at <https://www.elegislation.gov.hk>.

1.11 The Basic Law provides that the Department of Justice (“DoJ”) controls criminal prosecutions, free from any interference. The Judiciary, i.e. the courts of Hong Kong, is responsible for the administration of justice in Hong Kong and the adjudication of cases, criminal and civil, in accordance with laws. It exercises judicial power independently, free from any interference. It is fundamental to Hong Kong’s legal system that members of the Judiciary are independent of the executive and legislative arms of the HKSAR.

1.12 The courts of Hong Kong comprise the Court of Final Appeal, the High Court (which consists of the Court of Appeal and the Court of First Instance), the District Court, the Magistrates’ Courts and other specialised Courts and Tribunals<sup>13</sup>.

1.13 The Court of Final Appeal is the final appellate court within the court system with the power of final adjudication. It hears appeals involving important questions of law, including in particular points of public and constitutional importance, or where leave to appeal has otherwise been granted as provided in the governing ordinance. There are one Chief Justice, three Permanent Judges, and 15 Non-Permanent Judges. Final appeals are heard by the full court comprising five judges, usually including the Chief Justice, three permanent members, and one non-permanent member. The Court of Final Appeal may as required invite judges from other common law jurisdictions to sit on the court and a number of distinguished judges from the United Kingdom, Australia and New Zealand have sat and continue to sit as members of the court.

1.14 The Court of Appeal of the High Court hears appeals on civil and criminal matters from the Court of First Instance and the District Court, as well as appeals from the Lands Tribunal.

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<sup>13</sup> Including the Juvenile Court, the Family Court, the Coroner’s Court, the Obscene Articles Tribunal, the Competition Tribunal, the Lands Tribunal, the Labour Tribunal, and the Small Claims Tribunal etc.

It also makes rulings on questions of law referred to it by the lower courts. There are 13 Justices of Appeal, including the Chief Judge of the High Court and three Vice-Presidents.

1.15 The Court of First Instance of the High Court, comprising 27 Judges, has unlimited jurisdiction in both civil and criminal matters. In its appellate jurisdiction, it hears appeals from the Magistrates' Courts and other tribunals. The most serious indictable offences, such as murder, manslaughter, rape, armed robbery, complex commercial fraud and drug offences involving large quantities, are tried in the Court of First Instance, by a judge sitting with a jury of seven (or nine on the special direction of the judge).

1.16 The District Court has limited jurisdiction in both civil and criminal matters. In its criminal jurisdiction, the court may try the more serious offences with the exception of a few very serious offences such as murder, manslaughter and rape. The maximum term of imprisonment it can impose is seven years. There are 43 District Judges, including the Chief District Judge.

1.17 The Magistrates' Courts exercise criminal jurisdiction over a wide range of offences. Although there is a general limit of two years' imprisonment or a fine of HK\$100,000 certain statutory provisions give magistrates the power to sentence up to three years' imprisonment and to impose a fine up to HK\$5 million. Prosecution of indictable offences commences in the Magistrates' Courts. Depending on the seriousness of a case, the DoJ may apply to have a case transferred to the District Court or committed to the Court of First Instance of the High Court. As at 8 February 2018, there were 72 magistrates sitting in seven Magistrates' Courts.

## Law and Order

1.18 Hong Kong is one of the safest cities in the world. There were 56,017 reported crimes (excluding corruption) in 2017, a decrease of 7.6% from 2016. The crime rate stood at 758 cases per 100,000 of population, down 8.3% from in 2016.

1.19 Established in 1974, the Independent Commission Against Corruption ("ICAC") combats corruption independently from other LEAs, winning wide community support and international recognition. Hong Kong was rated one of the cleanest cities in the world in several international surveys, with marked improvements in both score and ranking in 2016 and 2017<sup>14</sup>.

## Economy

1.20 Hong Kong is one of the world's most open economies with a business-friendly environment characterised by free trade, a mature financial regulatory regime and legal system, simple taxation and low tax rates, and advanced transport and telecommunications infrastructures.

1.21 Over the past two decades, the Gross Domestic Product ("GDP") has doubled, growing at an average annual rate of 3.4% in real terms. In 2016, GDP at current market prices reached HK\$2,489.1 billion, and per capita GDP of US\$43,700 was among the highest in Asia.

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<sup>14</sup> For example, both the Fraser Institute 2017 Economic Freedom of the World and the Heritage Foundation 2018 Index of Economic Freedom ranked Hong Kong as the freest economy. The World Economic Forum 2017-2018 Global Competitiveness Report ranked Hong Kong the 6<sup>th</sup> most competitive economy. These surveys include corruption as one of the indicators. Whereas Hong Kong was ranked 15<sup>th</sup> in the Transparency International Corruption Perceptions Index 2016, the World Bank 2017 Worldwide Governance Indicators ranked Hong Kong 18<sup>th</sup> out of 209 economies under the dimension of Control of Corruption.

1.22 Hong Kong's financial markets offer high levels of liquidity and are governed by effective and transparent regulations that are in line with international standards. Together with other important financial centres, such as London and New York, Hong Kong's markets play a vital role in the global financial system which operates round the clock. Hong Kong also provides an important gateway to the Mainland China economy and financial system. The financial sector employs 246,000 people, accounting for 6.5% of the city's total workforce, and 16.6% of its GDP. Hong Kong was the world's seventh- and Asia's second-largest banking centre, with assets of HK\$22.7 trillion at the end of 2017. The city's stock market capitalisation, at about HK\$31.9 trillion<sup>15</sup> in October 2017, ranked eighth in the world and fourth in Asia. The asset management business is highly international, with about 71% of assets under management coming from investors outside Hong Kong.

1.23 The overriding objective of Hong Kong's monetary policy is currency stability defined as a stable external exchange value of Hong Kong's currency against the US dollar, at around HK\$7.8 to US\$1. The interbank money market is also well established, supported by a robust real-time gross settlement interbank payment system enabling transactions in US\$, HK\$, Euro and Renminbi ("RMB") to be settled in real time.

1.24 Amid continuing internationalisation of the RMB, Hong Kong is the world's largest offshore RMB business hub supporting cross-border trade transactions, investment, financing and asset management through the development of RMB bonds, loans and equity products. In 2016, RMB trade settlement handled by banks in Hong Kong amounted to RMB4,542 billion and RMB deposits amounted to RMB625 billion<sup>16</sup>.

1.25 Active international engagement and cooperation with global partners, such as membership of the Asia-Pacific Economic Cooperation forum, World Trade Organisation, World Customs Organisation, etc., participation in the Trade in Service Agreements of the World Trade Organization, and the automatic exchange of financial account information in tax matters ("AEOI") coordinated by the Organisation for Economic Co-operation and Development ("OECD"), enable Hong Kong to maintain its status as an international financial and trading centre. In 2016, the city accounted for 3.3% of world merchandise trade amounting to US\$1,064 billion<sup>17</sup>, its principal trading partners being Mainland China, the US and Taiwan<sup>18</sup>.

1.26 Hong Kong is an active participant in global standard-setting bodies such as the International Monetary Fund, the World Bank, the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the International Association of Insurance Supervisors, the FATF and the APG.

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15 Main board. Source: Hong Kong Exchange website.

16 Source: HKMA Annual Report 2016.

17 Trade and Industry Department: <https://www.tid.gov.hk/english/aboutus/publications/tradestat/wmttt.html>.

18 Trade and Industry Department: [https://www.tid.gov.hk/english/trade\\_relations/mainland/trade.html](https://www.tid.gov.hk/english/trade_relations/mainland/trade.html).

# CHAPTER 2

## RISK ASSESSMENT METHODOLOGY

2.1 The FATF recommends that jurisdictions identify, assess, and understand the ML and TF risks specific to them and take action and apply resources to mitigate such risks.

2.2 In conducting this assessment, we have made reference to the *FATF Guidance on National Money Laundering and Terrorist Financing Risk Assessment* issued in February 2013 and adopted the World Bank National Risk Assessment Tool.

### The World Bank Tool

2.3 The World Bank Tool enables jurisdictions to identify the main drivers of ML/TF risks through a methodological process based on the understanding of the causal relations among risk factors and variables relating to the regulatory, institutional, and economic environment. In essence, the ML/TF risk of a jurisdiction comprises “threats” and “vulnerabilities”. Threats refer to the scale and characteristics (or patterns) of the generation, inflows, and outflows of the proceeds of crime or funds linked with terrorism. For ML, this points to an assessment of the internal and external threats, including the predicate offences that generate crime proceeds, the total size of the crime proceeds, the sectors in which proceeds are invested and laundered, and other relevant factors. For TF, threats point to the direction of TF funds, and the sources and channels used. Vulnerabilities refer to weaknesses or gaps in a jurisdiction’s defences against ML/TF, measured with respect to relevant “input variables” at the territory-wide or sectoral level<sup>19</sup>.

2.4 The ML risk of a jurisdiction is the combination of threats and vulnerabilities at the territory level, which is a function of threats and vulnerabilities of individual sectors, as well as the jurisdiction’s AML controls, which determine the jurisdiction’s ability to combat ML activities. The TF risk of a jurisdiction is an outcome of TF threats and vulnerabilities. Ratings (low, medium-low, medium, medium-high and high) are assigned to ML/TF threats and vulnerabilities, based on available qualitative and quantitative information, to generate results that can be represented graphically on a risk-level heat map. Figure 2.1 is a graphical overview of the World Bank Tool and Figure 2.2 shows the risk-level heat map<sup>20</sup>.

### The Process

2.5 In June 2014, under the direction of the CCC<sup>21</sup>, a Steering Committee of the ML and TF Risk Assessment in Hong Kong was established to oversee the conduct, monitor the progress, and evaluate the findings of the Risk Assessment. The Steering Committee is chaired by the Financial Services and the Treasury Bureau (“FSTB”) and members include the Security Bureau (“SB”), the Commerce and Economic Development Bureau (“CEDB”), the DoJ, the Hong Kong Police Force (“HKPF”), the C&ED, the ICAC, the HKMA, the Securities and Futures Commission (“SFC”), and the Insurance Authority<sup>22</sup> (“IA”). The members formed multi-disciplinary teams with experienced practitioners to conduct the assessment for the sectors under their purview. Resources were

19 The “input variables” include the AML/CFT legislative framework, the effectiveness of law enforcement and supervision, quality of suspicious transactions reporting, AML/CFT awareness, inherent factors such as geographic/demographic characteristics/the size of the economy or sector concerned, etc.

20 The description in paragraph 2.3 is based on World Bank *Introduction to the National Risk Assessment Tool*, June 2015 and Figures 2.1 and 2.2 are reproduced from the same document.

21 The CCC is a high-level Committee chaired by the Financial Secretary to steer the AML/CFT work in the Government.

22 The IA took over the regulatory functions of the then Office of the Commissioner of Insurance, which was a Government department, on 26 June 2017.

Figure 2.1 Graphical overview of the World Bank Tool

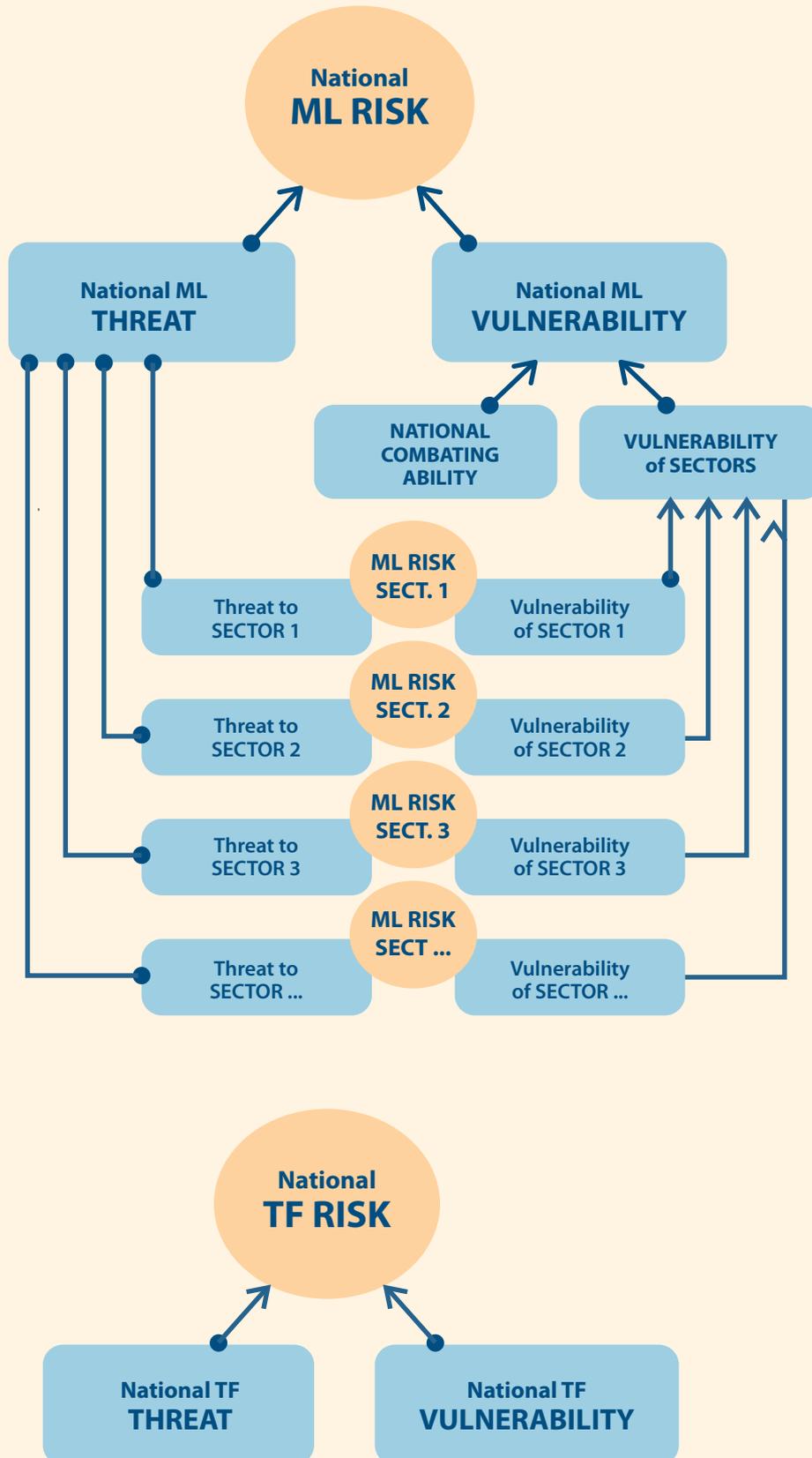
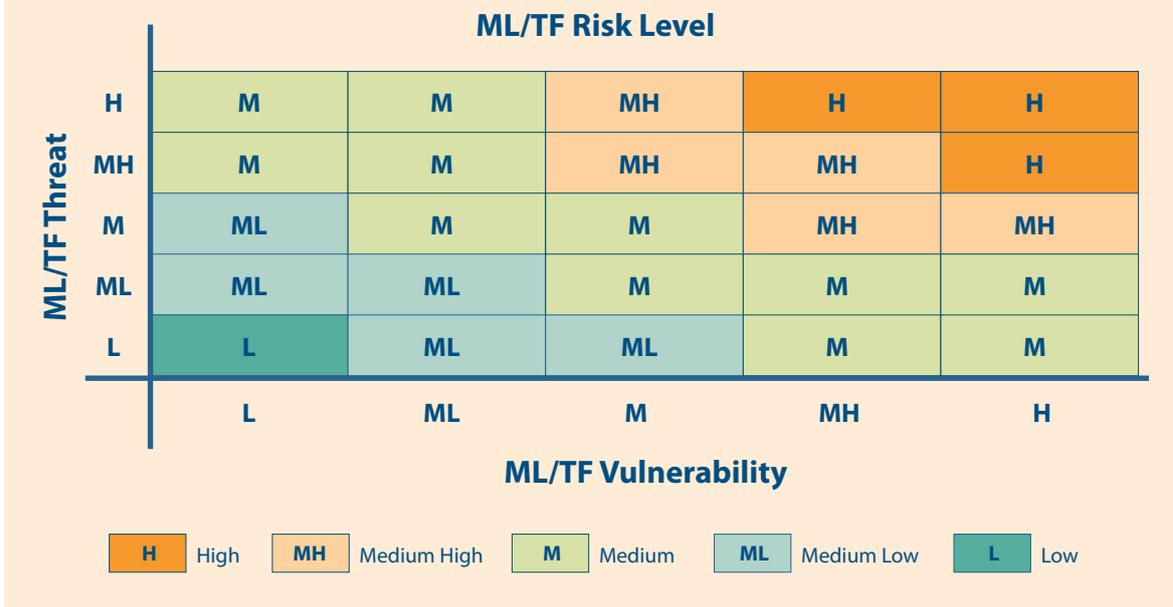


Figure 2.2: Risk-level heat map



also allocated to the HKPF to form a Risk Assessment Unit to conduct risk assessment on an ongoing basis. The findings of the Risk Assessment were reported to the Steering Committee and the CCC.

2.6 The assessment process includes extensive information-gathering and scoping through record reviews, data and statistical examination, literature reviews (typologies studies, mutual evaluation reports etc.), as well as engagement with regulators, LEAs and stakeholders in the private sector. In addition to the financial sectors and DNFBPs, other payment methods and legal persons and arrangements are assessed and identified as potentially vulnerable to ML.

2.7 Apart from assessment of ML/TF risks, an evaluation was undertaken to determine priorities for addressing identified risks, particularly the higher-risk areas. Action plans were formulated setting priorities and timelines for implementing mitigating measures. The progress of the action plans is under close monitoring.

2.8 In the case of stored value facilities (“SVFs”), which only came under regulation with the introduction of a licensing regime administered by the HKMA in 2015, only a preliminary assessment was carried out for this Risk Assessment since licences were issued in two batches in August and November 2016 and only limited business operating data were available. It is intended to conduct a more detailed review in 2018 (see Chapter 7 for details).

## Organisation of Report

2.9 In line with the Risk Assessment methodology, this report is organised as follows:

- (a) Chapter 3 on the overall AML/CFT framework includes analyses of factors such as the quality of AML/CFT policies and strategy, judicial and legal framework, financial intelligence and investigation units, cross-boundary cash control, and the effectiveness of domestic and international cooperation;
- (b) Chapter 4 on ML threats assesses the threats posed by various predicate crimes, taking note of the potential involvements of domestic and international crime syndicates, reflecting their sophistication, knowledge and expertise in ML activities. The prevalence and significance of ML and predicate offences, including information on investigations, prosecutions, restraint, confiscation, form of proceeds of crime, and business sectors involved were taken into account;
- (c) Chapters 5 to 8 on the sectoral ML risks analyse the ML risks of relevant sectors, including FIs, DNFBPs, other payment methods and corporate arrangements (i.e. legal persons and arrangements); and
- (d) Chapter 9 on TF risk outlines the landscape of terrorism and examines factors underlying the TF threat and vulnerability of Hong Kong.

# CHAPTER 3

## OVERALL ML/TF COMBATING ABILITY

3.1 This Chapter outlines and analyses factors affecting Hong Kong's ability to combat ML activities. It examines the AML/CFT legal and institutional frameworks, external and international cooperation, and the prosecution and judicial process.

### AML/CFT Legal Framework

3.2 The AML/CFT legal framework has high convergence with international standards, including the pertinent Articles of the Vienna Convention<sup>23</sup>, the Palermo Convention<sup>24</sup>, the Terrorist Financing Convention<sup>25</sup>, relevant UNSCRs and the FATF Recommendations.

### ML offences

3.3 ML offences are prescribed under sections 25 of the Organized and Serious Crimes Ordinance ("OSCO")<sup>26</sup> and of the Drug Trafficking (Recovery of Proceeds) Ordinance ("DTROP")<sup>27</sup>. These two provisions criminalise the dealing with<sup>28</sup> property known or reasonably believed by the person to represent proceeds of indictable offences<sup>29</sup> or of drug trafficking. Under the OSCO, proceeds of an indictable offence include proceeds of a crime committed elsewhere, if the crime would also have constituted an indictable offence had it been committed in Hong Kong. It is not necessary for the prosecution to prove the commission of or the specific conduct of the indictable offence or drug trafficking, or to prove that the property in question is in fact the proceeds of an indictable offence or drug trafficking<sup>30</sup>. The maximum penalty for ML is imprisonment for 14 years and a fine of HK\$5 million.

### TF offences

3.4 The UNATMO implements, *inter alia*, a decision of the UNSCR 1373 relating to measures for the prevention of terrorist acts. Sections 7 and 8 criminalise the provision or collection of any property to commit terrorist acts; and the act of making any property or financial (or related) services available, or collecting property, or soliciting financial (or related) services, to or for the benefit of a terrorist or terrorist associate. The maximum penalty for either of these offences is 14 years' imprisonment and a fine of unlimited amount.

3.5 Having regard to the FATF recommendation to enhance the freezing mechanism of terrorist property and UNSCR 2178 which affirms the need to combat threats by foreign terrorist fighters, a bill to amend the UNATMO was introduced into LegCo in June 2017 to prohibit any person from dealing with specified terrorist property and property of specified terrorists or terrorist associates, as well as to criminalise, among other things, the financing of the travel of individuals between states for the purpose of perpetration, planning or preparation of, or participation in, terrorist acts or the provision or receiving of terrorist training. The bill was enacted by LegCo in March 2018 and the amended Ordinance will come into operation on 31 May 2018.

23 The 1988 UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

24 The 2000 UN Convention Against Transnational Organized Crime.

25 The Terrorist Financing Convention (formally, the International Convention for the Suppression of the Financing of Terrorism) is a 1999 UN treaty designed to criminalise acts of financing acts of terrorism.

26 Chapter 455 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap455>.

27 Chapter 405 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap405>.

28 "Dealing", in relation to property, includes receiving, acquiring, concealing, disguising, disposing of, converting, and bringing into or removing from Hong Kong the property; and using the property to borrow money or as security.

29 "Indictable offences", as opposed to "summary offences", refer to the more serious crimes in common law jurisdictions.

30 There are strong policy reasons: the predicate offence is likely to have taken place in another jurisdiction not susceptible to proof in Hong Kong, and the proceeds of such crimes are likely to have passed through various layers and transformations aimed at concealing their provenance. (See paragraphs 90-91 of *HKSAR v Yeung Ka Sing, Carson and Another* [2016] HKCFA 54).

## Targeted financial sanctions related to proliferation financing (“PF”)

3.6 The United Nations Sanctions Ordinance (“UNSO”)<sup>31</sup> empowers the Chief Executive to make regulations to give effect to instructions given by the Ministry of Foreign Affairs of the PRC to implement sanctions<sup>32</sup> decided by the UNSC against places outside the PRC. The United Nations Sanctions (Democratic People’s Republic of Korea) Regulation<sup>33</sup> made under the UNSO implements targeted financial sanctions and other sanction measures decided by the UNSC against DPRK. The United Nations Sanctions (Joint Comprehensive Plan of Action—Iran) Regulation<sup>34</sup> implements targeted financial sanctions and other restrictions decided by the UNSC against Iran. The maximum penalty for contravening targeted financial sanctions under the two Regulations is imprisonment for seven years and a fine of unlimited amount.

3.7 Under the Weapons of Mass Destruction (Control of Provision of Services) Ordinance<sup>35</sup>, any services which may assist in the development, production, acquisition or stockpiling of weapons of mass destruction (“WMD”) in or outside Hong Kong are prohibited. Examples of such services include financing, sourcing of materials and provision of professional and consulting services, technological information or know-how. The maximum penalty for offences under the Ordinance is imprisonment for seven years and a fine of unlimited amount.

3.8 To prevent Hong Kong from being used as a conduit for proliferation of WMD, a strategic trade control system is also instituted under the Import and Export Ordinance (“IEO”)<sup>36</sup> and its subsidiary legislation, the Import and Export (Strategic Commodities) Regulations<sup>37</sup>, to regulate the movement of strategic commodities into and out of Hong Kong. Import, export and transshipment of strategic commodities (including munitions<sup>38</sup>, dual-use goods<sup>39</sup>, and other sensitive items intended for use in the production, development or use of WMD) are prohibited unless accompanied by valid licences issued by the Trade and Industry Department (“TID”). The processing of a licence application includes a technical assessment process and a risk assessment process. Under section 6A of the IEO, it is a criminal offence to violate the licensing requirements, and the maximum penalty is imprisonment for seven years and a fine of unlimited amount.

## Suspicious transaction reporting

3.9 Under sections 25A of the OSCO and the DTROP, and section 12 of the UNATMO, any person who knows or suspects that any property represents proceeds of an indictable offence/drug trafficking, or is terrorist property must report his/her knowledge or suspicion to the authorities as soon as is reasonable or practicable. Failure to do so constitutes an offence punishable by HK\$50,000 and up to three months’ imprisonment.

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31 Chapter 537 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap537>.

32 “Sanctions” is defined under the UNSO to include complete or partial economic and trade embargoes, arms embargoes and other mandatory measures decided by the UNSC, implemented against a place outside the PRC.

33 Chapter 537AE of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap537AE>.

34 Chapter 537BV of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap537BV>.

35 Chapter 526 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap526>.

36 Chapter 60 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap60>.

37 Chapter 60G of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap60G>.

38 For example, firearms, ammunition, explosives, bombs and rockets, tanks and toxicological agents, etc., and equipment and technology for the production of these weapons.

39 For example, nuclear materials, facilities and equipment; materials, chemicals, micro-organisms and toxins; electronics; computers; telecommunications and information security; sensors and lasers; navigation and avionics; marine; propulsion systems, space vehicles and related equipment.

## CDD and record-keeping requirements

3.10 The AMLO supports the prevention and detection of ML/TF activities by requiring FIs to conduct CDD on their customers and keep records for a specified period. Effective implementation of CDD rules is aided by the AML/CFT Guideline, which is published under the AMLO and may be taken into consideration in any court proceedings under the AMLO. FIs, including their management or employees, are subject to criminal or supervisory sanctions for breaches of the AMLO requirements. The maximum penalty for the most serious offence under the AMLO is a fine of HK\$1 million and imprisonment for seven years. Disciplinary actions that may be imposed on an FI include a public reprimand, an order for remedial action, and a pecuniary penalty not exceeding the greater of HK\$10 million or three times the amount of the profit gained (or cost avoided) by the FI as a result of a contravention.

3.11 In January 2018, a bill to amend the AMLO was enacted by LegCo to extend the CDD and record-keeping requirements to DNFBPs, including legal professionals, accounting professionals, estate agents and TCSPs, when they carry out transactions specified by the FATF. In respect of legal professionals, accounting professionals and estate agents, the AML(A)O empowers the regulatory bodies under the respective Ordinances to investigate breaches and discipline members or licensees found to be non-compliant. TCSPs are required to obtain a licence from the Registrar of Companies before they can provide trust or company services as a business in Hong Kong. The Registrar supervises compliance by licensees. Unlicensed provision of service is a criminal offence. The AML(A)O commenced operation on 1 March 2018.

## CBNIs

3.12 Passengers entering or leaving Hong Kong are subject to customs clearance. If a passenger is suspected of having committed an ML offence, C&ED officers may seize any CBNIs carried upon arrest of such passenger. Where CBNIs are transported as cargo, they must be manifested under the IEO, though the regime does not require reporting of the amount. It is an offence under the IEO to import or export unmanifested cargoes.

3.13 The R32 Ordinance was enacted in June 2017 to implement the FATF Recommendation 32 by establishing a declaration and disclosure system to detect the cross-boundary movement of large quantities of CBNIs into or out of Hong Kong, and provide powers to restrain the movement of CBNIs suspected to be crime proceeds or terrorist property, to which asset recovery procedures could apply. Under the R32 Ordinance, a declaration or disclosure is required for the import or export of CBNIs with a value of more than HK\$120,000 (around US\$15,000) in the possession of a traveller or in a cargo consignment. Criminal sanctions apply to failure to comply, with a maximum penalty of a fine of HK\$500,000 and two years' imprisonment. A specific procedure will apply to certain first-time offenders<sup>40</sup> in lieu of criminal prosecution. C&ED will be the enforcement agency. Preparation is under way for the R32 Ordinance to commence operation on 16 July 2018.

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<sup>40</sup> Travellers who have not previously contravened the declaration or disclosure requirements, who have not been previously been convicted of ML or TF offences, and whose CBNIs are not reasonably suspected to be crime proceeds or terrorist property, may pay a fee to discharge their statutory liability.

## Restraint and confiscation/forfeiture of crime proceeds and terrorist property

3.14 The OSCO<sup>41</sup> contains provisions for the restraint and confiscation of proceeds of an indictable offence and the DTROP<sup>42</sup> has similar provisions for proceeds of drug trafficking. Applications for restraint can be made to the Court of First Instance against the realisable property (assets and funds) of a person, against whom proceedings for an offence have been instituted. Upon conviction, the Court of First Instance or the District Court may make a confiscation order in respect of proceeds of at least HK\$100,000 of a specified offence under the OSCO, or proceeds of any amount of a drug trafficking offence under the DTROP. The Court of First Instance may also make a confiscation order against absconders or deceased persons. In addition, a civil forfeiture regime is available under section 24D of the DTROP in respect of monies in excess of HK\$125,000, seized and detained during import into or export from Hong Kong and representing proceeds of drug trafficking or property used or intended to be used in drug trafficking.

3.15 Proceeds of corruption may also be recovered under section 12 of the Prevention of Bribery Ordinance<sup>43</sup>, which empowers a court (of any level) to make a “restitution order” against a person guilty of a bribery offence to pay to the Government or to such person or public body and in such manner as the court directs the amount or value of any advantage received by the person.

3.16 Section 6 of the UNATMO provides for the freezing of suspected terrorist property under the direction of the Secretary for Security. Under section 13, the Court of First Instance may order the forfeiture of terrorist property which represents any proceeds arising from a terrorist act, or which was used or is intended to be used to finance or otherwise assist the commission of a terrorist act. A bill to amend the UNATMO was enacted by LegCo in March 2018 and the amended Ordinance will come into operation on 31 May 2018 to enhance the freezing mechanism of terrorist property by prohibiting any person from dealing with specified terrorist property and property of specified terrorists or terrorist associates.

3.17 The Criminal Procedure Ordinance<sup>44</sup> also provides for the disposal of property and instrumentalities related to crime, including ML/TF cases and the predicate offences. The court (of any level) can order the property to be returned to the owner or be forfeited.

3.18 Restraint and confiscation of crime proceeds and confiscation of terrorist property that have flowed from Hong Kong to other jurisdictions, or vice versa, are permissible under the framework of mutual legal assistance (“MLA”) in criminal matters, as discussed under the section of “External and International Cooperation”.

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41 Section 15 of the OSCO for restraint order; Section 8, Schedule 1 and Schedule 2 of the OSCO for confiscation order.

42 Section 10 of the DTROP for restraint order. Section 3 of the DTROP for confiscation order.

43 Chapter 201 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap201>.

44 Chapter 221 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap221>.

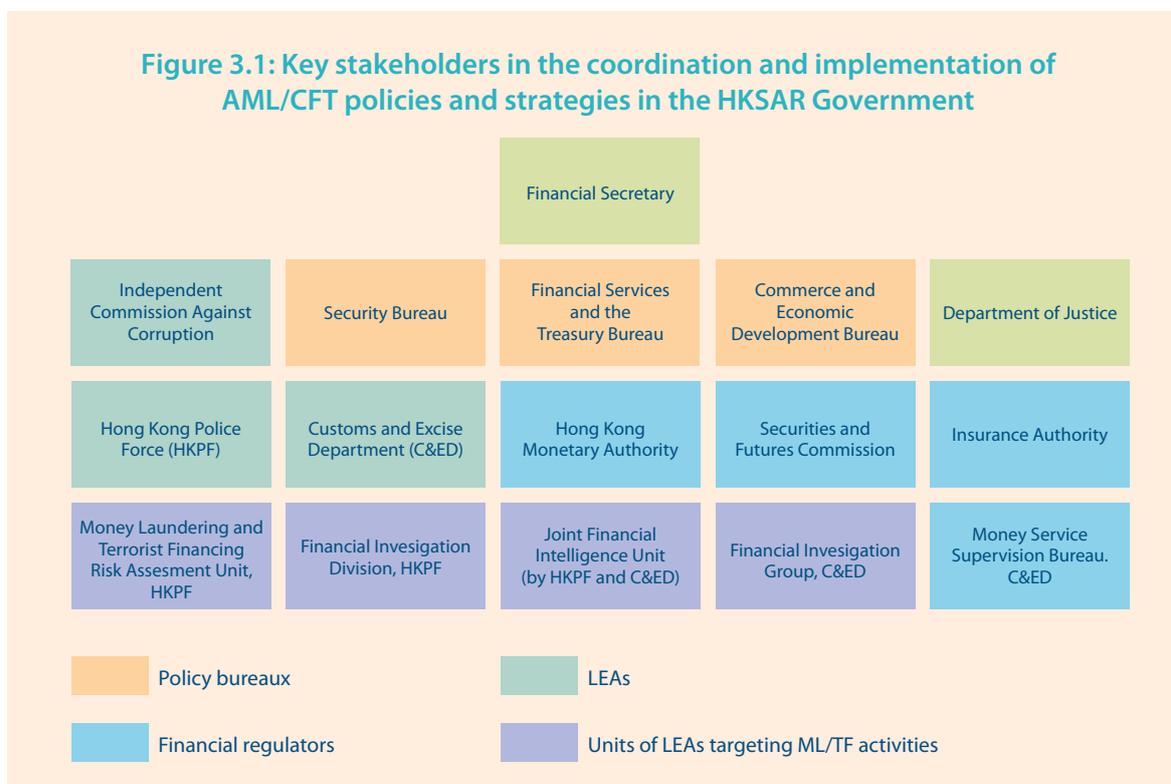
## High-level Commitment and Institutional Framework

3.19 As one of the world’s major financial centres, Hong Kong attaches great importance to safeguarding the integrity of the territory’s financial system and recognises the importance of maintaining a comprehensive and robust AML/CFT regime. This requires high-level political commitment from the Government and close collaboration and coordination among policy-making bodies, financial regulators, LEAs and others.

### CCC

3.20 The Financial Secretary chairs the CCC, established in 2008, to oversee the HKSAR Government’s AML/CFT policies and strategies. The CCC comprises senior representatives from the Government bureaux/departments with responsibilities for policy making or law enforcement: the FSTB, the SB, the DoJ, LEAs (the HKPF, the C&ED and the ICAC) and financial regulators (the HKMA, the SFC, the IA, and the Money Service Supervision Bureau (“MSSB”) of the C&ED). Other bureaux and departments (such as the CEDB, the TID and the CR) attend as necessary. The CCC meets regularly to examine the effectiveness of Hong Kong’s AML/CFT regime in light of the domestic situation and international developments. It spearheads measures to enhance the implementation of the AML/CFT policies and strategies under a risk-based and multi-agency approach. Below the CCC, an AML Regulation and Supervision Co-ordination Group, chaired by the FSTB and comprising the aforementioned financial regulators as members with other policy bureaux and LEAs invited as necessary, acts as a forum for discussion of issues relating to implementation of the AML/CFT regime.

**Figure 3.1: Key stakeholders in the coordination and implementation of AML/CFT policies and strategies in the HKSAR Government**



## Policy bureaux

3.21 The FSTB is responsible for coordinating the Government's efforts to deliver AML/CFT policies, strategies and legislative initiatives endorsed by the CCC. The FSTB monitors the overall effectiveness of Hong Kong's AML/CFT regime and compliance with the FATF Recommendations, and facilitates cooperation among stakeholders. The SB is responsible for overall counter-terrorism strategy, and supports the FSTB in a number of AML/CFT policy areas such as CDD and record-keeping measures for DNFBPs, and the declaration/disclosure system for CBNIs. The CEDB is responsible for coordinating the implementation of UNSCRs on PF and overseeing the WMD and strategic trade control regime.

## Financial regulators

3.22 The HKMA, the SFC, the IA and the MSSB of the C&ED are "relevant authorities" under the AMLO for their respective sectors and have powers to ensure compliance with CDD and record-keeping requirements. The regulators have issued guidelines, aligned with each other, on how they expect regulatees to comply with the AMLO requirements. They also issue sector-specific guidance and circulars and arrange training, seminars and other education for their sectors, including on AML/CFT matters.

3.23 In addition to the powers under the AMLO, the HKMA, the SFC and the IA have extensive powers to regulate their sectors under specific legislation (the HKMA under the Banking Ordinance ("BO")<sup>45</sup>, the SFC under the Securities and Futures Ordinance ("SFO")<sup>46</sup>, and the IA under the Insurance Ordinance<sup>47</sup>). These include licensing, requiring institutions to establish appropriate systems and controls including for AML/CFT, powers to appoint independent auditors or managers, and powers to enforce compliance and impose sanctions. All the regulators adopt an RBA for supervision of their sectors. Further details are given in Chapter 5.

3.24 The regulators participate in international bodies related to the industries that they regulate, including forums related to AML/CFT. They coordinate domestically via the AML Regulation and Supervision Co-ordination Group, the AML Regulatory Enforcement Co-ordination Group on enforcement matters, and through multilateral and bilateral contacts as required.

## DoJ

3.25 The Prosecutions Division of the DoJ prosecutes trials, including of ML/TF offences, and advises on and/or institutes proceedings to restrain and confiscate or forfeit crime proceeds or terrorist property. The Law Drafting Division and other relevant divisions work with policy bureaux from time to time on preparing legislation to update the AML/CFT legislative framework. The International Law Division processes requests for MLA and surrender of fugitive offenders and advises on legal matters in relation to the FATF and international AML/CFT standards in conjunction with other divisions of DoJ.

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45 Chapter 155 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap155>.

46 Chapter 571 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap571>.

47 Chapter 41 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap41>.

## LEAs

3.26 The investigation of ML and TF offences rests primarily with the HKPF and the C&ED, with the ICAC investigating ML offences that are facilitated by or connected with corruption. Hong Kong's LEAs have a reputation for integrity and effectiveness<sup>48</sup> and for fair and rigorous enforcement of the law. Laws<sup>49</sup>, regulations<sup>50</sup>, codes<sup>51</sup> and orders<sup>52</sup> are in place to preserve the integrity of investigating officers. The HKPF, the C&ED and the ICAC have also implemented measures, including vetting and regular interviews, to ensure a high standard of conduct and integrity among investigators at all times.



## HKPF

3.27 The HKPF is the primary LEA for ML/TF and predicate offences investigation under the Police Force Ordinance<sup>53</sup>, the OSCO, the DTROP and the UNATMO. The Financial Investigation Division (under the Narcotics Bureau of the HKPF) specialises in investigating ML and TF relating to drugs and organised crimes, as well as tracing and confiscating proceeds under the OSCO, the DTROP and the UNATMO. The Commercial Crime Bureau ("CCB") is responsible for investigating serious, complex and syndicated commercial crimes and business fraud. Other crime investigation teams or units (at headquarters, regional or district levels) also conduct ML investigations during enquiries into predicate offences, or other serious or organised crimes.

48 The "Corruption Perceptions Index 2016" published by the Transparency International stated that, Hong Kong is one of the least corrupt economies in the world that ranks 15 out of 176 countries, and scores 77 out of 100 points. The overall corruption scene in Hong Kong's civil service has remained generally stable over the years. Hong Kong is ranked 6th out of 159 countries for the "Reliability of Police" in the Human Freedom Index 2016 published by the Fraser Institute.

49 For example, the Prevention of Bribery Ordinance. See footnote 43.

50 Civil Service Regulations.

51 Civil Service Code.

52 Disciplinary and integrity related orders are issued by the respective departments and units.

53 Chapter 232 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap232>.

## C&ED

3.28 The C&ED has established the Financial Investigation Group under the Syndicate Crimes Investigation Bureau to investigate ML cases with predicate offences under the C&ED's purview, e.g. smuggling, intellectual-property and drugs offences, and to trace, restrain and confiscate proceeds of such offences. The Financial Investigation Group works closely with the Mainland Customs and overseas LEAs against cross-border and transnational ML syndicates.

3.29 The C&ED also safeguards the certification and licensing systems, which are of vital importance to Hong Kong's trading integrity. The C&ED carries out cargo examination at control points, factory inspections and consignment checks and is a member of the Hong Kong Compliance Office set up to assist the Central People's Government in implementing the Chemical Weapons Convention in Hong Kong through the Chemical Weapons (Convention) Ordinance<sup>54</sup>. As noted above, the MSSB under the C&ED licenses and regulates MSOs under the AMLO.

3.30 The C&ED is the enforcement agency of the strategic trade control system in Hong Kong instituted under the IEO and its subsidiary legislation, the Import and Export (Strategic Commodities) Regulations. The C&ED ensures that the licensing system is not abused by illegal imports and exports by conducting intelligence-led inspections and verifications on import and export of strategic commodities and investigating cases of abuse.

## ICAC

3.31 The ICAC is primarily responsible for investigating corruption complaints. The financial aspect of corruption or related offences, including fund flow analysis and tracing of proceeds of crime, is covered in investigation of the main offences. ML offences facilitated by or connected with corruption are pursued if revealed in the course of corruption investigations.

3.32 The ICAC Proceeds of Crime Section<sup>55</sup> was set up in 2010 to deal with the restraint and confiscation of assets under the OSCO. A Forensic Accounting Group<sup>56</sup> was formed in 2011 to support frontline officers in handling complex corruption cases, ML and other offences.

## JFIU

3.33 The JFIU<sup>57</sup> is a dedicated unit jointly operated by the HKPF and the C&ED to receive, analyse and disseminate STRs filed by FIs, DNFBPs and members of the public, and study typologies of ML and TF cases. On receipt of each STR, the JFIU will examine and conduct intelligence analysis in accordance with its risk-assessment mechanism, examining aspects of the report, including its degree of suspicion, severity and level of risk. Valuable intelligence from STRs is developed and/or disseminated to investigative units of LEAs or other agencies, enabling them to intervene and disrupt ML/TF activities, assisting investigations and leading to successful prosecutions.

3.34 The number of STRs received has risen between 2013 and 2017, partly due to increased monitoring of FIs and an improving AML/CFT compliance culture since implementation of the

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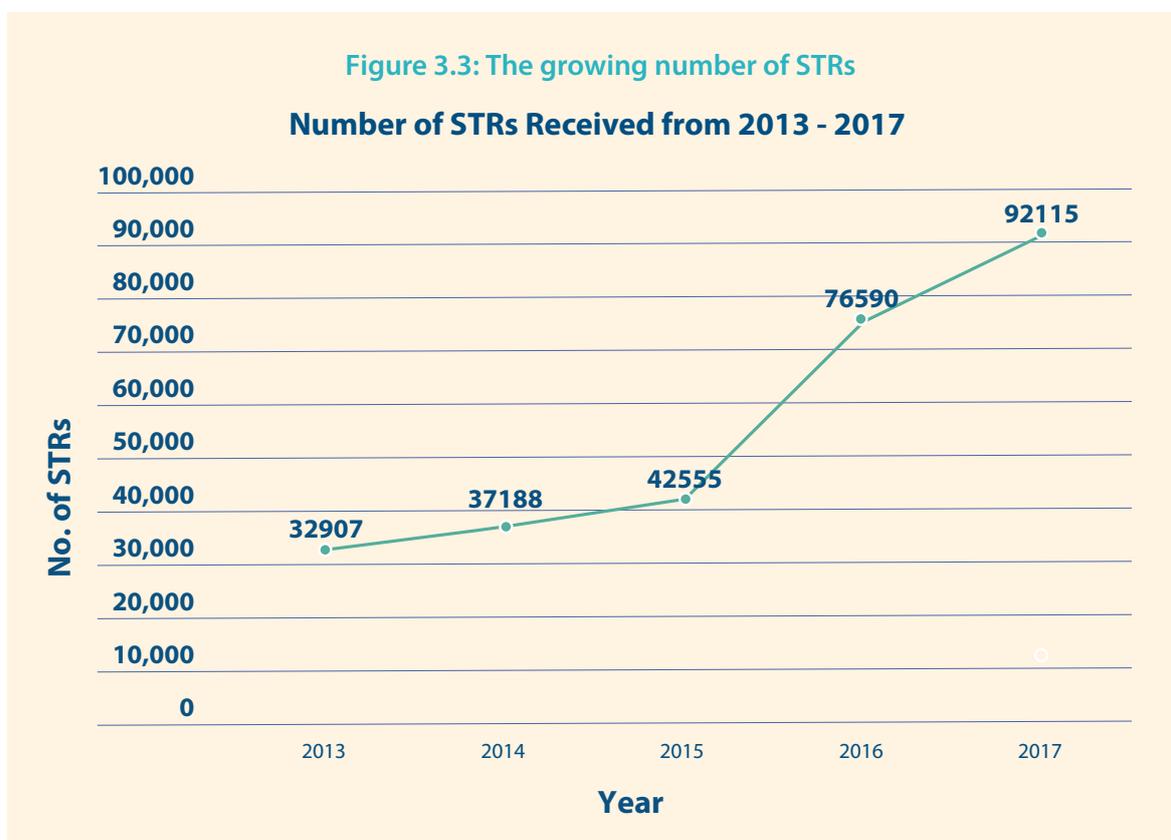
<sup>54</sup> Chapter 578 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap578>.

<sup>55</sup> This section has an establishment of one Chief Investigator, two Senior Investigators and two Assistant Investigators. The strength of staff deployed for asset tracing/ forfeiture may be subject to change depending on the workload.

<sup>56</sup> One Chief Forensic Accountant, two Senior Forensic Accountants and eight Forensic Accountants.

<sup>57</sup> There are a total of 48 established posts in the JFIU, headed by a Superintendent of Police.

AMLO in 2012. The increasing numbers present a challenge for the JFIU in terms of handling capacity.



### Multi-agency approach and public-private partnership

3.35 Members of the CCC collaborate on various levels. Policy bureaux, in implementing the AML/CFT policy initiatives and taking forward legislative exercises under the direction of the CCC, consult relevant Government agencies and stakeholders in the community. Feedback from these engagements plays a vital role in shaping policies.

3.36 In 2014, a Memorandum of Understanding (“MOU”) on supervisory and enforcement matters was signed among the relevant authorities under the AMLO (the HKMA, the SFC, the IA and the C&ED) to underpin the exchange of information and mutual assistance. Under the MOU, two coordination groups were established:

- (a) The AML Regulation and Supervision Co-ordination Group is chaired by the FSTB and comprises the HKMA, the SFC, the IA and the C&ED as well as representatives from other agencies including the HKPF. The group’s objectives include monitoring the operation of the AML/CFT regulatory regime for financial sectors and sharing information and insights on regulatory and supervisory issues of common concern. This group coordinates implementation of policies directed by the CCC; and
- (b) The Anti-Money Laundering Regulatory Enforcement Co-ordination Group, comprising the HKMA, the SFC, the IA and the C&ED, who chair meetings in rotation. The FSTB joins as needed. There are regular meetings to share outcomes of AML/CFT investigations and enforcement actions.

3.37 The SFC and the HKPF signed an MOU in August 2017 to formalise and strengthen cooperation in combating financial crimes. The MOU covers matters including referral of cases, joint investigations, exchange and use of information, mutual provision of investigative assistance, and establishes a framework for collaboration on policy, operational and training issues to make the combating of crime and illicit activities in the securities and futures markets more effective.

3.38 The HKPF, the C&ED and the ICAC cooperate closely on policy and operational matters, information sharing and intelligence. Under mechanisms and liaison channels provided for or permitted by law, investigative authorities are able to obtain financial information and intelligence from other authorities and mount joint operations to combat financial crime.

3.39 The FMLIT was established in May 2017. The FMLIT is a collaborative platform that is based around a HKPF-led public-private partnership, bringing together the collective expertise and resources of the banking sector and the Government in the fight against serious financial crimes and ML activities. Through regular meetings of the FMLIT's Strategic and Operations Group, senior representatives formulate and adjust its directions, allowing professional fraud and ML investigators from the HKPF and the banking sector to work side by side in tackling serious financial crimes and ML activities. Assessment reports and alerts are disseminated to the sector from time to time with a view to identifying risks and implementing appropriate mitigation strategies. The FMLIT provides a formal structure for banks and regulatory authorities to improve collective understanding of current and emerging threats, with a view to detecting, preventing and disrupting serious financial crimes and ML activities.

3.40 Other mechanisms (regular or ad hoc) to ensure timely and effective cooperation in response to ML/TF threats and typologies include:

- (a) The FSTB and the SB, with the JFIU, the financial and sectoral regulators or professional groups arrange seminars for the financial sectors and DNFBPs to share experience, information on risk and typologies and latest developments and promote CDD, record-keeping and suspicious transaction reporting;
- (b) The JFIU issues *STR Quarterly Analysis* to STR reporting entities to provide analysis and feedback on STRs and case typologies. It also delivers seminars to FIs and DNFBPs, and liaises with financial regulators to share information about topical AML/CFT issues;
- (c) The HKPF issues industry alerts and meets the HKMA regularly to discuss the latest crime trends and provide updates on cases of interest and referrals;
- (d) In response to the topical threat of certain cryptocurrencies, the FSTB, financial regulators and LEAs have started a dialogue on regulatory tools available to address local and international concerns. The FSTB engaged in a new round of exchanges with financial regulators in late 2017 to discuss the potential risks of initial coin offerings and formulate appropriate policy responses;
- (e) The JFIU participated in the development of a *Guidance Paper on Transaction Screening, Transaction Monitoring and Suspicious Transaction Reporting* issued by the HKMA in 2013;

- (f) In view of the noticeable increase of deceptions and frauds as well as the associated ML risk, the HKPF established the Anti-Deception Coordination Centre (“ADCC”) in July 2017 to step up actions against deception and enhance public awareness of various kinds of scams. Apart from the instant consultation telephone hotline service offered to the public and enhanced efforts in publicity and enforcement, the ADCC works together with the JFIU in strengthening cooperation with FIs, with a view to mitigating victims’ loss and upholding the AML regime in Hong Kong. Specifically, the ADCC has been assuming the role of urgent liaison with local FIs on suspicious cases. Initial success has been noticed in the stop payment capacity of the ADCC. As at the end of 2017, the ADCC has intercepted HK\$170 million upon urgent liaisons with FIs in Hong Kong;
- (g) With growing international concern over DPRK’s proliferation of weapons of mass destruction, the CEDB convenes a regular inter-agency platform on implementation of the relevant UNSC sanctions, to share intelligence, discuss trends and cases, and coordinate 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 and other co-opted members where needed. Follow-up actions, such as pursuing further investigation and enforcement, have been taken following the meetings, and alerts have been issued to the relevant trades to remind them of the need to comply with UNSC sanctions; and
- (h) In response to reports about the DPRK evading sanctions imposed by the UNSC allegedly using front companies based in Hong Kong, the HKPF and the CR have taken collaborative enforcement measures targeting the front companies and related company secretaries. The CR has formed a dedicated team to conduct thematic inspections targeting TCSPs and companies with a high risk of being abused. The operation is under way, under the policy oversight of the FSTB and supported by risk analysis undertaken by the LEAs. Meanwhile, the CR has set up a TCSP Registry to oversee a licensing regime for TCSPs and the conduct of licensees. The licensing regime has been instituted under the amended AMLO since March 2018 to ensure that only fit and proper persons are allowed to carry on TCSP business in Hong Kong, and that the AML/CFT conduct of TCSPs is closely supervised.

## Prosecution and Judicial Process

3.41 The Prosecutions Division of the DoJ provides legal advice to LEAs on their investigations, and generally exercises on behalf of the Secretary for Justice the discretion whether or not to bring criminal proceedings. Prosecution is initiated where the evidence demonstrates a reasonable prospect of conviction and that it is in the public interest to prosecute. ML offences can be tried summarily or on indictment.

3.42 All prosecution decisions are made strictly in accordance with the law, the Prosecution Code and admissible evidence. Prosecutors make decisions to prosecute or not independently. As noted in Chapter 1, the fair, transparent, and efficient adjudication of cases is guaranteed by the independence of the law courts from the executive and legislative arms of the HKSAR.

**Table 3.1: Number of ML prosecutions (by case)**

Year	2013	2014	2015	2016	2017
ML Prosecutions	137	167	118	94	103

3.43 The quality of prosecutions against ML/TF is backed by consistent and ongoing training for prosecutors. The DoJ continues to foster links with counterparts in other jurisdictions and participates in international conferences and events to keep prosecutors abreast of the latest developments in the AML/CFT regime.

**Table 3.2: Sentences of ML convictions (by person)**

Year	2013	2014	2015	2016	2017
Non-custodial sentence	13	20	6	9	9
Custodial sentence : Under 24 months	68	56	57	62	50
Custodial sentence : 2 to 4 years	36	61	68	34	29
Custodial sentence : 4 to 6 years	15	16	3	2	5
Custodial sentence : Over 6 years	5	2	1	0	1

Note: Since a single individual may serve more than one type of sentence (e.g. custodial and non-custodial), the total is not given.

**Table 3.3: Restraint and confiscation of crime proceeds**

Year	2013	2014	2015	2016	2017
Number of restraint orders applied	43	49	28	29	31
Value of proceeds restrained (in HK\$ million)	1,346	1,091	354	303	67
Number of confiscation orders applied	34	47	23	12	28
Value of proceeds confiscated (in HK\$ million)	704	318	139	134	336

Note: The drop in the numbers of restraints and confiscations in 2015 was partially due to cases pending judgment by the higher courts, which contained important clarifications of key legal issues in the prosecution of ML offences. The decrease may also be attributed to proceeds of some ML cases being returned to the victim(s) through civil proceedings without the need for restraint/confiscation proceedings.

## External and International Cooperation

3.44 ML often involves transnational crimes. Effective international cooperation is essential in tracing crime proceeds, and uncovering the identity and background of criminals. As a member of the FATF, the APG, the International Criminal Police Organisation (“INTERPOL”), and the Egmont Group of Financial Intelligence Units (“FIUs”) through the JFIU, Hong Kong participates in international efforts to combat ML and TF. Mechanisms are in place for providing assistance to other jurisdictions, including MLA, financial intelligence exchange, and cooperation among LEAs and financial regulators.

### MLA and surrender of fugitive offenders

3.45 The Mutual Legal Assistance in Criminal Matters Ordinance (“MLAO”)<sup>58</sup> provides a statutory framework for implementing bilateral and multilateral agreements on MLA, enabling assistance to be provided to or obtained from foreign jurisdictions in the investigation and prosecution of criminal offences and ancillary criminal matters.

3.46 Hong Kong has signed bilateral MLA agreements with 32 jurisdictions, all of which contain provisions for tracing, restraining, confiscating and sharing proceeds of crime. In addition, 13 multilateral conventions targeting serious crimes which provide for mutual legal cooperation have been applied to Hong Kong, including the Palermo, Vienna and Merida Conventions. In the absence of applicable bilateral agreement or multilateral conventions, MLA may still be provided on the basis of a reciprocity undertaking provided by the requesting place.

3.47 Types of MLA that may be provided include taking of evidence and statements (including via a live video link), search and seizure, production of materials, transfer of persons (in custody or otherwise) to provide assistance, confiscation of proceeds of crime (including freezing pending confiscation) and service of documents.

**Table 3.4: MLA requests related to ML/TF and predicate offences**

Year	2013	2014	2015	2016	2017
No. of MLA requests made	18	17	19	15	14
No. of MLA requests received <sup>59</sup>	264	301	334	339	342

3.48 The Fugitive Offenders Ordinance (“FOO”)<sup>60</sup> permits the surrender from Hong Kong of persons wanted abroad, either for prosecution or for the imposition or enforcement of a sentence, for certain offences against the laws of those places. Surrender is only permissible to places with which Hong Kong has entered into a bilateral surrender of fugitive offenders agreement, or where there is a relevant multilateral convention applicable to Hong Kong, and subsidiary legislation is in place under the FOO to bring such an agreement into effect.

58 Chapter 525 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap525>.

59 Some requests cannot be processed due to insufficient information provided in the request or a failure to meet minimum legal thresholds for processing etc.

60 Chapter 503 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap503>.

Hong Kong has signed bilateral surrender of fugitive offender agreements with 20 jurisdictions and 14 multilateral conventions<sup>61</sup> which contain extradition provisions<sup>62</sup> have been applied to Hong Kong.

**MLA with other parts of PRC**

3.49 The MLAO and the FOO do not apply to other parts of China, including the Mainland, Macao and Taiwan. Some assistance for evidence-taking may be rendered to or sought from other parts of China on the basis of letters of request issued by the court and under Parts VIII and VIIIA of the Evidence Ordinance<sup>63</sup>. This is a court-to-court letter rogatory process and limited to the taking of evidence and production of documents. To date some Hong Kong requests for taking of evidence in support of ML prosecutions have been successfully processed by the Mainland and Macao authorities. Hong Kong may also enforce external confiscation orders made in places designated under the Drug Trafficking (Recovery of Proceeds) (Designated Countries and Territories) Order<sup>64</sup> for recovery of proceeds of drug trafficking. China is one of the designated places.

**Financial intelligence exchange**

3.50 Under the OSCO, the DTROP and the UNATMO, the JFIU has the authority to exchange information with counterparts in other places without entering into MOUs. The signing of an MOU will be considered where the laws of a counterpart jurisdiction require an MOU for financial intelligence exchange. The JFIU has signed 12 bilateral agreements/MOUs with overseas FIUs and its Mainland and Macao counterparts<sup>65</sup>.

**Table 3.5: Financial intelligence exchanges by JFIU with Egmont Group and non-Egmont Group members**

Year	2013	2014	2015	2016	2017
Incoming Requests & Spontaneous Exchanges (Egmont Group)	705	744	824	794	991
Incoming Requests & Spontaneous Exchanges (Non-Egmont Group)	20	14	6	43	154
<b>Total Number of Correspondences</b>	<b>725</b>	<b>758</b>	<b>830</b>	<b>837</b>	<b>1,145</b>
Outgoing Requests & Spontaneous Exchanges (Egmont Group)	613	824	944	866	990
Outgoing Requests & Spontaneous Exchanges (Non-Egmont Group)	18	23	200	293	358
<b>Total Number of Correspondences</b>	<b>631</b>	<b>847</b>	<b>1,144</b>	<b>1,159</b>	<b>1,348</b>

61 The abovementioned 13 multilateral agreements plus the Convention on the Prevention and Punishment of the Crime of Genocide 1948.  
 62 Extradition is known as "surrender of fugitive offenders" in the context of Hong Kong, China.  
 63 Chapter 8 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap8>.  
 64 Chapter 405A of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap405A>.  
 65 As of July 2017, the JFIU has signed 12 MOUs with other jurisdictions, including Australia (the Australian Transaction Report and Analysis Centre and the Australian Federal Police), Korea, Singapore, Canada, Japan, Malaysia, Poland, Panama, Russia, Mainland China and Macao.

3.51 As a member of the Egmont Group, the JFIU works with FIUs worldwide to support cross-jurisdiction law enforcement and intelligence exchange. In 2017, the JFIU exchanged financial information with 99 Egmont Group members and one non-member. In addition, the JFIU provides assistance to overseas LEAs whenever appropriate. JFIU officers participate in the meetings and workshops of the FATF, the APG and the Egmont Group, with a view to exchanging financial intelligence and sharing experience. Between 2012 and 2017, the JFIU also received delegations from 22 jurisdictions.

### External cooperation by LEAs

3.52 The HKPF is part of the INTERPOL. INTERPOL Hong Kong, a Sub-Bureau of INTERPOL Beijing, National Central Bureau China, is the point of communication between the HKPF and the other 190 member countries.

3.53 The C&ED participates in enforcement operations coordinated by the World Customs Organization and has entered into 24 Cooperative Arrangements/Agreements since May 1991 to promote international cooperation in the fight against contraventions of customs law. Under the above cooperation framework, the C&ED exchanges intelligence with counterparts for investigation of suspected customs crimes. The C&ED takes part in various international enforcement fora and participates in seminars and workshops on capacity-building, customs integrity, trade facilitation, AML, anti-drug trafficking, anti-piracy, environmental issues and global supply-chain security.

3.54 The ICAC has established direct liaison channels with a large number of overseas LEAs, and is a member of the Economic Crime Agencies Network (a global network of LEAs dealing with corruption and other economic crimes). The ICAC represents Hong Kong in the Law Enforcement Meeting of the Asian Development Bank - OECD Anti-Corruption Initiative for Asia and the Pacific, the International Association of Anti-Corruption Authorities, and the Asia-Pacific Economic Cooperation Network of Anti-Corruption Authorities and Law Enforcement Agencies. In May 2017, the ICAC hosted an international seminar on financial investigation, attended by more than 240 anti-graft professionals and law enforcers from over 40 jurisdictions and 100 organisations, who shared experience and expertise in financial investigation and asset recovery.

### Regulators' external and international cooperation

3.55 The HKMA is a member of the Basel Committee on Banking Supervision and its AML Experts Group. The Basel Committee on Banking Supervision has 45 members from 28 jurisdictions, consisting of central banks and authorities with responsibility for supervision of banking business. The HKMA participates actively in Hong Kong's representation at the FATF and the APG, providing assessors or reviewers for three mutual evaluations in recent years and taking part in technical assistance to a regional jurisdiction.

3.56 The HKMA maintains close contacts with the People's Bank of China and the China Banking Regulatory Commission and is discussing improvements to cooperation on AML/CFT. MOUs or other formal arrangements have been signed with 28 overseas banking supervisory authorities in 23 jurisdictions. These arrangements provide the formal framework, under which the HKMA and its counterparts agree to share and exchange, to the extent permitted by law, supervisory information (including AML/CFT matters) to assist in the supervision of banks, and to discuss matters of common interest. The HKMA continues to extend its cooperation with banking supervisors in other jurisdictions, including through college-of-supervisors meetings.

3.57 The SFC is a signatory to the International Organization of Securities Commissions Multilateral Memorandum of Understanding, which is a global information-sharing arrangement among securities regulators that facilitates cross-border enforcement against securities related misconduct. International Organization of Securities Commissions members regulate more than 95% of the world's securities markets in more than 115 jurisdictions<sup>66</sup>. The SFC also has collaborative arrangements with more than 70 regulators in other jurisdictions in the form of MOUs, confidentiality undertakings, memoranda regarding administrative arrangements and memoranda of regulatory cooperation<sup>67</sup>.

3.58 The SFC cooperates and coordinates with international counterparts in supervising firms regulated by multiple authorities and participates in supervisory colleges which share information among regulators and develop better understanding of the risk profiles and activities of globally active firms. In 2015, the SFO was amended to empower the SFC to obtain information from licensed corporations ("LCs") for the purpose of providing supervisory assistance to regulators outside Hong Kong upon request, subject to certain safeguards and conditions. The changes enable the SFC to engage in more cooperation with external regulators to facilitate group-wide supervision and monitoring.

3.59 The SFC collaborates closely with the China Securities Regulatory Commission, the People's Bank of China, the State Administration of Foreign Exchange and other Mainland authorities under bilateral agreements/arrangements setting out cooperative frameworks, including investigatory assistance, exchange of information, and market- or product-related arrangements. In 2016 the SFC entered into an MOU with the China Securities Regulatory Commission in connection with the Shenzhen-Hong Kong and Shanghai-Hong Kong Stock Connect<sup>68</sup>.

3.60 The IA is a signatory to the International Association of Insurance Supervisors Multilateral Memorandum of Understanding, a global framework for cooperation and information exchange between insurance supervisors. It has also signed bilateral MOUs or other arrangements with insurance supervisors of 10 overseas jurisdictions for sharing of regulatory information. Cooperation and information exchange in respect of AML/CFT matters are covered under the aforesaid MOUs and arrangements.

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66 The SFC also participated in the work of the International Organization of Securities Commissions Asia-Pacific Regional Committee on monitoring extraterritorial rulemaking, strengthening regional enforcement and supervisory cooperation, and mapping regional regulatory frameworks for collective investment schemes.

67 These cooperative arrangements mainly focus on investigatory assistance, exchange of information, and market or product-related arrangements, and cover matters related to or relevant for AML/CFT purposes.

68 The MOU further enhances an existing platform established in 2014 in respect of the Shanghai-Hong Kong Stock Connect, for cooperation on information sharing, alerts, investigative assistance and joint investigations.

3.61 The IA has signed a Cooperative Agreement on Insurance Supervision with the China Insurance Regulatory Commission to promote efficient, fair and stable insurance markets in Hong Kong and Mainland China, by providing a framework for cooperation, mutual understanding, exchange of information and assistance. The Trilateral Cooperative Agreement on Anti-insurance Fraud signed with the China Insurance Regulatory Commission and the Monetary Authority of Macao enables the provision of assistance and information sharing among the signatories.

3.62 To strengthen international supervisory cooperation in the insurance industry for effective group-wide supervision of multinational insurance groups, supervisory colleges are organised by relevant group-wide supervisors with the participation of other insurance supervisors of jurisdictions where such groups have operations. Supervisory colleges cover AML/CFT controls, which allow supervisors to share inspection findings and regulatory concerns, with a view to identifying and addressing group weaknesses. In the past years, the IA held group-wide as well as regional supervisory colleges in Hong Kong where involved overseas insurance supervisors participated. The IA also attended supervisory colleges hosted by various group-wide supervisors overseas.

## Next Steps

3.63 Hong Kong's ability to combat ML and TF is medium-high, characterised by a sound legal framework, high-level commitment, a multi-agency AML/CFT institutional framework, rigorous law enforcement with LEAs of high capability and integrity, a fair prosecution and judicial system, and effective external and international cooperation. That said, there is room for enhancement in some areas:

- (a) Enhancing the AML/CFT legal framework. Ongoing efforts are needed to improve the AML/CFT legal framework in keeping with the changing security landscape and FATF recommendations. To this end, LegCo enacted in January 2018 a bill to amend the AMLO to codify CDD and record-keeping requirements for DNFBPs, and another bill to amend the CO to require the keeping of beneficial ownership information by companies. Another bill to amend the UNATMO having regard to the FATF's recommendation to enhance the freezing mechanism of terrorist property and UNSCR 2178 which affirms the need to combat threats against foreign terrorist fighters was also enacted by LegCo in March 2018, and the amended Ordinance will come into operation on 31 May 2018. With the enactment of the R32 Ordinance, preparation is being made for implementing the declaration/disclosure system for cross-boundary movement of large quantities of CBNIs in July 2018. While the full effects of these enhancements will only be seen with more time, they will provide the legal basis for the authorities to better detect, deter and combat ML/TF. Hong Kong's ability to combat ML and TF has been significantly strengthened as a result;

- (b) Expanding AML/CFT partnerships. There is strong cooperation among Government bureaux/departments and regulators on AML/CFT matters, ranging from policy-making to law enforcement. While engagement of the private sector has always been a priority, the FMLIT pilot project is a new initiative where key private sector stakeholders play a stronger role in intelligence development and sharing with a view to enhancing overall capability to combat serious ML; and
- (c) Strengthening external and international cooperation. The HKSAR's participation in international cooperation arrangements provides a solid basis for cooperation with regulators and LEAs of other jurisdictions but needs to be further strengthened to ensure resources are focused on the most complex and multi-jurisdictional cases.

# CHAPTER 4

## MONEY LAUNDERING THREAT

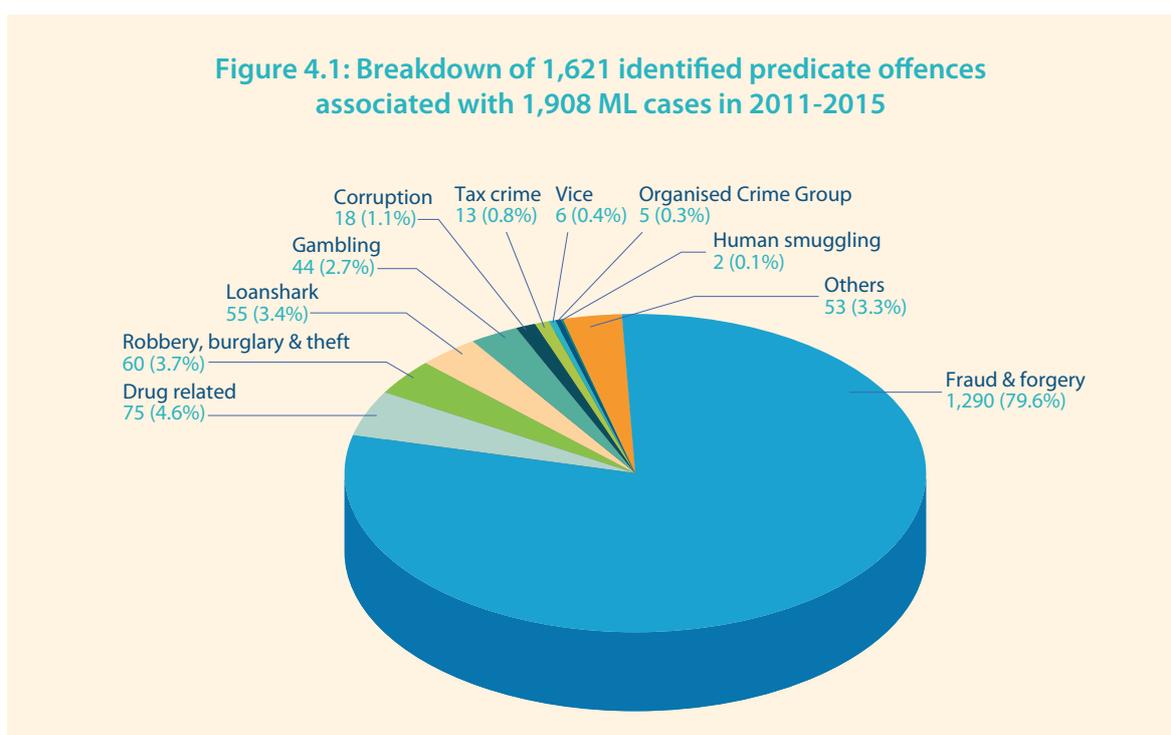
### Overview

4.1 This Chapter identifies and assesses major ML threats based on examination of 1,908 ML cases<sup>69</sup> between 2011 and 2015. A breakdown of the predicate offences identified to be associated with the 1,908 ML cases is available in Figure 4.1. Updated statistics related to the predicate offences were also examined in parallel for diagnosing the latest trends and ML threats. The assessment takes into account the number of reports emanating from different predicate crimes; the magnitude of proceeds generated; the scope, complexity and sophistication of ML; and the impact of predicate crimes on the social, legal and economic development of Hong Kong.

4.2 While Hong Kong has a low overall crime rate, as an international finance, trade and transportation centre, it is exposed to both internal ML threats – those arising from domestic predicate offences, and external ones involving the laundering of proceeds from illicit activities elsewhere, which flow into or through the market or financial system. In practice there is considerable overlap between the two groups of threats in terms of the methods employed, such as the use of the Internet, email and social media platforms in the commission of predicate offences.

4.3 However, there are differences in the ML techniques employed with respect to domestic and external threats, with transnational criminals, whether individuals or syndicates, tending to be more sophisticated in the methods they employ. The assessment below looks at the predicate offences and the ML threats they present, drawing out differences between internal and external threats where they are significant.

### Major Predicate Offences



69 The 1,908 ML cases cover ML investigations and ML cases resulting in convictions of the HKPF, the ICAC, the C&ED and the Immigration Department between 2011 and 2015.

4.4 Figure 4.1 gives a breakdown of 1,621 identified predicate offences associated with the 1,908 ML cases examined between 2011 and 2015. Of the 1,621 predicate offences, around 40% were domestic predicate offences and 58% originated outside Hong Kong<sup>70</sup>. Fraud, drugs-related offences, loansharking and bookmaking are identified as the major internal threats. Further statistical analysis of ML cases with convictions in 2015 shows that the top two jurisdictions from which the predicate crimes originated were the US and Mainland China.

## Fraud

4.5 In general, fraud-related cases are observed to have increased between 2011 and 2015, and recorded a drop in 2016 and 2017. Domestic fraud offences mainly encompass telephone deception, online business fraud<sup>71</sup>, email scams<sup>72</sup> and social media fraud<sup>73</sup>. External fraud offences mainly concern online fraud, telephone deception and investment fraud. Whilst domestic fraud offences constitute around 20% of the identified predicate crimes of the ML cases examined, external fraud offences account for 59%. In general, domestic fraud cases perpetrated by locals are comparatively simple. The principal offenders would either deal with the proceeds personally (self-ML) or through family members or associates (third-party ML). In external fraud cases, stooge accounts are used by cross-border syndicates to move money across the globe. In Hong Kong, the majority of the stooge accounts used to launder proceeds are corporate bank accounts<sup>74</sup> of non-residents. Local MSOs<sup>75</sup> are also observed to be misused for receiving the money and later dissipating to other jurisdictions. In most cases, victims became aware of and reported the scams only at a late stage, after the proceeds had been dissipated to other jurisdictions.

## Telephone deception

4.6 The *modus operandi* of telephone deception has evolved in recent years, from “Detained Son” and “Guess Who” to “Pretend Official”. In most cases, victims received demands, accompanied by threats or inducements, to provide bank account numbers and passwords; remit money to bank accounts in Hong Kong<sup>76</sup>, Mainland China or overseas through local banks or MSOs; or to pay cash locally to agents of the fraudsters. In 2017, 991 telephone deception cases were reported, involving losses of HK\$229 million<sup>77</sup>. To combat telephone deception, HKPF has adopted a number of strategies, including proactive enforcement actions to strengthen the partnership with Mainland law enforcement units, cultivation and analysis of intelligence for investigation, publicity and education for the public, and deterrence through confiscation of proceeds and application to the court for enhancing the sentences of those who have been convicted of ML. In 2015, 42 of 116 (36.2%) predicate offences for ML reaching trial were domestic telephone deception cases.

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70 The origin of the remaining 2% was unknown.

71 Where a buyer fails to receive goods ordered online after payment has been made or a seller fails to receive payment where goods have been delivered.

72 Where culprits hack into email accounts and cheat victims into making remittances.

73 Fraud committed via the use of social media sites.

74 Corporate bank accounts may involve both local and overseas corporations. Local corporations involved in ML activities are usually incorporated through secretarial firms that can assist in the incorporation and registration of companies. They also act as agents of companies and provide them with registered offices and business addresses, as well as providing nominee director, secretary or shareholder services designed to ensure the confidentiality of the true ownership or control of a company. Company services provided by secretarial firms are susceptible to abuse by stooges, who may approach those firms to purchase shelf companies or register companies for laundering proceeds of crime.

75 A study of the cases shows that both licensed and unlicensed MSOs have been misused to launder proceeds of crime.

76 Local bank accounts are often opened by stooges, who would subsequently dissipate the funds by cash withdrawals.

77 The number of telephone deception cases has dropped by 147 (12.9%) and the pecuniary loss has increased by HK\$7.83 million (3.5%) compared to 2016.

4.7 Telephone deception may involve solely local syndicates, or transnational syndicates based outside Hong Kong<sup>78</sup>. They commonly employed stooges to open bank accounts or use MSOs to remit proceeds<sup>79</sup>.

### Online fraud

4.8 Most of the online fraud cases reported in 2017 were online business fraud<sup>80</sup>, email scam<sup>81</sup> and social media fraud<sup>82</sup>. Email scams involved losses amounting to HK\$993 million in 2017, about 73% of the total losses from online fraud. The total losses incurred from external commercial email scams are HK\$757 million, which accounted for 76.3% of all commercial email scam reported in Hong Kong. Analysis of convicted ML cases in 2015 revealed a transnational element<sup>83</sup>. In social media fraud, instead of using bank accounts, perpetrators commonly use social media platforms and instant messaging applications to pose as account holders and deceive their relatives and friends into buying and paying for SVF or prepaid devices such as online game tokens. The credit is deposited instantly to the perpetrator's account on the relevant platform. Proceeds in such cases flow out of Hong Kong swiftly.

### Investment fraud

4.9 Investment fraud commonly involves fraudulent investment schemes with features such as high return, low risk and quick profit, in which victims are lured to send their payments abroad. In this type of predicate crimes, companies set up in different jurisdictions are commonly used to project the false impression of investment activities. In a number of ML cases involving external investment fraud, overseas ML syndicates have used front companies to transmit crime proceeds between jurisdictions. The commingling of funds helps to disguise proceeds of crime.

### Drugs

4.10 The local drug situation remains stable and the total number of reported drug abusers in Hong Kong decreased between 2011 and 2017. Drugs are mostly manufactured outside Hong Kong and smuggled into Hong Kong by air, sea or mail. The structure of drug trafficking varies from retail-level traffickers to syndicates with layers of management, such as brokerage, logistics and drug couriers. Some of the drugs smuggled into Hong Kong are re-routed to other places, for example to Asia-Pacific jurisdictions.

4.11 Analysis of the predicate crimes behind local ML activities shows that about half of the drug-related ML cases were associated with trafficking activities in jurisdictions outside Hong Kong. Whilst domestic drug-related offences constitute around 2.4% of the identified predicate crimes of the ML cases examined, external drug-related offences account for 2.2%.

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78 Some of the cross-border telephone deception cases involved syndicates from Taiwan and Mainland China.

79 Between 2013 and 2017, 117 cases were reported by local MSOs after they became aware of the scam and before they assisted the victims to transfer the proceeds.

80 In 2017, a total of 1,996 cases of online business fraud cases were reported, representing 47% of the overall online fraud cases.

81 In 2017, a total of 693 cases of email scam were reported, representing 16% of the overall online fraud cases.

82 In 2017, a total of 1,063 cases of social media fraud were reported, which represented 25% of the overall online fraud cases.

83 In 2015 13.8% of convicted ML cases originated from the US and 10.3% from Mainland China. The rest of the analysed ML cases originated from the United Arab Emirates, Australia, the Netherlands, Italy, Taiwan, Yemen, Canada, Czech Republic, Egypt, Germany, India, Israel, Malaysia, Montenegro, Panama, the Philippines, Poland, Russia, Spain, Sweden and the United Kingdom.

4.12 To combat drug trafficking and interdict the flow of proceeds into Hong Kong, the HKPF and the C&ED have worked closely with overseas and Mainland China LEAs. In 2017, 1,617 kg<sup>84</sup> of drugs were seized by the HKPF and the C&ED, a number of drug cartels were apprehended and drug proceeds were seized in Hong Kong and overseas.

4.13 Between 2011 and 2016, HK\$82.4 million was restrained from domestic drugs offences and related ML, representing 2.4% of proceeds restrained in Hong Kong. HK\$53.2 million was confiscated from domestic drugs offences, accounting for 1.8% of proceeds confiscated in Hong Kong. ML techniques employed by local drug syndicates are comparatively simple. Proceeds are often dealt with by the drug syndicates, their family members or associates, either stored as cash or in family members' or associates' bank accounts, or used to acquire real estate. International drug cartels, in addition to using local bank accounts opened by stooges and shell companies to launder proceeds, have also adopted trade-based money laundering ("TBML")<sup>85</sup> in Hong Kong.

### Loansharking

4.14 Loansharking is the criminal act of lending money at exorbitant interest<sup>86</sup> and adopting aggressive or illegal means to compel loan settlements. Debtors in Hong Kong are often low-income individuals or cash-strapped businessmen, who are unable to obtain a loan from banks or other regulated FIs due to various reasons, or habitual gamblers who incurred gambling debts in Hong Kong or Macao. In general, the number of loansharking reports was stable between 2011 and 2017.

4.15 As illustrated at Figure 4.1, amongst the ML cases examined, about 3.4% of the identified predicate crimes were about loansharking, mostly domestic. In many cases, debtors who could not pay their debts were recruited to open bank accounts for loan sharks to collect repayments from other debtors. Some individuals may also have sold their bank accounts to loansharking syndicates.

### Bookmaking and illegal gambling

4.16 With advances in mobile technology and the Internet, bets can be received online by bookmaking syndicates operating outside the territory. Bookmakers in Hong Kong usually take bets on horse racing and football<sup>87</sup>. Bookmaking on horse racing is largely confined to local events, whereas football bookmaking normally involves matches outside Hong Kong.

4.17 Amongst the ML cases examined, bookmaking and other illegal gambling<sup>88</sup> between 2011 and 2015 account for 2.7% of the identified predicate crimes as illustrated at Figure 4.1. However, they pose an ML threat given that the funds can be generated within a short period. For example, during the 2014 World Cup, 176 persons were arrested for bookmaking-related offences and HK\$11 million in cash and betting slips amounting to HK\$750 million were seized. In 2015, 17 persons were arrested and HK\$97 million in betting slips seized.

84 Representing the weight of substance seized at the spot. The actual amount of drug contained therein will be released after analysis by the Government Laboratory.

85 TBML, according to the FATF, is the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins.

86 In Hong Kong, the legal interest rate cannot exceed 60% a year.

87 Operating as a not-for-profit organisation, the Hong Kong Jockey Club is the only authorised operator licensed by the Government to offer horse race betting, football betting and 'Mark Six' lottery.

88 Gambling offences primarily include receiving, negotiating or settling of a bet; and operating or managing a gambling establishment or permitting premises to be used as such.

4.18 In such cases, inter-bank transfers and personal bank accounts are commonly used to receive proceeds. Proceeds placed in stock trading through banks or securities firms as well as hidden as cash were also occasionally seen.

## Corruption

4.19 The number of corruption reports declined between 2011 and 2016 and the level of corruption domestically is generally very low. Two-thirds of corruption complaints relate to the private sector.

4.20 As the Mainland market continues to grow, economic crimes including corruption will continue to threaten processes across all businesses. Given the close geographical proximity and economic linkage between Mainland China and Hong Kong, there is a potential ML threat posed to Hong Kong by possible corrupt activities in the Mainland. As an international financial centre with a free and open economy, Hong Kong might also attract foreign business entities and officials, seeking to launder proceeds of corruption.

4.21 Laundering of corrupt proceeds can take different forms, depending on the nature of the corrupt act. Local bank accounts and offshore companies set up by locals, as well as corporate vehicles, trusts, and non-profit entities, could be used to hide corrupt proceeds.

4.22 Transnational and cross-border corruption activities have presented a challenge to the ICAC in recent years, resulting in the strengthening of liaison and exchanges with Mainland China, Macao and overseas anti-corruption and law-enforcement agencies. Apart from agency-to-agency law enforcement co-operation, the ICAC would render MLA to overseas jurisdictions in corruption cases pursuant to bilateral agreements with Hong Kong under the MLAO, as well as multilateral agreements such as the United Nations Convention Against Corruption. For cases involving Mainland China, effective co-operation is maintained under the Mutual Case Assistance Scheme<sup>89</sup>.

## Tax evasion

4.23 Hong Kong has a simple tax regime. The majority of the tax-related offences in Hong Kong are about late or non-submission of tax returns whilst tax evasion cases are limited. The ML threat from domestic evasion is therefore negligible, having regard to the simple taxation regime and nature of tax violation. In contrast, the ML threat from external tax evasion is higher. As illustrated at Figure 4.1, amongst the ML cases examined, tax evasion accounts for 0.8% of the identified predicate offences, all of them were committed outside Hong Kong. The laundering methods for tax evasion in Hong Kong vary, depending on the scale and technique of the culprits in other jurisdictions. From a detected ML case involving proceeds of foreign tax evasion, it is noted that the tax evasion scheme involved the use of complex corporate structures and trusts to conceal ownership and control of proceeds of tax evasion.

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<sup>89</sup> The Mutual Case Assistance Scheme allows the ICAC and the Mainland's anti-corruption authorities to render mutual assistance in investigating corruption and related offences through arranging witnesses to be interviewed or to testify in court on a voluntary basis, or checking of public records. (<http://www.icac.org.hk/en/intl-persp/engage/international-and-mainland-liaison-and-mutual-assi/index.html>)

4.24 Hong Kong joined the Inclusive Framework on Base Erosion and Profit Shifting in June 2016. The Inland Revenue Ordinance (“IRO”)<sup>90</sup> was amended in 2016 to implement the AEOI<sup>91</sup>, a new international standard designed to enhance tax transparency and combat cross-border tax evasion, through the exchange of financial account information between jurisdictions. Amendments to the IRO were enacted by LegCo in January 2018 providing the legal framework for Hong Kong to implement the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, thereby allowing more effective implementation of the AEOI arrangements. After completion of the necessary legislative and administrative procedures, we will ride on the Multilateral Convention to conduct AEOI with other relevant jurisdictions on a multilateral basis starting from September 2018.

#### Box 4.1: Enhancing tax transparency and combating tax evasion

As an international financial centre and a responsible member of the international community, Hong Kong has all along been supportive of the international efforts to enhance tax transparency and combat tax evasion. We have made strenuous efforts to deliver our international tax commitments, including measures to counter Base Erosion and Profit Shifting (“BEPS”) and AEOI.

Hong Kong committed in 2016 to implementing the four minimum standards of the BEPS package<sup>92</sup> promulgated by the OECD. Hong Kong also seeks to codify its transfer pricing rules, which are consistent with the guidelines of the OECD, into the tax law. The relevant legislative proposal is being scrutinised by LegCo, and will be implemented immediately once approved.

To ensure that Hong Kong’s Comprehensive Double Taxation Agreements (“CDTAs”) meet the international standards on countering BEPS, Hong Kong plans to implement the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting for modifying the application of the CDTAs in a swift and synchronised manner.

Hong Kong committed in 2014 to implementing the standard on AEOI promulgated by the OECD. The first round of exchange with appropriate partners is expected to take place in September 2018.

90 Chapter 112 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap112>.

91 AEOI is an international standard promulgated by the OECD. Under the AEOI standard, FIs are required to identify financial accounts held by tax residents of reportable jurisdictions in accordance with the OECD’s due diligence procedures. Required information of these accounts has to be collected and furnished to the Inland Revenue Department (“IRD”). FIs are also required to collect the reportable information of these accounts and furnish such information to the IRD beginning from the reporting year. The IRD will exchange the information with the tax authorities of the AEOI partner jurisdictions on an annual basis. The IRO was amended in 2016 to put in place a legislative framework for Hong Kong to implement the AEOI.

92 The four minimum standards are countering harmful tax practices, preventing treaty abuse, imposing country-by-country reporting requirement and improving cross-border dispute resolution mechanism.

## Goods smuggling

4.25 Criminals have sought to smuggle prohibited and controlled items into and out of Hong Kong, including dutiable commodities, narcotics, endangered species<sup>93</sup>, firearms, articles infringing intellectual property, and goods with false trade descriptions. Between 2010 and 2017, the value of annual seizures ranged from HK\$345 million to HK\$712 million. Amongst the ML cases examined, smuggling constituted around 0.1% of the identified predicate crimes.

4.26 Given the differences in the tax regimes of Mainland China and Hong Kong, syndicates have sought to smuggle dutiable commodities, such as cigarettes and motor spirit, from the Mainland to Hong Kong and high-value electronic goods, including mobile phones and computer hardware, from Hong Kong to the Mainland. The C&ED regularly mounts operations with their counterparts in Mainland China against smuggling syndicates.

4.27 Smuggling activities are cross-jurisdictional in nature, and the impact on the ML threat is never restricted to a single jurisdiction. The ML activities could be organised and sophisticated involving the use of different techniques.

### Box 4.2: Sophisticated ML of smuggling proceeds

#### Case 1

In January 2012, in a joint operation with another jurisdiction, 10 containers of smuggled goods, including copper plates and electronic goods (LCD monitors, hard disks and second-hand mobile phones) valued at HK\$40 million were seized. After investigation, the mastermind and five other locally resident syndicate members were charged with conspiracy to smuggle and conspiracy to launder HK\$3.3 billion, by using a local company to commingle the proceeds with funds generated by normal trade activities. HK\$91 million of realisable properties held by the syndicate was put under restraint.

#### Case 2

Beginning in 2010, a joint investigation with another jurisdiction was mounted against a cross-border syndicate suspected of smuggling over 500,000 tons of marked oil, also known as “industrial diesel oil”, in fishing vessels and laundering proceeds up to HK\$2.6 billion within three years. During the operation in Hong Kong, 19 persons including the masterminds of the syndicate were arrested. Five persons were prosecuted in August 2010 and HK\$240 million of assets held by the syndicate in Hong Kong were restrained.

In 2012, the five defendants were convicted of conspiracy to export unmanifested cargo and ML charges, and sentenced to four to six years’ imprisonment. In 2016 HK\$124 million realisable assets held by three defendants were confiscated.

<sup>93</sup> Goods that have been smuggled into Hong Kong include frozen masked palm civet, frozen pangolin, pangolin scales, live Asiatic bony tongue, bear bile powder, stony coral, agarwood, red sandalwood, ivory and rhino horns. Different methods of entry have been adopted by smuggling syndicates. Airmail or cargo containers were used to conceal the items being imported, mostly from Africa and South America.

## Typologies Analysis and ML Trends

4.28 The following paragraphs analyse the common methods and parties/sectors involved in converting crime proceeds into various forms of asset, and other factors affecting ML in Hong Kong.

### Third-party ML

4.29 The use of third parties to launder proceeds generated domestically or outside Hong Kong is prevalent. Around half of the 300 ML cases leading to convictions between 2011 and 2012 were identified as third-party ML involving money mules. Over half of the assets restrained or confiscated between 2011 and 2015 were owned by parties other than the criminals or suspects.

4.30 Third-party ML commonly involves non-residents, students and low-paid stooges who are recruited to open bank accounts for a small monetary reward and do not know the use to which the accounts are put.

### Use of bank accounts

4.31 Bank accounts are one of the most common tools exploited by money launderers for both domestic and external predicate offences via cash deposits, cash withdrawals or wire transfers. In 2015, among ML cases involving the use of bank accounts that led to convictions, 60% involved personal and 40% corporate accounts.

4.32 From detected ML cases, personal accounts were observed to be opened by the criminals themselves, family members or associates, or operated by stooges, who may or may not be Hong Kong residents. In some cases, false identity documents were used to open accounts. Corporate accounts of legitimate businesses may be exploited, or set up by shell companies to hide beneficial ownership.

#### Box 4.3: Use of overseas shell company corporate account

A company in the UK was deceived into transferring HK\$11.35 million to a corporate bank account in Hong Kong belonging to an offshore shell company with a foreign national as signatory. There were 28 deposits between June 2010 and March 2011 totaling HK\$62.93 million, all subsequently dissipated by 50 withdrawals. In September 2012, the foreign national was arrested on entering Hong Kong. He stated that he had been paid to open the account and had no knowledge about the transactions. In January 2013 he was convicted of ML and sentenced to 32 months' imprisonment.

### Use of remittance services

4.33 While the banking system remains one of the main conduits for cross-border transfer of crime proceeds, MSOs have become another avenue for fund transfer.

4.34 The growing business integration between Hong Kong and Mainland China has led to more popular usage of MSO services. The frequent cross-border transfers, correspondingly, have exposed MSO services to the risk of being misused for ML purposes. There were 16 ML conviction cases involving use of MSOs in 2015, with only one case involving complicit MSO.

## ML involving professionals

4.35 Professionals can be used by criminals who need expert advice to devise complicated ML schemes. Cases of complicit involvement of professionals in ML in Hong Kong are relatively rare. There were three cases involving accountants convicted and sentenced to imprisonment for six years, 2.75 years, and 4.5 years in 2010, 2011 and 2014 respectively.

4.36 In Hong Kong, TCSPs, many owned or managed by solicitors or accountants, provide services such as forming companies, acting as company secretary or assisting in the opening of bank accounts. In 2015, 16 out of 97 ML cases leading to convictions involved the use of TCSP services.

## Misuse of legal persons and arrangements

4.37 Chapter 8 gives an overview of legal persons and arrangements in Hong Kong. Corporate vehicles and legal structures are inherently attractive for ML because:

- (a) It looks more reasonable to move large sums of money between companies without attracting attention;
- (b) It takes time and multiple efforts to verify the source of the funds or the alleged trade or business if fictitious invoices or shipping documents are used;
- (c) Corporate structures may hide beneficial owners or persons who control the company;
- (d) Commingling of legitimate and unlawful activity makes it harder to distinguish companies' assets from crime proceeds; and
- (e) Criminals may take advantage of the transactions with reputable companies to minimise suspicions.

4.38 In addition to its efficient financial services, Hong Kong is also known for low taxes and efficient company-formation procedures. As well as laundering money through Hong Kong, corporates may be abused to facilitate ML elsewhere. This is because using a front company to carry out transactions or open bank accounts elsewhere may make it harder for banks or LEAs to identify beneficial owners or verify business transactions. The activities of offshore or shell companies are common and not illegal, but their opaque structures may make it easier to conceal ownership and illicit proceeds. To address ML risks and in line with the FATF Recommendations 24 and 25, measures have been taken to enhance transparency and accountability and to verify the ownership information of companies (see Chapter 8).

4.39 Corporates in ML cases were mostly used in the layering process to increase the difficulty and time required to trace proceeds of crime. To deter ML through corporates, opening accounts with FIs is subject to stringent CDD requirements as described in Chapter 5.

## Complex ML techniques

4.40 Use of complex financial transactions to obscure audit trails is common and detection requires cooperation by multiple stakeholders. Camouflage of commercial activities through commingling, front companies, and TBML occur in the analysed ML cases.

## Use of front companies

4.41 In those ML cases involving the use of more sophisticated ML techniques, front companies were often established to transfer crime proceeds from one country to another, under the disguise of payments resulting from legitimate business activities, such as imports and exports or other business activities. The cross-jurisdictional camouflage of commercial activities, or commingling of funds with those stemming from legitimate businesses, can create numerous layers of funds as disguise.

## TBML

4.42 TBML requires intermingling of the trade and finance sectors and practices vary in complexity. Given the large volumes<sup>94</sup> of financial transactions with trading partners, Hong Kong faces an inherent threat of TBML.

4.43 According to the FATF, the most basic schemes are fraudulent trade practices (e.g. under- or over-invoicing, multiple invoicing of goods and services, under- or over-shipment of goods or provision of services, etc.)<sup>95</sup>. Crime proceeds from overseas drugs and local or overseas fraud have been laundered via TBML, for example as payment for genuine or purported sales of products, or by issuing letters of credit.

4.44 Considering the complexity of international trade and the absence of any system cross-referencing trade and trade finance data globally, TBML is difficult to detect. Nevertheless, the C&ED has developed an advanced information technology system to enhance its ability to select cargo and identify high-risk shipments for customs clearance, and conduct post-clearance analysis to detect false declaration and valuation fraud. On individual case basis, the C&ED shares information with their counterparts in other jurisdictions to verify values, quantities or descriptions of goods to detect over- or under-invoicing and over- or under-shipment. The C&ED also enforces a strategic trade control regime, which requires the import, export or transshipment of strategic commodities to be accompanied by licences issued by the TID. Local investigations and joint enforcement with overseas LEAs have resulted in successful detection of TBML cases. There was also financial intelligence from the JFIU suggesting possible TBML activities overseas<sup>96</sup>.

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94 See Trade Statistics published by TID (<https://www.tid.gov.hk/english/aboutus/publications/tradestat/wmttt.html>) and Hong Kong's Principal Trading Partners in 2016 published by TID ([https://www.tid.gov.hk/english/trade\\_relations/mainland/trade.html](https://www.tid.gov.hk/english/trade_relations/mainland/trade.html)).

95 More complicated schemes integrate these fraudulent practices into a web of complex transactions, which involve movement of value through the financial system (e.g. cheques or wire transfers) or physical movement of banknotes (e.g. cash couriers). In addition, while trade finance products were introduced to reduce transaction costs, their accessibility makes them vulnerable to TBML. For example, exporters and importers may use more complex forms of trade financing such as bills of exchange, counter trade, letters of credit, and open account facilities including factoring, forfeiting and other forms of credit. These transactions obscure the money trail and complicate detection. From the FATF's report on TBML in 2006, the FATF's paper on TBML in 2008 and the APG's typology report on TBML in 2012, foreign predicate crimes in respect of ML could involve fraudulent trade practices by abusing the service of remittance or wire transfer.

96 Between 2011 and June 2014, the JFIU received two pieces of TBML-related information on overseas companies, and subsequently shared the received intelligence with overseas FIUs for follow up.

## Assets restrained or confiscated in ML cases

4.45 To disguise their source, crime proceeds may be converted into forms that are difficult to retrace, such as by placement in bank accounts, and purchasing real estate, securities, insurance policies or other assets. The most common restrained and confiscated assets in Hong Kong are cash in bank accounts, real estate and securities held with LCs or banks. Other types of assets include precious metals, stones, jewellery or wristwatches and physical cash. The following tables show the amounts restrained or confiscated as realisable assets of persons convicted of ML, their family members or associates between 2011 and 2015<sup>97</sup>.

**Table 4.1: Types of assets in restraint orders (2011-2015)**

		Type of Assets	Amount (HK\$ in million)	%
<b>Breakdown of Realisable Assets in Restraint Orders (2011-2015)</b>	<b>Categorised Assets</b>	Assets placed in banks <sup>98</sup>	2,085.09	55.96
		Securities <sup>99</sup>	530.89	14.25
		Insurance policies/products	17.93	0.48
		Real estate	919.86	24.69 <sup>100</sup>
		Precious metals and stones, jewellery or wristwatches	91.60	2.46
		Cash <sup>101</sup>	34.47	0.92
		Vehicles	14.25	0.38
		Vessels	15.24	0.41
		Others <sup>102</sup>	6.06	0.16
		Sub-total	3,715.39	99.71
	<b>Uncategorised Assets</b>	Uncategorised company assets	10.70	0.29
		Sub-total	10.70	0.29
	<b>Total</b>		<b>3,726.09</b>	<b>100</b>

Note: Total amount of assets owned by third parties (HK\$ in million) **2,387.72** **64.08**

97 181 Restraint Orders and 123 Confiscation Orders in 2011-2015 were analysed. Restraint and Confiscation Orders of some ongoing cases in the period were not examined.

98 Include cash, securities products, trust (unit trust) and insurance products in bank accounts.

99 Securities include physical shares and shares in securities firm accounts.

100 Including 0.18% being property outside Hong Kong.

101 Cash includes physical cash in banknotes and bail money.

102 Others include vehicle registration marks, trading licences, luxury bags and pens, HKJC betting accounts and stamp duty held by the IRD.

Table 4.2: Types of assets in confiscation orders (2011-2015)

	Type of Assets		Amount (HK\$ in million)	%
	<b>Breakdown of Realisable Assets in Confiscation Orders (2011-2015)</b>	<b>Categorised Assets</b>	Assets placed in banks <sup>103</sup>	2,567.08
Securities <sup>104</sup>			6.21	0.21
Insurance policies/products			7.45	0.25
Real estate			287.06	9.64 <sup>105</sup>
Precious metals and stones, jewellery or wristwatches			89.28	2.99
Cash <sup>106</sup>			20.35	0.68
Vehicles			1.43	0.05
Others			1.12	0.04
Sub-total			2,979.98	99.98
<b>Uncategorised Assets</b>		Uncategorised company assets	0.57	0.02
		Sub-total	0.57	0.02
<b>Total</b>			<b>2,980.55</b>	<b>100</b>

Note: Total amount of assets owned by third parties (HK\$ in million) **1,733.94** **58.18**

4.46 Around 60% of the assets were held in the name of other persons, often family members or close associates of the criminals.

### Typologies Revealed by STRs and Intelligence Exchange

4.47 STRs filed locally by entities and intelligence exchanges with other jurisdictions show a general increase in number in recent years. Both internal and external intelligence shows that fraud cases, particularly email scam, dominate the predicate crimes.

4.48 Examination and analysis of STRs reveal certain common *modus operandi* employed in pursuing ML activities including:

- (a) Change of directorship or shareholding of the commercial customers in question soon after the opening of bank accounts;
- (b) Use of the bank accounts concerned is ceased upon receipt of one or a few fraudulent payments; and

103 Includes cash, securities products, trust (unit trust) and insurance products.

104 Securities include physical shares and shares in securities firm accounts.

105 Including 0.5% being identified property outside Hong Kong.

106 Cash include physical cash (banknotes) and bail money.

- (c) Small amount of ‘test money’ was credited to the recipient / suspect’s account prior to the receipt of fraudulent payments.

4.49 “Temporary Repository of Fund”, “Large Transaction”, and “Transaction Incommensurate with the Customer Background” were the most reported suspicious indicators, followed by “Large Cash Transaction”, “Non-resident Personal Account” and “Transaction with no Business Purpose”.

## Other Observations

### Rise of technology crime

4.50 In the past decade, technological advances and globalisation have given rise to new opportunities for cross-border crimes and ML. The Internet enables new forms of interaction, activities and associations, and allows greater flexibility in operation in terms of hour and location. It enables easier, faster and globalised commission of crimes. International dimensions of the Internet, the ease with which users can hide their locations, the difficulty of tracing the genuine identity, and the simplicity with which hackers can divert browsers to fraudulent sites and record payment card details have all contributed to very rapid growth of Internet crimes. The local community is susceptible to an elevated scale of sophistication and penetration of technology crimes. Criminals have taken advantage of increased online business activities, rapid movements of money, enhanced telecommunications and computer links. As a result, LEAs face a more complex and sophisticated challenge from criminals who extend their activities across different jurisdictions.

4.51 Technology crime<sup>107</sup> trends are rising in Hong Kong. In 2015, total reported losses from technology crime amounted to HK\$1.83 billion, of which corporate email scams accounted for HK\$1.37 billion.

4.52 In addition to the fraud activities discussed earlier in this Chapter, other types of crime using technology (e.g. attacks on computer systems for ransom) could lead to significant financial loss and generation of crime proceeds. The majority of such cases also involve the use of bank accounts.

4.53 Copyright infringement and trademark counterfeiting are increasingly committed online using auction sites and social media platforms. Total seizures related to Internet piracy reached about HK\$3 million in 2015. Counterfeit payment-card syndicates also use technology to circumvent security measures and obtain details of cardholders.

### Organised crime or triad groups

4.54 Triad gang activities are mainly territorial and triad members commonly committed offences such as unlawful society offences, wounding and serious assault, criminal intimidation, criminal damage, possession of offensive weapons, as well as involvement in the proceeds-generating crimes such as fraud, drug trafficking, gambling, vice and blackmail that represent an ML threat<sup>108</sup>.

<sup>107</sup> Besides the specific offence “Access Computer with Dishonest Intent”, technology crime also involves conventional offences such as deception, blackmail and fraud, committed using computing equipment and / or software and social media.

<sup>108</sup> In a case of cross-border bookmaking activities involving triad, financial investigation against a local triad leader (Person A) and his associates revealed that they had been engaging in cross-border illegal bookmaking activities and using their bank accounts to launder HK\$357 million between 2006 and 2011. The bookmaking syndicate was neutralised in July 2012, with 11 persons arrested. Over HK\$1 million cash was seized at the residence of two syndicate members. Three of the arrested persons were convicted of ML in March 2015 and sentenced to 18 and 38 months’ imprisonment. A confiscation order was granted in August 2015 to confiscate the realisable assets of Person A and one of his close associates.

4.55 Not all syndicates operating in Hong Kong are triads. Such groups are usually involved in fraud, drug trafficking, bookmaking, vice, smuggling of counterfeit goods and payment card fraud. Transnational organised crime groups are generally more sophisticated, with the knowledge and network to perpetrate predicate crimes and ML across multiple jurisdictions. There is no evidence supporting any strong network between local and transnational organised crime groups in the facilitation of ML.

4.56 Operation of organised crime or triad groups in the commission of predicate crime and laundering of proceeds poses an ML threat in Hong Kong, especially in parallel with transnational crime. In the analysed cases, not only could the involvement of local syndicates recruiting stooges to open accounts for dissipation of local crime proceeds be seen, there were also individual cases with signs of international ML cells recruiting foreign stooges to open bank accounts in Hong Kong for dissipation of crime proceeds generated from organised crimes occurring outside Hong Kong.

### **Overall ML Threat**

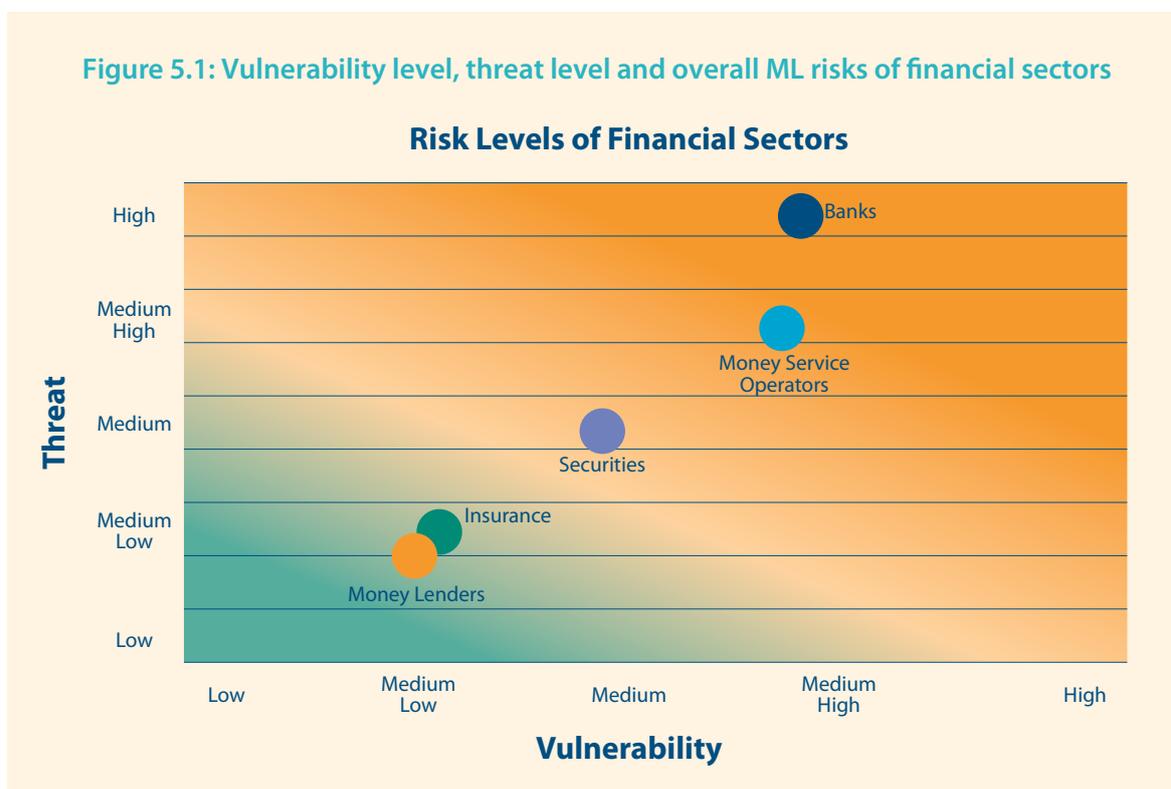
4.57 The ML threat to Hong Kong comes from both internal and external sources and ML is becoming more complex and transnational. There were cases of transnational criminals having misused Hong Kong's financial and telecommunications infrastructure and free-trade system, quickly transferring large sums by wire transfers and e-banking facilities. Considering the magnitude of proceeds, the complexity and scope of ML techniques, the extent of predicate crimes, and the inherent threats in the territory, the external threat is assessed to be higher than the internal threat. The overall level of ML threat is assessed as medium-high.

# CHAPTER 5

## SECTORAL RISK ASSESSMENT - FINANCIAL INSTITUTIONS

### 5.1 OVERVIEW

5.1.1 This Chapter sets out the assessment of the banking, securities, insurance, MSO and money lender sectors. The first four are the major financial sectors covered by the AMLO and supervised by the relevant authorities. They are subject to AML/CFT requirements prescribed in the AMLO and the guidelines issued by the regulators. In addition to the CDD and record-keeping requirements, overarching statutory obligations exist in primary legislation for regulated FIs to establish AML/CFT controls, to ensure proper safeguards to prevent contravention of CDD and record-keeping provisions, and more generally to take all reasonable measures to mitigate ML/TF risks. The AML/CFT regimes in these four sectors have undergone significant enhancement since the AMLO came into effect in April 2012.



### 5.2 BANKING

5.2.1 Hong Kong has a large, well-developed banking system with one of the highest concentrations of banking institutions in the world. As at end-2017, there were 191 institutions with total assets of HK\$22.7 trillion<sup>109</sup>, equivalent to 853% of Hong Kong's GDP.

<sup>109</sup> As at end-2017, the 191 banking institutions had total assets of HK\$22.7 trillion, registering an increase of 52% from HK\$14.9 trillion at 2012.

5.2.2 The highly externally-oriented economy has given rise to significant foreign participation in the banking sector: 75 of the world's top 100 banks operate in Hong Kong, including 29 of 30 globally systemically important banks identified by the Financial Stability Board. With its strengths as an international financial centre and close links with Mainland China, Hong Kong has become a global and regional hub for offshore RMB business, asset management, and payment and settlement.

5.2.3 Three tiers of deposit-taking institutions make up the banking sector: licensed banks which can carry on the full range of banking business, restricted licence banks which are mostly merchant or investment banks, and deposit-taking companies which principally engage in consumer and trade finance<sup>110</sup>. As at end-2017, there were 155 licensed banks, including 133 branches of foreign banks operating diverse business models; 19 restricted licence banks and 17 deposit-taking companies. These are collectively referred to as authorised institutions ("AI")<sup>111</sup> which are licensed and supervised by the HKMA under the BO. The AML/CFT regime is provided for in a number of ordinances<sup>112</sup>. The AMLO, among other things, stipulates CDD and record-keeping requirements and is supported by a detailed guideline.

#### Box 5.1: About the HKMA

One of the main functions of the HKMA is to maintain monetary and banking stability, and to promote the integrity of Hong Kong's financial system and development of its financial infrastructure. The HKMA derives its powers in these areas from the BO and the PSSVFO, as well as the AMLO.

The HKMA adopts an RBA to the supervision of the banking and SVF sectors. It uses a wide range of regulatory tools to supervise institutions' AML/CFT controls, including off-site reviews and on-site examinations, issuance of guidance and engagement with the industry. It also investigates suspected breaches of AML/CFT requirements and imposes a range of effective, proportionate and dissuasive sanctions where appropriate.

The HKMA participates actively in international forums including the Financial Stability Board, the Basel Committee on Banking Supervision and the FATF. It cooperates with other financial regulators in Hong Kong and with overseas counterparts via numerous bilateral MOUs.

5.2.4 The following sections describe the key threats and vulnerabilities of the banking sector, which arise from Hong Kong's role in the global financial system and its strong inter-connectedness with the Mainland China economy, and mainly include:

- (a) Transnational crime syndicates abusing the banking sector as a conduit for illicit funds;
- (b) Vulnerabilities (including those relating to TF, PF and financial sanctions) arising from Hong Kong's status as a global and regional trading and financial hub, processing transactions from other higher-risk jurisdictions;

110 Restricted licence banks can take deposit of at least HK\$500,000 of any maturity while deposit-taking companies can take deposits of at least HK\$100,000 of a tenor of not less than 3 months.

111 In this report, the terms "AIs" and "banks" are used interchangeably.

112 See Chapter 3 for a description of the statutory framework for AML/CFT.

- (c) ML threats related to Hong Kong's development as a wealth management centre, such as tax evasion, corruption and other offences committed externally; and
- (d) Emerging cybercrime threats, together with rapid advances in financial services technology, which have created new avenues for ML.

## ML Threats in the Banking Sector

5.2.5 ML threats for the banking sector are high: bank accounts are one of the most common vehicles exploited for ML and over half of the ML-related realisable assets in restraint and confiscation orders between 2011 and 2015 were held by banks<sup>113</sup>. Threats arise from domestic activities, but also, and to a greater extent, external activities due to Hong Kong's status as an international financial centre and its strong links to the economy of Mainland China.

### Fraud

5.2.6 Cases in which bank accounts are used as conduits for proceeds of crime in and outside Hong Kong are particularly prevalent. Of these, fund flows from fraud committed in multiple overseas jurisdictions present significant threats to the banking sector.

5.2.7 Bank accounts are opened by money mules or stooges (including individuals of various nationalities and corporates domiciled in different jurisdictions) who are often complicit. They are operated remotely to receive fraud-related transfers from victims before the money is withdrawn or dissipated to other accounts in and outside Hong Kong. While banks have become more effective in identifying and reporting related suspicious activities (for example, as described in Box 5.2), crime syndicates have adapted (e.g. by reducing the use of newly opened bank accounts) to better conceal the true nature of the account operation.

#### Box 5.2: Typology and case example for the abuse of corporate bank accounts

A number of typologies are reflected whereby non-residents were recruited to represent offshore companies and travelled to Hong Kong to open corporate bank accounts. The risk profiles of such customers included: (i) single shareholder and director; (ii) no nexus to Hong Kong; and (iii) newly established account with a vague business nature (e.g. commodities trading). The operation of the account was characterised by large and frequent transactions, with the funds transferred into and out of the account very quickly (e.g. three days or less) or in a 'U-turn' pattern, and while the total amount channeled through the account was considerable, the account balance maintained was low. In the case set out in Box 4.3, for example, a total of HK\$62.93 million was transacted through the account during a nine-month period. Following the HKPF's actions, the concerned non-resident shareholder and director was convicted of ML and sentenced to imprisonment.

5.2.8 The HKPF, the HKMA and the banking industry have cooperated closely on this threat, providing up-to-date fraud-related ML typology information which has contributed to more effective interdiction of suspect accounts. Mitigating this threat remains challenging due to the large number of accounts and volume and values of transactions.

<sup>113</sup> See Tables 4.1 and 4.2 in Chapter 4.

5.2.9 The HKPF analyses fraud-related ML cases, including information on common characteristics and red flags, which have been disseminated in annual AML seminars for the banking sector. The HKPF also publishes regular alerts to banks providing updates on prevalent or topical fraud and ML typologies. Information provided has included detailed analysis or trends of typical account operation (e.g. corporate accounts with vague or inaccurate business information, single shareholder and director of a corporate, high percentage of accounts established for a year or more before use, and increasingly several years) and account holders (often non-Hong Kong residents, changes in the nationalities of connected parties, percentage of accounts opened via secretarial firms).

#### Box 5.3: Information sharing on fund flows linked to fraud and other serious financial crimes

The 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, ML and other financial crimes. Building on existing cooperation, the FMLIT establishes a formal architecture of information sharing which improves the collective understanding of current and emerging fraud and ML threats. The FMLIT operates at both strategic and operational levels with threat-specific alerts disseminated to the banking sector through the Hong Kong Association of Banks.

### Tax evasion

5.2.10 A low and simple tax regime, a sophisticated financial sector and the absence of exchange and capital controls have increased the attractiveness of Hong Kong for external tax evasion<sup>114</sup>, which is a particular threat in private wealth management and corporate banking. While available data indicate that external tax crimes account for less than 1% of the identified predicate crimes, the vulnerability of financial centres like Hong Kong to this activity is well recognised. The threat from external tax evasion is therefore assessed as medium-high and requires steps to address information gaps, such as how tax evasion-related ML materialises in the context of Hong Kong's banking sector.

5.2.11 Thematic examinations of banks' tax evasion-related AML/CFT controls were conducted in 2013-14 and the results provided to the industry in specific seminars. While banks had established controls to combat tax evasion, there was room for improvement, particularly in how tax-evasion risk is assessed and higher risks mitigated. To assist sector-wide implementation of best practices, the HKMA published a guidance paper on *Anti-Money Laundering Controls over Tax Evasion* in 2015, giving examples of vehicles or structures which exhibit vulnerabilities (e.g. use of overly complex structures without apparent purpose).

5.2.12 The threat of tax evasion is also mitigated by Hong Kong's role in global efforts to enhance tax transparency and banks have made significant efforts in recent years to more effectively combat external tax evasion, e.g., by developing systems to identify customers who are tax residents of jurisdictions other than Hong Kong for fulfilling the obligations under AEOI.

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114 The ML threat from domestic tax evasion is assessed as low in Chapter 4 of the report.

## Corruption

5.2.13 While the level of domestic corruption is assessed as low<sup>115</sup>, the ML threat to the banking sector from external corruption is assessed as medium-high, with banks regarding certain contextual factors as combining to produce significant threats. Some jurisdictions geographically close or with close economic ties to Hong Kong have higher levels of corruption. Although corruption-related threats are generally more prevalent in the private wealth management segment, retail banking can also be misused to launder the proceeds of corruption.

## Other ML threats

5.2.14 Proceeds generated from other organised crimes, including bookmaking and loansharking, continue to pose some ML threat to the banking sector, although the scale and impact are lower, for reasons such as the increasing popularity of legal football betting in Hong Kong.

5.2.15 There is also a growing awareness in the banking sector of ML threats arising out of human trafficking and wildlife trafficking in the Asia-Pacific region and beyond. Like elsewhere in the world, Hong Kong is not immune from these threats. CDD practices, including gathering source of wealth/funds information and negative news searches, coupled with higher-quality external data sources assist banks to mitigate this risk.

5.2.16 Technology-related and cybercrimes are evolving rapidly, making continued cooperation and sharing of experience on such crimes essential. The HKMA's specialist division works closely with the HKPF to provide guidance and share information with the banking industry. For example, in 2016, following attempts to circumvent controls over banks' SWIFT payment messages, the HKPF and the HKMA worked with banks and SWIFT to share details, and give guidance on how to detect and prevent similar attacks. In mid-2016, the HKMA collaborated with the banking industry on a "Cybersecurity Fortification Initiative"<sup>116</sup> to help banks assess the adequacy of their cybersecurity risk management and strengthen controls.

## Financing proliferation of WMD

5.2.17 Various risks arise from Hong Kong's role as a financial centre and payments hub, involving the provision of financial services in support of any part of efforts to evade United Nations sanctions, such as those targeting the North Korean regime's WMD and ballistic missile programmes. Where cases have occurred, these have often involved the use of front or shell companies, with complex corporate and ownership structures often sharing similar characteristics. Risks to the banking sector may be through both direct and indirect relationships including payments activity and correspondent banking. There is a strong understanding among AIs of the legal obligations to ensure compliance with resolutions of the UNSC, which continues to accord the highest priority to proliferation and has imposed sanctions

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115 Hong Kong ranked 15th (out of 176 countries) in the 2016 Corruption Perception Index constructed by the Transparency International (up from 18th in 2015) and was one of the top-ranked jurisdictions in Asia (source: website of Transparency International).

116 <http://www.hkma.gov.hk/eng/key-information/press-releases/2016/20160518-5.shtml>.

regime against the DPRK<sup>117</sup> and established restrictions against Iran<sup>118</sup>. Quality of data obtained by banks on beneficial owners and connected parties is an important factor in the ability of AIs to screen against designations, which has recently been tested using an external firm as part of the HKMA's thematic work on sanctions controls. Various measures including circulars on WMD<sup>119</sup>, an industry seminar in July 2017 and circulation of guidance have been taken to raise awareness of PF and the importance of developing a greater understanding of the specific types of PF activities. To enhance the collective response of the banking sector, the first in a series of roundtable meetings was held in March 2018 for industry representatives, the HKMA and other stakeholders to discuss the types of customers and transactions more vulnerable to being involved in PF activities, and to share cases and typologies.

## ML Vulnerabilities of Banking Products and Services

5.2.18 While banking services generally are more vulnerable to ML than other financial sectors, different banking products and services do not all carry the same type or level of vulnerabilities. The following paragraphs cover the specific features of major products and services and their vulnerabilities to ML.

### Private banking

5.2.19 Hong Kong has increasingly tapped into the rapidly growing private wealth market in the Asia-Pacific region, achieving the highest growth since 2008 among other wealth management centres<sup>120</sup>. In 2017, around a quarter of AIs provided private banking and wealth management services to local and international customers with combined assets under management of around HK\$4.9 trillion<sup>121</sup>.

5.2.20 The characteristics of private banking, such as the large size of assets under management, complexity of products and services, and a culture of confidentiality and personalised services, result in higher vulnerability to ML, particularly where the customers come from jurisdictions with higher identified corruption or tax-evasion risks. Risks arising from politically exposed persons are adequately understood and an industry-led forum was held in early 2016 to clarify expectations and best practices for source of wealth. The HKMA has recently taken enforcement action against a private bank for failing to establish and maintain effective procedures for determining whether customers or beneficial owners were politically exposed persons.

5.2.21 The vulnerabilities for high-end ML are adequately understood by the banking industry such as the use of front and shelf companies with funding from opaque sources and complex corporate structures, often established with professional expertise. Front companies, which are functioning businesses that may mingle legitimate and illegitimate funds, pose particular challenges for banks to identify and mitigate risks.

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117 UNSCRs 1718 (2006), 1874 (2009), 2087 (2013), 2094 (2013), 2270 (2016), 2321 (2016), 2356 (2017), 2371 (2017), 2375(2017) and 2397 (2017).

118 Pursuant to UNSCR 2231 (2015), the UNSC endorsed the Joint Comprehensive Plan of Action and would terminate all provisions of previous UN Security Council resolutions on the Iranian nuclear issue - 1696 (2006), 1737 (2006), 1747 (2007), 1803 (2008), 1835 (2008), 1929 (2010) and 2224 (2015) – simultaneously with the International Atomic Energy Agency-verified implementation of agreed nuclear-related measures by Iran and will establish specific restrictions.

119 HKMA circular, *Combating Financing of Weapons of Mass Destruction Activities*, dated 5 April 2013.

120 Reference: "The Deloitte Wealth Management Centre Ranking 2015 (2nd Edition)".

121 Aggregate figure based on data obtained from the banking sector in the information collection exercise in 2017.

## Trade finance / trade-related business

5.2.22 In 2016, Hong Kong was the world's seventh-largest trading entity in goods with a trade value of US\$1,064 billion. Its major trade markets were Mainland China (50.8% of total), the US (7%), Japan (4.8%) and Taiwan (4.8%)<sup>122</sup>. This trade is facilitated by highly efficient trade operations of banks, in particular international payments and provision of credit facilities. Approximately 70% of AIs engage in trade-related businesses<sup>123</sup>, many of which are foreign bank branches primarily serving customers from their home jurisdictions.

5.2.23 Trade-related business and transactions exhibit generally higher ML vulnerabilities arising from significant trade flows, involvement of multiple parties, institutions and locations, the paper-based nature of many transactions, and the ability to commingle legitimate and illicit funds. Trade-related banking services are also vulnerable to exploitation for circumvention of sanctions and WMD proliferation. Thematic examinations indicated that banks' trade-based AML/CFT controls required improvements in some areas, including institutional<sup>124</sup> and customer risk assessments and sanctions screening. To help banks understand risk, the industry association published guidance on *Combating Trade-based Money Laundering* in early 2016. The C&ED and the US Immigration and Customs Enforcement Homeland Security Investigations also co-hosted a seminar on TBML in January 2017 to share TBML enforcement experience, typologies and case studies with the banking industry. Over 100 AML/CFT and financial crime compliance staff from more than 30 banks participated.

## International fund transfer

5.2.24 Hong Kong is a regional hub for payment and settlement, processing hundreds of thousands of cross-border payments daily through an extensive correspondent banking network.

5.2.25 Correspondent banking exposes banks to higher ML vulnerabilities because the correspondent bank often has limited information on the parties or the purpose and nature of underlying transactions. However, correspondent banking business in Hong Kong is assessed to have lesser vulnerabilities because, compared with some other products or services such as private banking, local banks maintain limited numbers of relationships with banks from higher-risk jurisdictions<sup>125</sup> and the use of payable-through accounts is comparatively low and subject to identification and close monitoring. Testing has shown that banks' understanding of vulnerabilities in this area and their ability to mitigate them have improved, for example, through the quality of payment message information. This has also improved banks' ability to manage related sanctions risks.

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122 Trade Statistics published by TID (<https://www.tid.gov.hk/english/aboutus/publications/tradestat/wmttt.html>) and Hong Kong's Principal Trading Partners in 2016 published by TID ([https://www.tid.gov.hk/english/trade\\_relations/mainland/trade.html](https://www.tid.gov.hk/english/trade_relations/mainland/trade.html)).

123 For example issuing or advising on letters of credit, bills for collection, guarantees etc.

124 A recent review on institutional risk assessments of banks found that some banks did not cover trade business in their assessments.

125 In 2016 less than 0.5% of banks maintained higher-risk correspondent banking relationships.

5.2.26 The risk of unlicensed MSOs conducting cross-border fund transfers through the banking system has been proactively targeted and progress has been made in the ability of banks to identify this and mitigate the risk (e.g. through transaction monitoring and filing STRs which have contributed to actions by the C&ED to interdict such activity). The HKMA has used a range of tools to strengthen banks' ability to identify and mitigate activities connected to unlicensed MSOs. Suspicious activity indicators communicated to the industry include: vague business purpose such as import and export; multiple linked accounts, often with common features such as mode of referral; multiple currency accounts with heavy utilisation; patterns of account operation inconsistent with the claimed business nature; large deposits followed by transfer/withdrawal in other currencies to the same connected counterparty accounts on the same day, leaving low account balances despite significant fund flows; and dormant periods before the account is utilised or at conclusion of use.

5.2.27 Wire transfers could be abused by money launderers to move funds rapidly across borders and are common in ML cases, while banks have made significant investments in transaction monitoring and screening systems over the year, including large international banks upgrading and renewing systems and regional and local banks moving to automation to harness more effective monitoring and screening technology.

5.2.28 The HKMA's supervisory efforts have focused on testing and validation, governance of development and implementation, and how scenarios, parameters and thresholds are validated for the risks assessed. *Guidance on Transaction Monitoring, Transaction Screening and Suspicious Transaction Reporting* was issued in December 2013 and updated in 2018, with best practices shared in the annual AML/CFT seminars. Subsequent on-site examinations found that effectiveness varies with how well banks understand risk, their data quality and their ability to monitor performance of controls.

### Retail and corporate banking

5.2.29 Retail and corporate banking provide traditional banking products and services, including saving and current accounts, credit facilities, and investment accounts to individuals, small-and-medium-sized enterprises ("SMEs"), and other corporate customers. In mid-2017 retail banks maintained over 1,100 branches and about 3,300 ATMs, with most retail banks offering Internet banking services. Approximately 70% of retail financial transactions are conducted through such non-branch channels.

5.2.30 As described in Chapter 4, abuse of banking services by stooge account holders or shell and shelf companies has presented particular challenges for banks in differentiating these customers from legitimate ones as they often present very similar risk profiles at the time of onboarding. Appropriate application of an RBA, particularly with regard to SMEs and start-up companies from other jurisdictions, has presented many challenges.

5.2.31 Since unusual transaction patterns or suspicion of, for example, structuring<sup>126</sup> often appear only after a period of account operation, the banking industry and the HKMA continue to focus on effective transaction monitoring and risk mitigation based on adequate CDD

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<sup>126</sup> That is, parceling a financial transaction into a series of smaller transactions to help avoid scrutiny and/or specific controls. This is a well-recognised method by which criminals' attempts to evade transaction monitoring thresholds.

information and customer risk assessment. As all large or systemically important banks have moved to automated transaction monitoring systems<sup>127</sup>, the ability of banks to detect unusual or suspicious activities has improved, which has also driven increases in quantity and improvement of quality of STRs filed by banks<sup>128</sup>.

5.2.32 Cash remains an important part of the Hong Kong economy and banks' retail operations continue to be exposed to potential ML risks from customers engaged in cash-intensive businesses. Assessment and understanding of cash-related risks at the customer and institution level is important and has improved as a result of the HKMA's supervisory engagement. The introduction of disclosures for cross-boundary movement of CBNIs is expected to help mitigate cash-related risks.

## AML/CFT Control Environment of Banking Sector

5.2.33 Analysis of the overall vulnerability of the banking sector also requires assessment of the AML/CFT control environment, which can significantly reduce overall risk.

### Legal and regulatory framework

5.2.34 As highlighted in Chapter 3, the regulatory framework for the banking sector is mature and includes the full range of AML/CFT legal and regulatory requirements, including CDD and record-keeping requirements under the AMLO, as well as the STR provisions under the OSCO, the DTROP and the UNATMO. The AMLO also provides a range of proportionate and dissuasive administrative and criminal sanctions to address non-compliance. Criminal sanctions can also be imposed against bank management or employees. The AML/CFT Guideline, published under the AMLO, provides detailed guidance and illustrates regulatory expectations, particularly around how AIs should understand beneficial ownership of corporate customers.

5.2.35 To prevent criminals or their associates from controlling or influencing the operation of banks, control over market entry is an important part of the AML/CFT regulatory framework. The HKMA operates a robust authorisation framework (including fit-and-proper and approval requirements for bank controllers, directors and chief executives) under the BO.

### Internal controls of banks

5.2.36 The importance of strong senior management support for ML/TF risk management is widely recognised and has been emphasised in the HKMA's engagement with banks' senior management, including a seminar in 2013 for chief executives of all banks<sup>129</sup>, training at director level, and increased engagement with the board and senior management in the course of AML/CFT supervisory activities. A circular was issued in March 2017, providing guidance on the development of a sound corporate culture that supports prudent risk management, and incentivises the right behaviour and high ethical standards.

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127 The transaction monitoring systems not only cover retail and corporate banking, but also other banking businesses like private banking, trade-related business etc.

128 In 2015, 34,959 (82.15%) of all STRs made to the JFIU were made by banks; while in 2016, 68,745 (89.76%) of them were made by banks.

129 After the seminar, follow-up letters with questionnaires were sent to all AIs requiring responses from the Board on adequacy of AML/CFT resources, risk culture and AML/CFT control deficiency.

5.2.37 Als' assessment of ML/TF risks has been a supervisory priority in recent years. Guidance on institutional ML/TF risk assessments was provided in 2014, followed by a series of desk-based reviews, and most Als now use a wider range of sources to enhance their understanding of risks. However, the quality of risk assessments and effective implementation of an RBA varies among Als.

5.2.38 The banking industry has devoted significant resources to enhancing AML/CFT systems and controls in recent years, including significant engagement of external experts. At the same time, increased demand for AML/CFT professionals, particularly by large international banks, together with the limited local talent pool, has presented vulnerabilities, particularly in retention of experienced staff in key roles. This is being addressed by banks recruiting from outside Hong Kong, and the collaborative efforts of the HKMA and the Hong Kong Institute of Bankers to launch the Enhanced Competency Framework for AML/CFT in December 2016<sup>130</sup>.

## Supervision

5.2.39 The HKMA has consolidated resources into a single division since April 2014 and strengthened manpower both in the terms of numbers and experience<sup>131</sup>. In parallel, the HKMA has enhanced its RBA to supervision, including formalising its ML/TF risk profiling framework in 2015 to ensure adequate assessment of individual banks' risk levels taking into account inherent risks and effectiveness of risk management and controls. The framework is used to determine the frequency and intensity of on-site and off-site supervision and, with risk scoping conducted prior to each examination, allows the HKMA to focus its efforts on higher-risk areas.

5.2.40 The additional supervisory resources allow more on-site examinations and desktop reviews to evaluate the adequacy and effectiveness of Als' controls, earlier intervention where appropriate, and stronger sector-wide engagement on specific threats and risks. The examinations also involve joint work with technology and operational risk specialists in the HKMA.

5.2.41 Areas in which the HKMA will strengthen its supervisory work include the ability to test increasingly complex technology-dependent systems, consistency in applying an RBA and the sources used to inform the HKMA's understanding of ML/TF risk. Cooperation between regulators (domestic and international) and with LEAs has improved but more needs to be done. In light of international developments and rapid technological change, policy development remains challenging. Similar to a number of other countries, resources have been allocated to work with the industry in developing innovative, technology-based means to perform certain AML/CFT tasks more efficiently and effectively, including know-your-customer utilities.

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130 Enhanced Competency Framework is a qualification programme with training, examination and continuing professional development.

131 In 2011 the AML Division consisted of 11 specialists, rising to 35 in 2016 and 41 in September 2017.

#### Box 5.4: De-risking

As in other international financial centres, the issue of de-risking has affected Hong Kong, with customers including SMEs and start-ups from other jurisdictions encountering difficulties in account opening. De-risking undermines efforts to promote financial inclusion and transparency and poses a risk that customers and fund flows with higher ML/TF risks are displaced into informal or unregulated channels.

While a number of drivers, not all AML/CFT-related, have been identified, the HKMA has focused on clarifying regulatory expectations for effective application of an RBA to ensure AIs' efforts and resources are focused on the higher risks. The HKMA issued a circular in September 2016 stating its supervisory stance on de-risking and providing guidance on risk differentiation and proportionality, while clarifying that an RBA does not imply a zero-failure outcome.

#### Remedial actions and sanctions

5.2.42 The HKMA applies a range of supervisory and enforcement measures, progressive in severity, requiring banks to remedy control deficiencies and breaches of AML/CFT legal and regulatory requirements. These include advisory letters, warnings to remediate, limiting or imposing conditions on businesses or activities, appointment of external advisers under the BO, as well as remediation orders, pecuniary penalties and public reprimands under the AMLO. The use of these actions and sanctions has increased with the strengthening of AML/CFT supervision in recent years. The nature of the shortcomings identified is moving away from simple non-compliance towards system effectiveness issues. In determining which sanctions to impose, the HKMA considers a number of factors, including the nature and seriousness of deficiencies, overall internal controls, competence of the bank's senior management and any non-compliance history.

#### Overall ML Risk of the Banking Sector

5.2.43 Given the size of Hong Kong's banking sector, its role as an international financial centre and open economy, together with the analysis of predicate crimes and other information, the banking sector faces a high ML threat. This assessment is generally consistent with other large international financial centres. Although all banks face similar ML threats, large international banks that are active globally and process large volumes of transactions are most at risk, particularly from threats presented by transnational crimes. That said, it is recognised that smaller banks, including private banks, can also be misused for ML.

5.2.44 While the banking sector, particularly the international banks, the HKMA and other competent authorities have made significant efforts to ensure controls are adequate and effective, the nature of banking activities in an international financial centre nevertheless presents a medium-high level of vulnerability. Although the inherent vulnerabilities of various banking products and services are adequately understood, given the size and efficiency of the banking sector and the speed at which transactions are processed, threats arising from high-end ML (e.g. fraud, tax evasion and corruption) will continue to exploit weaknesses in banks' AML/CFT systems and controls.

5.2.45 Taking into account the levels of threats and vulnerabilities, the ML risk level of the banking sector is assessed to be high.

## Next Steps

5.2.46 To address the high ML risk in the banking sector, the HKMA has identified a number of areas for further action:

- (a) Strengthening the understanding of ML/TF, by monitoring new typologies and addressing any information gaps so that supervision continues to be effectively targeted. This requires ongoing cooperation with LEAs and other financial regulators;
- (b) Providing stronger encouragement for banks to adopt an RBA in order to focus efforts on genuine ML/TF risks, while reducing unnecessary compliance burden by updating guidance to provide greater clarity around standards and expectations;
- (c) Strengthening the partnership with the banking sector through engagement and guidance to enhance understanding and mitigation of risks;
- (d) Strengthening cooperation with regulatory authorities in other jurisdictions, in particular Mainland China, in view of the increasing cross-border flows of trade, finance and banking activities; and
- (e) Supporting innovative means by which banks implement financial crime controls effectively and exploring the greater use of technology and analytical tools in supervisory work.

## 5.3 SECURITIES

5.3.1 Hong Kong has one of the world's most active and liquid securities and futures markets. Hong Kong's securities and futures markets respectively ranked tenth and sixth in the world in terms of value of share trading (US\$2.1 trillion) and notional turnover (US\$11.3 trillion) in 2017, and sixth globally in equity funds raised through initial public offerings (HK\$195.3 billion) in 2016. Hong Kong is also a large asset management centre in Asia, with assets under management of around HK\$13 trillion in 2016.

5.3.2 As at end of 2017, there were 119 banks and 2,660 non-bank intermediaries registered with or licensed by the SFC to carry on securities business in Hong Kong. Under the SFO, a corporation must be licensed as an LC or registered as a Registered Institution ("RI")<sup>132</sup> (in the case of a bank which is licensed and supervised by the HKMA under the BO) to carry on one or more types of Regulated Activity<sup>133</sup> as defined in the SFO under a single licence or registration. The SFC is the front-line supervisor of LCs whereas the HKMA is the front-line supervisor of RIs<sup>134</sup>.

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132 Put simply, LCs are securities firms licensed by the SFC, while RIs are banks registered to conduct securities business.

133 As defined in Schedule 5 of the SFO, the following are regulated activities – dealing in securities; dealing in futures contracts; leveraged foreign exchange trading; advising on securities; advising on futures contracts; advising on corporate finance; providing automated trading services; securities margin financing; asset management and providing credit rating services.

134 Under the co-operative supervisory regime set out in the SFO, the HKMA acts as the front-line supervisor of RIs, conducting day-to-day supervision of their securities business. The AMLO and the BO also empower the HKMA to conduct ongoing AML/CFT supervision and enforcement functions over the entire business of banks including their securities business. In addition to the generic guidance in HKMA's AML/CFT guideline that is uniformly applied to all FIs covered by the AMLO, RIs are required to have regard to the examples of sector-specific indicators set out in SFC's AML/CFT guideline in identifying suspicious transactions in relation to securities, futures and leveraged foreign exchange businesses.

#### Box 5.5: About the SFC

The SFC has clear and comprehensive powers under the SFO to regulate intermediaries in the securities and futures markets through licensing control, ongoing supervision, and enforcement to combat misconduct. The AMLO also gives supervisory and enforcement powers to the SFC to ensure compliance by LCs with the statutory CDD and record-keeping requirements.

On-site inspections and off-site monitoring and analysis are an integral part of the SFC's risk-based supervisory framework, which applies to its AML/CFT supervision of LCs. The SFC also investigates suspected serious AML/CFT breaches and imposes a range of effective, proportionate and dissuasive sanctions for violations.

The SFC plays an active role in global regulatory policymaking through participation in forums such as International Organization of Securities Commissions, and works closely with the HKSAR Government to support the work of the FATF.

The SFC fosters effective cooperation with regulators in Hong Kong, Mainland China and major overseas markets. It has entered into bilateral or multilateral arrangements with a number of local, Mainland and overseas regulatory bodies for exchange of information and provision of investigatory and/or supervisory assistance to combat securities-related crimes and misconduct on a cross-border basis.

5.3.3 Banks are key participants in the securities sector. Retail funds distribution in Hong Kong is dominated by banks and a sizable proportion of securities trading in the stock market is conducted by banks. Banks have a majority market share in the private wealth management industry which is a significant component of the fund management business<sup>135</sup>.

5.3.4 Banks conduct their securities business in conjunction with other banking services such as private, retail and corporate banking. The ML risk of the securities business of banks is hence assessed together with the major types of banking services and products offered by banks under section 5.2.

### ML Threats in the Securities Sector

5.3.5 The securities sector is exposed to both domestic and transnational ML threats due to its globalised nature, and high volume of transactions and liquidity. It can be misused both to generate illicit proceeds through securities-related predicate offences and to launder illicit proceeds from non-securities related offences. Since cash is not generally used or accepted in securities transactions, the sector is less conducive to the placement of illicit funds and is more likely to be used at the layering and integration stages, where proceeds can be converted to assets such as securities or futures contracts.

<sup>135</sup> In 2016, 78% of the funds managed or advised by the private wealth management industry in Hong Kong were attributed to private banking business of banks. Private wealth management industry accounted for 29% of Hong Kong's fund management business, whereas asset management business and fund advisory business accounted for the remaining 71%.

5.3.6 The incidence of misuse of the securities sector in cases where ML was detected was comparatively low. Fewer than 5% of the major ML investigation and conviction cases between 2013 and 2015 involved the use of securities services or products, and only 14% of the restrained property and 0.2% of the confiscated property between 2011 and 2015 were held in securities firms' accounts or physical share scrips<sup>136</sup>.

5.3.7 The percentage of STRs filed by LCs is low compared to the banking sector, accounting for 2-4% of STRs received by JFIU each year between 2011 and 2017.

5.3.8 However, the low detection of ML cases and volume of STRs may not truly reflect the level of ML threats. The fact that the securities sector is usually used at later stages of ML schemes, the speed and frequency with which transactions are executed, and the globalised nature of the securities and futures market all make it difficult to detect ML.

### Transnational and domestic ML threats

5.3.9 Hong Kong is an open market with significant participation by overseas investors, who, according to surveys, contributed around 40% of market turnover in 2016. Apart from domestic ML threats, the securities sector is also exposed to transnational threats due to the prevalence of cross-border transactions and exposure to non-Hong Kong clients who may be connected with corruption, tax evasion and other predicate offences. The case studies in Box 5.6 and Box 5.7 illustrate how the securities sector in Hong Kong was used by persons elsewhere or connected with cross-border drug trafficking to generate and/or launder proceeds.

### ML threats from securities-related offences

5.3.10 The securities market has the inherent vulnerability of being used to conduct transactions constituting market misconduct, such as market manipulation and insider dealing, which generate illicit proceeds to be laundered. One type of securities fraud involving the hacking of online securities accounts and market manipulation is perpetrated by way of "pump and dump"<sup>137</sup> schemes. For example, 24 securities accounts with four securities firms were affected by "pump and dump" schemes in 2015 with about HK\$27 million stolen.

### ML threats from non-securities related offences

5.3.11 Where the securities industry is used to launder illicit funds generated from non-securities related offences, criminally derived funds are usually first introduced to the financial system through the banking sector, before being transferred to the securities sector. Once a securities account is funded, the money launderer can engage in transactions that further conceal the source of funds, thereby layering and integrating illicit assets.

5.3.12 Hong Kong's securities sector faces similar ML threats as other financial sectors, albeit in varying degrees. The fact that LCs do not normally accept cash, which limits the use of the sector for placement of illicit proceeds, and investors' funds are typically channeled through banks which are subject to stringent AML/CFT requirements, lowers the ML threats of the securities sector. Having regard to the factors discussed above, the ML threat level of the securities sector is assessed as medium.

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<sup>136</sup> See Tables 4.1 and 4.2 in Chapter 4.

<sup>137</sup> "Pump and dump" is a method of market manipulation involving securities trades that raise the price of the security. The stock price is artificially raised ("pumped") and the security is then sold ("dumped") for a profit.

#### Box 5.6: Typology and case study for “pump and dump” schemes

Fraudsters first gain control of, mostly by way of hacking, securities trading accounts of legitimate investors. They then employ stooges or money mules to open securities trading accounts with banks, and the fraudsters retain full control (including transfer of or cashing out the balance) of these accounts. These stooge accounts will be used to buy penny stocks at a low price followed by orders placed for these accounts to sell the stocks at a higher price. Fraudsters then used cash in the hacked accounts (which may involve selling off the existing stock holdings in the hacked accounts for cash) to buy the penny stocks which the fraudsters are selling from their fully controlled stooge accounts. By repeating these steps, the fraudsters can transfer monies without authorisation through the stock markets from the hacked accounts to their fully-controlled stooge accounts.

In October 2015, a number of online securities accounts from three local brokerage firms were found being hacked and used to perform unauthorised stocks trading. Investigation revealed that the hacker(s) first opened an overseas account to trade Hong Kong stocks and to pile up on some penny stocks. Later, the hacker(s) manipulated those hacked accounts to buy the targeted penny stocks in order to pump up their market price. When the price of the penny stocks went up, the hacker(s) off-loaded their holdings in the penny stocks and generated profits.

The HKPF, with the assistance of the SFC, identified one suspicious account (opened with a brokerage firm in the US) as the counterparty off-loading the involved stocks to the hacked accounts. A sum of about HK\$2.3 million stocks and cash held by the brokerage firm in Hong Kong which executed trade orders of the aforementioned brokerage firm in the US was frozen swiftly by the HKPF. Furthermore, the SFC issued restriction notices pursuant to sections 204 and 205 of the SFO prohibiting the Hong Kong brokerage firm and its affiliate (both of which are LCs) from dealing with certain assets that were the suspected proceeds of market manipulation and/or fraud. At the same time, the HKPF disseminated the relevant *modus operandi* and other information to INTERPOL by “Purple Notice” to alert all member countries.

#### Box 5.7: Use of securities account to launder illicit proceeds generated from transnational drug trafficking

Financial investigation conducted by the HKPF over Hong Kong members of a transnational drug trafficking organisation revealed that one of them (the defendant) received over HK\$68 million between 2001 and 2007 mainly at his bank accounts, with a large percentage of funds received via cash and some in the form of payments from casinos, of which HK\$3.6 million was transferred into the defendant’s securities account at an LC. The funds in the securities account were further laundered via layering and integration during 2007 by making stock purchases which were typically sold within a few weeks of their purchases, with the proceeds of their sale being routed back to the defendant’s bank account which funded the securities account. The financial background of the defendant was not commensurate with the substantial amount of money involved in the activities in his securities account and bank accounts. The defendant was convicted of ML offences in March 2012 and was sentenced to five years’ imprisonment.

## ML Vulnerabilities of the Securities Sector

5.3.13 For the ML vulnerability assessment, LCs' business activities are classified into four major sub-sectors: brokerages, asset managers, advisers on investments, and advisers on corporate finance (Table 5.1). Under the SFO "single licence" regime, an LC may fall into one or more sub-sectors depending on the number and types of Regulated Activity it is licensed for<sup>138</sup>.

**Table 5.1: ML vulnerability and number of LCs under each business sub-sector**

Business sub-sectors	ML vulnerability	Number of LCs as at the end of 2017
Brokerages	Medium	1,420
Asset managers	Medium-low	1,477
Advisers on investments	Medium-low	1,349
Advisers on corporate finance	Low	315

5.3.14 The assessment of the ML vulnerability of each sub-sector takes into account the inherent vulnerabilities arising from specific features and users of that particular sub-sector, and the quality of supervision discussed in paragraphs 5.3.37 to 5.3.48 below.

5.3.15 Taking into account the assessments of ML vulnerability of the four sub-sectors, the overall ML vulnerability level of the securities sector is assessed to be medium.

### Brokerages

5.3.16 Brokerages deal in securities, futures contracts and/or leveraged foreign exchange products on behalf of or with investors. They may also provide automated trading services and/or securities margin financing.

5.3.17 The high liquidity and turnover of exchange-traded products, which brokerages of all sizes mostly deal in, are attractive to money launderers seeking to move large amounts of illicit proceeds quickly at relatively low transaction costs.

5.3.18 Local and overseas typology studies in the securities sector show that money launderers may receive or pay funds from or to third parties to conceal the control and ownership of their securities accounts and source of funds. Some brokerages restrict payments from or to third parties, while others that accept such payments regard them as a red flag for potentially suspicious transactions. The SFC's AML/CFT guideline includes frequent funds or other property transfers to or from third parties that are unrelated, unverified or difficult to verify among examples of red flags which might give rise to suspicion of ML. The SFC also reminds LCs from time to time to be vigilant in monitoring ML/TF risks associated with third-party payments through advisory circulars and industry outreach events.

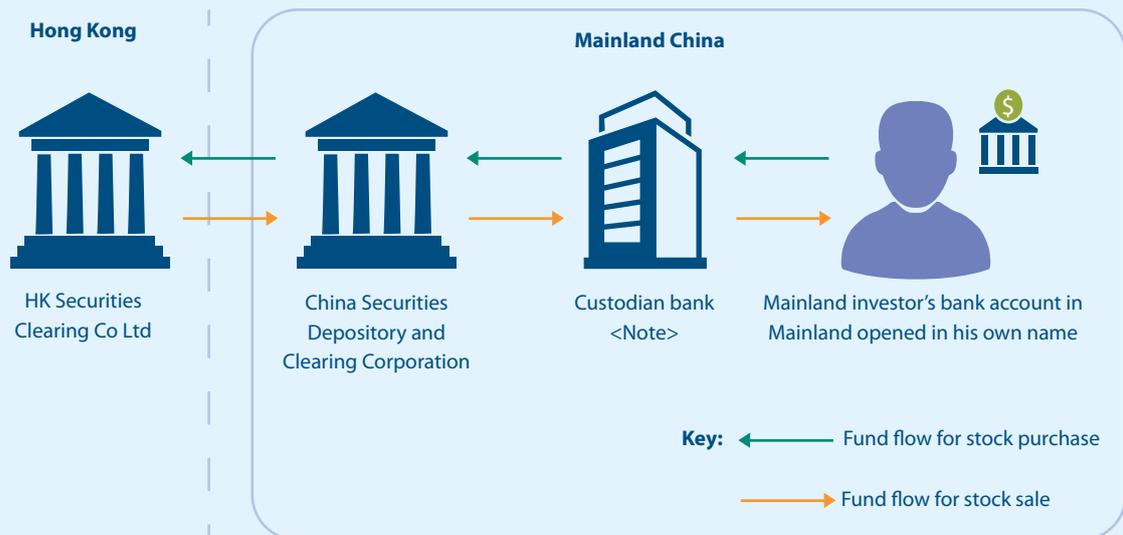
<sup>138</sup> For example, a brokerage firm licensed for Type 1 Regulated Activity (Dealing in securities) and for Type 9 (Asset management), would fall under two sub-sectors, brokerages and asset managers.

5.3.19 Like other major international financial centres, Hong Kong’s securities market is vulnerable to transnational ML. This vulnerability is mitigated by stringent CDD measures that LCs are required under the AMLO to apply to clients from Hong Kong or elsewhere. Where an overseas client does not open a brokerage account directly but executes trades through an omnibus account established by an overseas financial intermediary with the brokerage, the brokerage is required to identify and verify the identity of the underlying overseas client (i.e. the beneficial owner). Exceptions to this requirement occur when the overseas financial intermediary is incorporated in an equivalent jurisdiction, has measures to ensure compliance with CDD, transaction monitoring and other relevant requirements similar to those in the AMLO with respect to the underlying client, and is supervised for compliance with those requirements by a competent authority. LCs are also required to identify suspicious cross-border activities in their transaction monitoring.

5.3.20 The launch of Shanghai-Hong Kong Stock Connect in November 2014 and Shenzhen-Hong Kong Stock Connect in December 2016 (collectively, Stock Connect) has increased market connectivity with Mainland China. Under Stock Connect, eligible Mainland investors can trade Hong Kong stocks through accounts with Mainland brokerages<sup>139</sup> which apply CDD

**Box 5.8: Closed-loop cross-border fund flow arrangement for Stock Connect**

Under the closed-loop cross-border fund flow arrangement for Stock Connect, funds for settlement of a Mainland investor’s purchases of Hong Kong stocks via Stock Connect must be paid out of the investor’s bank account in Mainland China, whereas the proceeds from the subsequent sales of Hong Kong stocks by the Mainland investor must be paid into the investor’s Mainland bank account from which consideration for the original purchase was paid as shown in the graph below. These features render Stock Connect relatively less vulnerable to cross-border ML.



<Note> The custodian bank plays a role to ensure the fund transferred to/from the Mainland investor’s bank account and the China Securities Depository and Clearing Corporation can only be used for securities transaction settlement purpose for that particular Mainland investor.

139 The PRC is a member of the FATF and Mainland brokerages are subject to AML/CFT regulations which conform to the FATF standards.

and other measures similar to those set out in the AMLO. The inherent vulnerability to cross-border ML in light of the trading link is further mitigated by the closed-loop cross-border fund flow arrangement for Stock Connect and the MOU between the SFC and the China Securities Regulatory Commission for strengthening cross-border regulatory and enforcement cooperation pertaining to Stock Connect.

5.3.21 Many brokerages do not accept non-face-to-face account opening, which is vulnerable to identity fraud. Brokerages which allow non-face-to-face account opening are required to take additional measures to mitigate the ML vulnerability, including use of suitable persons (e.g. lawyers) to certify verification of identity documents.

5.3.22 Market turnover<sup>140</sup> is concentrated in 39 most active LCs in the brokerages sub-sector who account for around 70% of the market total. The ML vulnerabilities of these larger brokerages arise mainly from the variety of products and large volume of transactions they deal with, and the accompanying challenge of developing appropriate parameters for transaction monitoring. The SFC has provided more than 20 sector-specific indicators in its AML/CFT guideline to assist LCs in identifying suspicious transactions. Given the size of their business operations, larger brokerages generally deploy more resources and establish more sophisticated AML/CFT systems and controls to mitigate risks. Larger brokerages also deal with institutional investors and regulated FIs for a sizable portion of their transactions, which reduces their exposure to ML risks.

5.3.23 Smaller LCs in this sub-sector typically offer a limited range of products and services with a relatively small volume of transactions. Their products, services and client bases are more local, and their exposure to high-risk clients such as politically exposed persons or those connected with high-risk jurisdictions is more limited. Smaller brokerages therefore have a lower inherent vulnerability. However, many are small-scale businesses whose AML/CFT systems and controls are generally less robust and sophisticated than those of larger brokerages.

5.3.24 The overall ML vulnerability for brokerages is assessed as medium.

### Asset managers

5.3.25 Asset managers manage portfolios of securities or futures contracts for another person. Fund management companies and portfolio managers (including those offering discretionary account-management services) fall into this sub-sector.

5.3.26 Most asset managers are licensed to conduct business subject to a condition that they shall not hold client assets. Investors' money flows into and out of funds under their management through banks and distribution of funds is typically handled by regulated FIs. AML/CFT safeguards already exist in both cases. Moreover, the generally longer settlement period and higher transaction costs for subscription and redemption of unlisted funds render them less attractive than exchange-traded products insofar as ML is concerned.

5.3.27 This sub-sector is exposed to transnational ML. A survey showed that over 60% of the funding for Hong Kong's fund management business came from foreign investors in 2016<sup>141</sup>.

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140 In terms of value of share trading and the number of contracts traded on the stock exchange and futures exchange in Hong Kong respectively in 2014.

141 See [http://www.sfc.hk/web/EN/files/ER/PDF/FMAS%20Report\\_English\\_2016.pdf](http://www.sfc.hk/web/EN/files/ER/PDF/FMAS%20Report_English_2016.pdf).

This vulnerability is mitigated by stringent CDD measures and transaction monitoring on investors, which must be conducted by the asset managers and/or service providers<sup>142</sup> appointed by the funds.

5.3.28 Asset managers perform their own sales and marketing more often for institutional clients and managed accounts, where they apply CDD and transaction monitoring on the investors as direct clients. SFC-authorized funds are distributed to retail investors normally through intermediaries (a bank or LC in the brokerages sub-sector) which perform CDD measures and transaction monitoring on their clients.

5.3.29 Starting from July 2015, the distribution channel for eligible SFC-authorized Hong Kong funds has been extended to Mainland investors through the Hong Kong and Mainland Mutual Recognition of Funds programme<sup>143</sup>. The inherent vulnerability to cross-border ML is mitigated by the arrangement that recognised Hong Kong funds are distributed by Mainland FIs which are subject to similar AML/CFT regulations, and the SFC has entered into regulatory and supervisory cooperation arrangements with the China Securities Regulatory Commission.

5.3.30 The vulnerability of asset managers to being used by high net-worth individuals to set up complex products and diversified portfolios for ML in relation to tax evasion and corruption is limited. According to the recent Fund Management Activities Survey<sup>144</sup>, private client funds under management by LCs accounted for a relatively small percentage (less than 10%) of the aggregate asset management and fund advisory business in Hong Kong in 2016. For discretionary account management, asset managers generally meet investors in person to carry out CDD, and monitor the investors' deposits and withdrawals to identify suspicious activity.

5.3.31 The overall ML vulnerability for asset managers is assessed as medium-low.

### Advisers on investments and advisers on corporate finance

5.3.32 Advisers on investments give advice or issue analysis reports on securities or futures contracts. Advisers on corporate finance give advice on activities such as listing of securities, acquiring and disposing of securities from or to the public, business restructuring, mergers and share repurchases.

5.3.33 LCs conducting business solely as advisers on investments and/or corporate finance are normally subject to a licensing condition that they shall not hold client assets. Although they have a very low ML risk at placement stage, there is scope for them being drawn into ML at the layering and integration stages.

5.3.34 Advisers on investments normally give advice on non-exchange-traded investment products. Although these products are less attractive to money launderers due to the relatively lower liquidity and higher transaction costs, advisers on investments are still vulnerable to being implicated in ML schemes, including tax evasion, involving these products.

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142 For example, regulated entities from equivalent jurisdictions that impose CDD, transaction monitoring and other relevant requirements similar to those set out in the AMLO.

143 Under the Hong Kong and Mainland Mutual Recognition of Funds programme, Mainland and Hong Kong funds that meet the eligibility requirements can obtain authorisation or approval under streamlined procedures for offering to retail investors in each other's market.

144 See footnote 141.

5.3.35 Advisers on corporate finance generally perform due diligence on clients in addition to AML/CFT procedures to better understand their business nature, financial circumstances and purposes of the transactions under consideration. Hence these advisers usually have a thorough understanding of the background and business of clients (which are mostly listed corporations or corporations planning to go public or whose owners are subject to high transparency standards<sup>145</sup>). This reduces the vulnerability of these advisers to ML.

5.3.36 The overall ML vulnerability for advisers on investments and advisers on corporate finance is assessed as medium-low and low respectively<sup>146</sup>.

## Supervision

5.3.37 The SFO and the AMLO set out the powers and responsibilities of the SFC in the AML/CFT regime of the securities sector. The SFC uses a range of supervisory tools including:

- (a) A strict fit-and-proper test under the SFO for licence and substantial shareholder applicants (including their directors) seeking to enter the market;
- (b) Risk-based supervision of LCs through on-site inspections and off-site monitoring and disseminating information to industry participants through circulars and seminars, to monitor and promote compliance with AML/CFT requirements; and
- (c) Enforcement investigations of suspected AMLO violations and related internal control failures, and market misconduct for which a range of remedial measures and dissuasive sanctions (disciplinary<sup>147</sup> and criminal) may be imposed.

5.3.38 The SFC codes and guidelines, including the AML/CFT guideline, provide guidance on the responsibilities of senior management of LCs. In April 2017, the SFC launched the Manager-In-Charge regime to heighten the accountability of senior management of LCs and promote awareness of their regulatory obligations. This initiative includes a requirement that all LCs must appoint at least one fit-and-proper individual to be the Manager-In-Charge for each of the eight Core Functions identified by the SFC. The Managers-In-Charge for the AML/CFT Core Function are expected to be held accountable and responsible for ensuring compliance with AML/CFT requirements.

5.3.39 ML risks of the securities sector are reduced to a large extent by regulatory measures imposed on securities intermediaries to promote, monitor and enforce their compliance with AML/CFT requirements. Overall, LCs have implemented effective AML/CFT systems and controls to mitigate their vulnerabilities to ML, although deficiencies or inadequacies were noted for some firms.

5.3.40 During on-site inspections, the SFC found inadequacies in the monitoring, evaluation and reporting of suspicious transactions and failure to conduct enhanced CDD and appropriate transaction monitoring for high-risk customers at some LCs. These deficiencies were shared with industry participants in AML/CFT training seminars conducted by the SFC on various occasions. In an advisory circular issued in January 2017, the SFC notified the industry that AML/CFT

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<sup>145</sup> Listed corporations are normally subject to disclosure requirements (either by stock exchange rules or through law or enforceable means) which ensure adequate transparency of beneficial ownership.

<sup>146</sup> Notwithstanding the lower ML vulnerability of these two sub-sectors, their assessment results are discussed in this report because a considerable number of LCs conduct these two types of business (see Table 5.1).

<sup>147</sup> Examples of disciplinary actions include fines, public reprimands, and revocations or suspension of licences.

compliance would continue to be a focus of the SFC's supervision of LCs and draw the industry's attention to a number of key areas where deficiencies and inadequacies were detected in the AML/CFT systems of some LCs. The SFC seeks to change behaviour through signaling to the industry the focuses of its inspection, while providing necessary guidance and clarification on standards.

5.3.41 Since a growing number of LCs are subsidiaries of Mainland financial groups, the SFC organised a joint training seminar with the China Securities Regulatory Commission in November 2016 for Mainland securities brokerages and fund managers with operations in Hong Kong. The SFC also gave an AML/CFT presentation in June 2017 at a training seminar organised with an association of Mainland-affiliated LCs for their members. These are examples of seminars held for target groups to help them understand the ML risks they are particularly exposed to.

## Emerging Risks

5.3.42 The SFC has received an increasing number of reports from securities brokerages about customers' Internet trading accounts being compromised and unauthorised securities trading transactions conducted through these accounts. For the 18 months up to 31 March 2017, there were 27 reported cybersecurity incidents involving 12 securities brokerages. Most of the cases involved hackers gaining access to customers' Internet-based trading accounts resulting in unauthorised trades in excess of HK\$110 million when some other people involved distributed denial-of-service attacks targeting their websites accompanied by threats of extortion.

5.3.43 Cybersecurity management is a priority for the SFC's supervision of LCs. Since 2013 the SFC has conducted a number of Internet trading and cybersecurity reviews and issued circulars to draw the industry's attention to common deficiencies and vulnerabilities. The latest round of the SFC's review was conducted in late 2016 to assess the cybersecurity features of Internet/mobile trading systems of selected LCs and the industry's preparedness for and resilience to cybersecurity risks.

5.3.44 The industry is exploring the use of new technology for non-face-to-face account opening. After considering the industry's proposals, the SFC issued an advisory circular in 2016 to provide guidance to the industry on the application of alternative approaches including the use of electronic certification services to achieve effective client identity verification during non-face-to-face client account opening.

## Enforcement

5.3.45 AML/CFT and combating market misconduct have always been the SFC's enforcement priorities.

5.3.46 In 2016, following a comprehensive strategic review of its enforcement priorities, tools, policies and organisation structure, the SFC established a specialised team to conduct focused investigations of suspected AML/CFT violations and related internal control failures. The SFC also issued a press release in September 2016 to notify the industry of a number of areas of concern (including failures to scrutinise third-party deposits into client accounts and inadequate enquiries to assess potentially suspicious transactions) identified from on-site inspections and investigations, and the SFC's intention to take enforcement proceedings against firms that failed

to implement effective AML/CFT measures or take their AML/CFT responsibilities seriously. Disciplinary actions by the SFC on these cases from then to end-November 2017 resulted in public reprimands and fines against four brokerages totaling more than HK\$13 million and disciplinary actions against the former responsible officers of three of the four brokerages.

5.3.47 As part of the ongoing effort to combat market misconduct, the SFC has deployed rigorous market surveillance and other enforcement efforts to detect unusual activities in the securities market. The SFC currently has around 30 staff working in market surveillance and uses the Nasdaq's SMARTS Trade Surveillance system for market monitoring. When unusual activity is detected, it will be promptly analysed and, where appropriate, referred to a specialised team for further investigation and other enforcement actions. The SFC regularly implements new measures to enhance its ability to detect market manipulation and insider dealing activities, and collaborates closely with Hong Kong Exchanges and Clearing Limited on market surveillance matters. For example, a requirement was introduced in SFC's Code of Conduct in 2012 for a licensed or registered person to report to the SFC when it reasonably suspects that its clients

#### Box 5.9: Market misconduct cases

##### Insider dealing case

The SFC investigated and took enforcement action against a former managing director of an investment bank (the defendant) who was found guilty of insider dealing in shares of a listed company during an acquisition deal in 2007.

The defendant purchased a total of 26.7 million shares of the aforesaid listed company at a cost of HK\$86 million whilst in possession of insider information. He realised a profit of HK\$33.4 million from his insider dealing activities.

During the course of the investigation, the SFC obtained an injunction order freezing HK\$46.5 million of the liquid assets of the defendant.

The defendant left Hong Kong after the SFC completed the investigation. With the assistance from the HKPF, the SFC secured the arrest of the defendant upon his arrival from Beijing.

The SFC obtained restoration orders against the defendant requiring him to pay HK\$23.9 million to 297 investors affected by his misconduct.

##### Market manipulation case

The SFC took enforcement action against a futures trader for market manipulation in the Hong Kong futures market. The futures trader was convicted of five offences of price rigging following a retrial, and was sentenced to six months' imprisonment to be suspended for two years, fined HK\$500,000 and ordered to pay the SFC's investigation costs.

The SFC also brought proceedings under section 213 of the SFO that resulted in payment of around HK\$14 million made by the futures trader to restore approximately 500 of his counterparties to their respective positions before the relevant transactions.

may have committed market misconduct under the SFO. This separate reporting requirement to the SFC, which is in addition to the obligation to report suspicious ML transactions to the JFIU, further enhances the regulatory capability in the detection of market misconduct.

5.3.48 The SFC takes proportionate and dissuasive enforcement actions to punish and deter market misconduct perpetuated from Hong Kong and to prevent the dissipation of unlawful proceeds of crime or misconduct. Some of these actions led to the return of unlawful proceeds to the victims and marked important milestones in the SFC's efforts to protect the investing public from the consequences of wrongdoing.

## **ML Risk Assessment**

5.3.49 Taking into account the ML threat and vulnerability levels for the securities sector discussed above, which are both assessed to be medium, the ML risk level for the sector is assessed to be medium.

5.3.50 In conducting this assessment, information has been gathered and analysed on a sub-sector level to the extent possible. The information includes statistics from internal and external sources for the period from 2012 to 2017 where available, outputs of a risk assessment survey conducted by the SFC in 2015, supervisory findings, meetings with industry participants, and typology studies on ML in the securities sector.

## **Next Steps**

5.3.51 While the assessment indicates that the overall ML risk level is not high, the SFC will continue to play an active role in identifying and mitigating ML risks in the securities sector, and has identified a number of areas for action:

- (a) To improve the resilience of the securities sector to cybersecurity risks, the SFC released guidelines, which set out 20 baseline requirements for the industry to reduce and mitigate hacking risks associated with Internet trading, on 27 October 2017 following a public consultation;
- (b) To monitor and address any emerging risks associated with the use of electronic certification services or other financial technology for client identity verification in non-face-to-face account opening; and
- (c) To further improve AML/CFT compliance by LCs, particularly in areas where deficiencies and inadequacies are detected, the SFC will continue to conduct training seminars and outreach activities to target groups of LCs that are vulnerable to specific risk factors, and provide regulatory guidance through updating the SFC's AML/CFT guideline and issuing advisory circulars from time to time.

## 5.4 MONEY SERVICE OPERATORS

5.4.1 The AMLO defines a money service as a money-changing or remittance service and stipulates that any person who wishes to operate a money service must have a licence granted by the Commissioner of Customs and Excise. Any person who operates a money service without an MSO licence is liable on conviction to a fine of HK\$100,000 and six months' imprisonment.

5.4.2 An applicant for an MSO licence is required to declare whether he or she would carry on a business of money changing and/or remittance service. As at end-December 2017, there were 1,309 licensed MSOs comprising 596 sole proprietorships, 674 limited companies and 39 partnerships of varying sizes and structures. The majority of the licensed MSOs carried on both money changing and remittance business.

5.4.3 The AMLO imposes AML/CFT obligations on MSOs<sup>148</sup> including CDD, record-keeping requirements, ongoing monitoring of transactions and enhanced due diligence in high-risk situations such as those involving customers who are not physically present for verification purposes or politically exposed persons. MSOs must also ensure all their branches and subsidiaries outside Hong Kong have procedures in place to comply with requirements similar to those under the AMLO and inform the relevant authority if this is not possible, in which case they must take additional measures to mitigate ML/TF risks faced by their overseas branches or subsidiaries as a result.

5.4.4 Under the licensing regime, MSOs must take all reasonable measures to ensure that proper safeguards exist to mitigate ML/TF risks and prevent contravention of the AMLO. These include appropriate internal AML/CFT policies, procedures and controls, appointment of a compliance officer and an ML reporting officer. The maximum penalty on conviction for a licensed MSO which fails to comply with CDD and record-keeping requirements is a fine of HK\$1 million and imprisonment for seven years. Apart from criminal sanction, disciplinary action may also be taken, including public reprimand, direction to take remedial action and a pecuniary penalty not exceeding the greater of HK\$10 million or three times the amount of the profit gained or costs avoided by the MSO. The Commissioner of Customs and Excise is also empowered to impose licensing conditions, and suspend or revoke the licence of an MSO that does not meet the fit-and-proper person requirements.

5.4.5 MSOs are also required to refrain from carrying out transactions which they know or suspect to be related to ML/TF and report suspicious transactions to the JFIU with their observation and analysis. Under the DTROP, the OSCO, and the UNATMO, failure to report knowledge or suspicion of ML/TF carries a maximum penalty of three months' imprisonment and a fine of HK\$50,000.

### Threats and Vulnerabilities

5.4.6 The cash-intensive nature of money-changing<sup>149</sup> and frequent cross-border, walk-in and one-off transactions create a medium-high risk of exposure to ML/TF. The sector's ability to process numerous transactions conveniently and quickly also brings about the risk of illicit funds being introduced into the financial system. Cross-border activities pose challenges; analysis has

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<sup>148</sup> The Postmaster General, which operates a remittance service, is also regulated under the AMLO by the C&ED.

<sup>149</sup> A 2015/16 survey by the C&ED showed that, among payment methods such as bank transfers and cheques, the MSOs' transactions are mainly conducted in cash.

shown that 4% of the major cross-border ML cases involved the MSO sector<sup>150</sup>. Typology studies show that MSOs are misused as a conduit for laundering proceeds from crimes committed outside Hong Kong.

5.4.7 Between 2012 and 2017, MSOs filed 1% to 8% of all STRs. The rise in STRs indicates that MSOs have an improved understanding of their reporting obligations. Information from JFIU shows that the quality of STRs submitted by MSOs varies, with some STRs containing insufficient or inaccurate information or not providing the results of CDD or elaboration as to what suspicion triggered the filing.

5.4.8 The threats and vulnerabilities affecting MSOs are not uniform because they vary in terms of size and business models. Widespread use of cash in transactions presents higher risks. MSOs with compliance deficiencies, such as failures to implement CDD effectively, or who are deficient in AML/CFT knowledge may become vulnerable to exploitation by criminals seeking to launder funds. These vulnerabilities are, to some extent, addressed by C&ED through ongoing supervisory, educational as well as law enforcement activities.

#### Box 5.10: “Hawala”

Hawala is an alternative remittance system that exists outside of the traditional banking system. Unlike the conventional method of actually moving money across borders through bank wire transfers, money transfer in hawala is arranged through a network of hawala brokers who operate largely based on trust and communication. Transactions between hawala dealers can be settled in cash, property, or services.

Hawala is not common in the MSO sector and C&ED seldom receives intelligence or complaints of this type of unlicensed money service operation. FDHs and ethnic minority groups generally use more secure and convenient remittance services provided by licensed MSOs of the same ethnicity to transfer funds to their homelands. The following case of a unlicensed MSO providing money services to FDHs showed features closer to the working of licensed MSOs than the trust-based network of hawala.

A local grocery store retailing Southeast Asian products provided remittance services without an MSO licence to FDHs involving a large number of transactions totalling HK\$4.32 million. The sole proprietor of the grocery store solicited FDHs to use remittance services offered by licensed MSOs. Once the transactions were completed, the licensed MSOs would dispatch copies of the remittance orders to the proprietor, who handed them to the customers for record and charged a handling fee for each remittance. Finally, the proprietor was prosecuted by the C&ED and fined for operating a money service without a licence.

As part of the ongoing efforts to enhance supervision of the MSO sector, the C&ED is conducting a thematic review of the client base of MSOs, which will form the basis for the formulation of more targeted measures to mitigate ML/TF risks associated with the individual segments of clientele.

150 Nine major ML cases in 2013-2014 involved MSOs.

5.4.9 A 2015/2016 survey by the C&ED revealed some deficiencies in AML/CFT systems. There is a need to enhance AML/CFT training for MSOs and thus seminars and small group meetings, etc. are regularly organized to strengthen their AML/CFT knowledge. Besides, some small-scale MSOs rely on manual instead of computerised monitoring of customer transactions. This is because some of them lack the resources and knowledge to facilitate ML/TF screening and monitoring. To address this, the C&ED has been, among other things, exploring available sources of funding such as the Technology Voucher Programme of the Innovation and Technology Commission to assist MSOs, particularly the small ones, in installing or improving computer systems so that they can make use of automation for effective monitoring. The survey also revealed a need for MSOs to improve the role of the audit function of their compliance programmes.

### Unlicensed MSOs

5.4.10 The C&ED applies strict controls on entry to the MSO sector, conducting full background verification of licence applicants to ensure they meet the fit-and-proper requirements with effective measures to mitigate ML/TF risk for its proposed money service before the granting or renewal of an MSO licence. Between implementation of the AMLO in April 2012 and the end of 2017, the C&ED suspended 10 MSO licences, revoked two and refused to grant licences to 90 applicants on fit-and-proper grounds.

5.4.11 The C&ED maintains an up-to-date MSO licensee register, which is accessible on the Internet. This public register facilitates identification of false or inaccurate information about MSOs and unlicensed operation of money services. To combat unlicensed MSOs, the C&ED monitors higher-risk areas through street-level patrols, cyber monitoring, surveillance of suspected unlicensed MSOs, analysis of STR referrals and intelligence and other sources such as complaints from the public. Television, radio announcements, posters and pamphlets, etc.

#### Box 5.11: Case study on combating unlicensed MSOs

##### Unlicensed MSO case detected by cyber patrol

Cyber patrol initiated by the C&ED found a woman offering remittance service from Hong Kong to Taiwan by means of bid links through an online auction website. Further investigation unfolded that the woman had been operating remittance business between November 2015 and June 2016 without an MSO licence. The woman was finally convicted of operating money service without a valid licence and was fined HK\$25,000.

##### Unlicensed MSO case originated from complaint

Acting on information, the C&ED found an Indonesian male and an Indonesian female providing remittance service to Indonesian FDHs. Investigation unveiled that they solicited Indonesian FDHs to use remittance offered by a licensed MSO, and they charged a handling fee for each remittance. As the Indonesian male and Indonesian female had been operating remittance business between August 2016 and March 2017 without an MSO licence, they were prosecuted and finally convicted of operating money service without a valid licence. Each was fined \$15,000 and disqualified from holding MSO licence for six months.

are used to raise public awareness of the licensing regime. Between 2012 and 2017, the C&ED conducted 170 investigations into alleged unlicensed MSOs derived from information referred by the JFIU, resulting in five convictions.

## Supervision and Enforcement

5.4.12 To raise MSOs' awareness of the licensing regime and requirements, the C&ED launched compliance promotion programmes at the inception of the AMLO regime to educate MSOs, assist them in formulating their own AML/CFT policies and address concerns and difficulties in adapting to the regulatory regime.

5.4.13 Between December 2013 and December 2017, the C&ED conducted on-site and off-site inspections of 622 high-risk MSOs focusing on CDD and record-keeping requirements. MSOs are required to lodge quarterly returns to report general information such as transaction volumes for monitoring purposes. The C&ED issues general and thematic guidance via circulars to MSOs, keeping them abreast of information on areas of concern such as the UNSC Sanction Lists.

5.4.14 The C&ED conducts compliance inspections on MSOs using an RBA and will instigate prosecution and/or disciplinary actions in the event of failure to comply with the statutory requirements during inspection. If underground remittances are discovered, the C&ED will apply dissuasive sanctions. Supervisory findings, records and strategies are periodically reviewed by internal audit and the ICAC's on-site assignment study to ensure effective AML/CFT supervision of the MSO sector.

5.4.15 Between 2012 and 2017, there were 56 convictions under the AMLO with total fines of HK\$1.03 million. Suspended prison sentences and disqualification from holding an MSO licence for a specified period were also imposed on some convicted unlicensed MSOs.

5.4.16 Amongst the aforementioned 56 conviction cases, five involved non-compliance with CDD and record-keeping obligations, with four MSOs being fined and one given a community service order. Fines were also imposed in other seven cases concerning breach of the licensing requirements and 44 cases of unlicensed operation of money service. Further to criminal sanctions, on the advice of the DoJ, the C&ED also served written warnings to two MSOs for non-compliance with CDD and record-keeping obligations and one for non-compliance with requirements. Between 2012 and 2017, the C&ED also completed disciplinary action against two non-compliant MSOs, resulting in one MSO being publicly reprimanded by the Commissioner of Customs and Excise in November 2015, and the other being ordered to pay a pecuniary fine of HK\$21,000 in November 2017.

## Education and Outreach

5.4.17 In September 2016, the C&ED took part in an HKMA seminar to enhance banks' understanding of the regulatory regime for MSOs. The C&ED has also introduced an "Information Corner" on its website to facilitate MSOs' access to AML/CFT materials such as FATF publications. In addition to regular information sharing among internal formations, the C&ED also conducts outreach programmes to different communities, distributing information to businesses of ethnic minorities and at gathering places of FDHs to promote the use of legitimate remittance services and encourage report of unlicensed MSO activities, organising seminars for the elderly to raise their awareness of the licensing regime and remind them to stay vigilant against bank accounts

being exploited by swindlers for ML/TF, coordinating with the Hong Kong Federation of Youth Groups to produce video clips for uploading to its website and YouTube, and distributing leaflets through youth centres and at the annual Hong Kong Book Fair and the Animation-Comic-Game Hong Kong Fair.

5.4.18 The C&ED has issued guidelines including the Guideline on AML/CFT for MSOs, the Disciplinary Fining Guideline and the Licensing Guide and organises seminars and meetings with speakers from the JFIU on STRs, the ICAC on anti-corruption issues and other C&ED Formations on unfair trade practices to raise awareness of the compliance obligations of MSOs. As at end of 2017, 23 seminars and 26 small group meetings were organised. The C&ED also engages with the Hong Kong Money Service Operators Association to exchange views on the industry's best practices. Such awareness-raising has led to some vigilant MSOs identifying and reporting phone scams in the course of their business.

5.4.19 In response to the recent upsurge of phone scams, which could expose MSOs to being exploited for ML, the C&ED worked closely with the HKPF to exchange information and referrals and organise training and thematic patrols to MSOs to promote better understanding and mitigation of the ML/TF risks.

## Risks

5.4.20 While the MSO sector is characterised by certain high-risk elements, having regard to the sound local AML/CFT legal framework, robust oversight of MSOs by the C&ED, stringent market entry controls, proactive enforcement against non-compliance and unlicensed MSOs, and education and outreach efforts, the overall ML threat and vulnerabilities of the sector are assessed as medium-high. Combining the two, the overall risk is therefore also rated as medium-high.

## Next Steps

5.4.21 With a view to addressing the identified deficiencies of MSOs in the risk assessment, the C&ED will, in addition to continuing with the efforts described above, enhance its supervision of the MSO sector by:

- (a) Assessing MSOs' AML/CFT knowledge and providing tailor-made AML/CFT compliance training programmes to MSOs;
- (b) Strengthening MSOs' level of compliance by raising their awareness in using computerised systems for transaction monitoring as well as in improving STR quality;
- (c) Supervising the proper implementation of AML/CFT compliance programmes by MSOs; and
- (d) Conducting a thematic review of the client base of MSOs including clientele segments to facilitate the formulation of more targeted mitigating measures against the identified risk factors.

## 5.5 INSURANCE

5.5.1 The insurance sector in Hong Kong accounts for around 4% of GDP. In 2016 long-term insurance business accounted for 90% of the insurance market. The long-term insurance market is concentrated, with the top 15 insurers capturing around 93% of market share.

5.5.2 For long-term business, new individual life premiums reached HK\$179.1 billion in 2016, an increase of 39.8% from a year earlier. New individual life (non-linked) business premiums increased by 47.2% to HK\$173.4 billion whilst individual life (linked) business premiums decreased by 44.6% to HK\$5.7 billion.

5.5.3 In 2016, total in-force premiums increased by 23.8% to HK\$406.2 billion. The individual life category remained the dominant line of business, constituting HK\$337.1 billion (non-linked) and HK\$47.5 billion (linked).

5.5.4 As at end-2017, there were 66 insurers authorised to carry on long-term insurance business in Hong Kong. There were 62,309 appointed individual agents, 418 insurance agencies, and 689 insurance brokers authorised in respect of long-term insurance business.

### Threats

5.5.5 The sector bears an inherent ML threat in that it could generate proceeds of crime. There have been isolated cases showing that the sector can generate proceeds through theft or fraud involving insurance agents or staff. However, in these cases, insurance was not used as a conduit (whether through placement, layering or integration) to launder crime proceeds.

5.5.6 Considering that Hong Kong is one of the most open insurance centres in the world, there is a plausible inherent ML threat to the sector. However, the detected cases of insurance being misused in laundering proceeds of crime or insurance products as realisable assets for restraint and confiscation are relatively negligible.

5.5.7 Given the above, the ML threat level of the insurance sector is assessed as medium-low.

### Vulnerabilities

5.5.8 The IA has comprehensive authorisation requirements for insurers, including conducting fit-and-proper test on directors and controllers. Applicants are required to submit AML/CFT policies, procedures and controls, which are scrutinised by a specialised team of the IA before authorisation is granted.

5.5.9 The AML/CFT supervisory procedures and practices for the insurance sector are effective. Using an RBA, the IA's supervisory work on AML/CFT compliance is carried out through on-site inspections and off-site reviews. Where any non-compliance is identified, the IA takes appropriate regulatory action by issuing management letters requiring insurance institutions to put forward concrete corrective/remedial action plans with specific timelines, the progress of which is closely monitored.

5.5.10 The IA has also devoted much effort to promote compliance, including training industry practitioners through seminars and briefings. Information on current ML/TF techniques, methods and trends, and sanitised examples of ML/TF cases are shared by the JFIU.

Industry practitioners have also been invited to share experience on AML/CFT compliance. Areas for focus and attention, as well as common deficiencies and good practices identified in the course of supervisory work are communicated by the IA in these seminars.

5.5.11 In general the insurance sector demonstrates compliance with relevant AML/CFT regulatory requirements. Insurers have appropriate systems to implement their AML/CFT policies and procedures, including CDD, ongoing monitoring, record-keeping, and suspicious transaction reporting, with a separate and focused AML/CFT compliance function within their institutions.

5.5.12 The IA is a signatory to the International Association of Insurance Supervisors Multilateral Memorandum of Understanding, a global framework for cooperation and information exchange between insurance supervisors including AML/CFT matters. It has also signed bilateral MOUs or other formal arrangements with insurance supervisors of other jurisdictions for sharing of regulatory information, including AML/CFT matters. To strengthen international supervisory cooperation for effective group-wide supervision of multinational insurance groups, supervisory colleges are organised by group-wide supervisors with the participation of other supervisors of jurisdictions where such groups have operations. The IA has held group-wide and regional supervisory colleges in Hong Kong with insurance supervisors from other jurisdictions participating. The IA also attends supervisory colleges hosted by group-wide supervisors from other jurisdictions. Supervisors share regulatory concerns on AML/CFT at these platforms, with a view to identifying and addressing group weaknesses.

5.5.13 Long-term insurance policies typically last for several decades. With new policies written each year, the number of in-force insurance policies is significant and continuously growing. During the span of an insurance policy, various transactions or activities can take place, including advance premium payment, policy loan and repayment, lump sum dump-in, changes of policy owner or beneficiary, policy assignment, etc. Apart from relying on the vigilance of staff, it is the prevalent practice for insurers to install IT-based systems for ongoing monitoring of transactions using criteria, including specified monetary amounts of premium receipts/policy payouts, stipulated time periods and a mix of various nature of policy transactions, for generating regular exception reports to capture possible suspicious transactions for review by operational and/or compliance staff. Continuous efforts to enhance such systems have been noted, including addition of comprehensive built-in criteria, reinforcement of priority, allocation of additional manpower, and improvement in quality of documentation and timeliness of review to facilitate effective and efficient identification of suspicious transactions.

5.5.14 The level of non-compliance or integrity breaches amongst insurers is found to be low.

5.5.15 The distribution channels for non-linked new business premiums in 2016 were banks (43%), agents (other than banks) (30%), and brokers (27%). The figures for linked new business premiums were: brokers (53%), and agents (other than banks) (47%). Insurance agents and brokers are subject to the same AML/CFT regulatory regime as insurers. The market share of long-term business sold through non-face-to-face channels, e.g. telemarketing and the Internet, is negligible.

5.5.16 Percentages of policyholders who are politically exposed persons or from high-risk jurisdictions are not significant, and are subject to enhanced due diligence requirements.

5.5.17 Insurers have controls on premium receipts and policy payouts to mitigate ML/TF risks. It is the norm in the market that initial premium payments for long-term insurance applications are made by policy applicants to insurers direct, and not through insurance intermediaries. Insurers have also set limits on the amount of cash they receive for premium payments. Policy payouts from insurers are in the form of cheques made out to policyholders or named beneficiaries but not to third parties. The proportion of international remittances, incoming or outgoing, has been low. Premium refunds due to policy cancellation during the cooling-off period have been insignificant and the refunds are normally made to policyholders through the means by which they are received. Also, the proportion of lapse/surrender benefits paid within 25 months after policy issuance has not been significant.

## Insurance Products

5.5.18 There are a variety of long-term insurance products issued by insurers, which have been classified for ML vulnerability analysis, depending on the level of protection/savings/investment elements and whether or not there is cash value. It is worth focusing on investment-linked assurance scheme (“ILAS”) and universal life insurance products as they entail more inherent ML risks.

5.5.19 ILAS is a hybrid product with both insurance and investment elements. Policyholders have to bear the associated investment risks but at the same time benefit from some form of insurance protection. The policy value is based on the performance of the “underlying or reference funds”. This product used to be a vehicle for tax planning or estate planning for expatriates, and became popular amongst local clientele. Due to the withdrawal of the bancassurance distribution channel from mid-2013, suspension of the Capital Investment Entrant Scheme<sup>151</sup> (under which ILAS products were recognised as an eligible investment) from mid-January 2015, and IA’s promulgation of the Guidance Note on underwriting ILAS business which came into operation on 1 January 2015, ILAS business has declined in recent years. Under the Guidance Note, market practices that may provide incentives for insurance practitioners to take risks and engage in illegal activities are prohibited. Specifically, indemnity commission, or any form of overly high upfront commission, coupled with a short clawback period, may create misaligned incentives for intermediaries to engage in ML or fraudulent acts. To address such risk for ILAS, indemnity commission has been banned, alongside with requirements on having an appropriate remuneration structure for insurance intermediaries and suitable clawback mechanisms.

5.5.20 Universal life insurance products are a type of life insurance with a savings element that provides a cash value buildup. The cash value is credited with declared interest, and cost of insurance charges and other policy charges and fees debited. The declared interest rate varies from time to time and is subject to a minimum if the product provides a guaranteed interest rate in early years. It provides flexibility to policyholders in respect of premium payment (allowing dump-in of extra premiums subject to a cap) as well as withdrawal from the policy account. Such products are usually aimed at high-net worth private-banking clients as

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<sup>151</sup> A scheme under which persons from outside Hong Kong could apply for residence in Hong Kong by making an investment in permissible eligible assets.

part of wealth management, with predominantly single-premium payment and distribution through banks and brokers. Notable growth in universal life business has been seen in recent years. It is not uncommon for these policyholders to engage in premium financing with banks as a source of funding for the policy and benefit from interest rate arbitrage. The market norm for such premium financing is 70%, reducing the ML risks involved. The IA has promulgated a Guidance Note on underwriting long-term business (other than ILAS), which came into operation on 1 April 2016, under which indemnity commission is banned and appropriate remuneration structure for insurance intermediaries and suitable clawback mechanisms are required.

## Mainland China Visitors

5.5.21 New individual long-term business premiums from offshore clients amounted to HK\$91.2 billion in 2016, with HK\$72.7 billion (80%) from Mainland China visitors (“MCV”). MCVs accounted for 39.3% of total new individual long-term business premiums (onshore and offshore)<sup>152</sup>.

5.5.22 MCVs take out insurance products in Hong Kong for a number of reasons: the effective legal and regulatory mechanism; lower premiums (due to the lower mortality rate compared with Mainland China); wider choice of products; and/or attractive product features, including investment options, currency options other than RMB, and better policy returns. MCVs acquire policies in Hong Kong for life protection, savings, children’s education, critical illness coverage, retirement and investment.

5.5.23 The current regime requires that insurance products taken out by MCVs are sold and underwritten in Hong Kong. Insurers are required to keep documentary proof of MCVs’ entry to demonstrate that the MCVs are physically present in Hong Kong when signing the insurance applications as part of CDD. MCVs assessed to present a higher risk are subject to enhanced due diligence and ongoing monitoring, including ascertaining their source of funds or wealth. Where insurers know or suspect that payment received represents the proceeds of crime or terrorist property, a disclosure must be made to the JFIU.

5.5.24 For long-term business policy applications, it is the mandatory industry practice for insurance intermediaries to carry out a financial needs analysis for clients, including MCVs, during the sales advisory process. Clients are required to sign forms stating, *inter alia*, their objectives in buying insurance products, the types of products they are looking for, and the time horizon in their insurance or investment plan.

5.5.25 In view of the sizable share of MCVs purchasing long-term insurance products in Hong Kong, focused regulatory measures have been strengthened. From 1 September 2016, the IA has issued an Important Facts Statement for MCVs applying for long-term insurance policies informing them of various factors and risks, and that insurers have the responsibility to verify the source of funds of applicants, including when necessary or in high-risk situations, requiring documentary proof of legitimate source of funds and income proof commensurate with the sum assured. In suspicious cases or upon requirement by LEAs in Hong Kong, insurers are obliged to transfer relevant information, without the policyholder’s prior consent,

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<sup>152</sup> New individual long-term business for policies issued to MCVs saw a declining trend, from HK\$23.7 billion in the fourth quarter of 2016 to HK\$10.1 billion in the third quarter of 2017, amounted to 28.4% of total new individual long-term business premiums (onshore and offshore).

to LEAs. The Important Facts Statement must be signed by the MCVs and filed with the insurers for record. The IA has also stepped up supervision of insurers with material long-term insurance business involving MCVs, and conducted thematic on-site inspections of their AML compliance in respect of such clientele. Further, the Cooperative Agreement on Insurance Supervision signed between the IA and the China Insurance Regulatory Commission enhances information exchange, cooperation and assistance on AML issues arising from MCVs buying insurance products in Hong Kong.

5.5.26 Given the above, the ML vulnerability level of the insurance sector is assessed as medium-low.

## Risks

5.5.27 Despite the insignificant occurrences of insurance-related ML cases being investigated and leading to convictions, Hong Kong, being one of the most open insurance centres in the world, is still prone to ML threat. The AML/CFT regulatory regime of the sector is strong, covering insurers, brokers and agents, which helps reduce vulnerability. Ongoing monitoring of possible increasing ML risks arising from growing popularity of certain insurance products, and measures taken in response have helped mitigate risks. Regulatory measures adopted in respect of notable growth in certain offshore clientele taking out insurance policies in Hong Kong have also helped reduce potential for ML.

5.5.28 Considering the ML threats and vulnerabilities above, the overall ML risk level of the insurance sector is assessed as medium-low.

## Next Steps

5.5.29 Given the growth in long-term business attributed to MCVs, focused regulatory measures in this respect will continue, including the requirement for MCVs to sign an Important Facts Statement when applying for long-term insurance policies, the supervisory AML/CFT compliance work on insurance institutions with significant long-term MCV business, and the strengthening of information exchange and cooperation with the China Insurance Regulatory Commission. The effectiveness of these measures will be monitored and reviewed.

5.5.30 Since the risk assessment is an ongoing process involving monitoring of trends and the effectiveness of risk mitigation measures, collation of long-term business statistics will be reviewed to ensure collection of requisite data on product types, transactions, and clientele to facilitate continuous risk assessment.

5.5.31 The IA will remain vigilant in identifying emerging ML/TF risks, and take a proactive approach to mitigate such risks through close liaison and regulatory guidance to the industry. The IA will also continue to work with the LEAs and financial regulators to keep abreast of AML/CFT trends and international developments.

## 5.6 MONEY LENDERS

5.6.1 Money lenders<sup>153</sup> are regulated by the Money Lenders Ordinance (“MLO”)<sup>154</sup>, which provides for, among other things, a licensing regime<sup>155</sup>, requirements for transparency and clarity of loan terms, and prohibition of excessive interest rates. A person who carries on business as a money lender without a licence, at any place other than the premises specified in his licence, or contravening the conditions of his licence commits a criminal offence subject to a fine of HK\$100,000 and two years’ imprisonment. In December 2017, there were 1,994 licensed money lenders.

5.6.2 Under the MLO, if the interest rate exceeds 48% per annum, the loan transaction shall be presumed to be extortionate, and the court may reopen the transaction so as to do justice between the parties. Any person who lends money at an interest rate which exceeds 60% per annum commits a criminal offence and is liable to a fine of HK\$ 5 million and to imprisonment for 10 years.

5.6.3 The money lending sector does not take deposits from customers, and customer loans (i.e. loans offered to the general public) are a major type of business. Some money lenders provide commercial, mortgage, and vehicle loans. Most of these loans are made to the local population. According to the Annual Survey of Economic Activities published by the Census and Statistics Department, the business receipts of the sector amounted to HK\$13.84 billion in 2016, accounting for 0.56% of GDP<sup>156</sup> and 1.41% of the financial services market<sup>157</sup>.

5.6.4 The HKSAR Licensed Money Lenders Association Ltd.<sup>158</sup>, a member of the Consumer Credit Forum<sup>159</sup>, has published a guideline on AML/CFT for the sector.

### Threats

5.6.5 There are two common typologies whereby money launderers may exploit money lenders. However, both typologies are rare in Hong Kong. One typology is to use loans or mortgages to layer and integrate illicit funds into high-value assets such as real estate. Loans or mortgages are essentially taken out as a cover for laundering criminal proceeds. Lump-sum cash repayments or smaller “structured” cash amounts are used to repay loans or mortgages allowing illicit funds to be commingled with legitimate funds.

5.6.6 Past ML cases in Hong Kong showed that perpetrators of predicate offences might use real estate and mortgages to layer the crime proceeds, but most of the loans were obtained from banks rather than money lenders due to better mortgage terms offered. This typology is therefore uncommon in the money lending sector.

5.6.7 Another typology is a “loan-back scheme”, which involves criminals engaging in money lending business and borrowing their own illicit funds. Offshore companies controlled by criminals may also be used as an apparently “arms-length” lender of the money lending business.

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153 Banks, insurers, cooperatives, etc. are exempted from regulation under the MLO.

154 Chapter 163 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap163>.

155 Licences are subject to renewal every 12 months.

156 Hong Kong GDP for 2016 is HK\$2,489.1 billion.

157 Total business receipts of financial services sector in 2016 amounted to HK\$980.8 billion.

158 The association comprises over 40 members, most of them being major players of the sector.

159 The forum is for formulating strategic and tactical solutions to bankruptcy-related problems and comprises four associations, namely the Hong Kong Association of Banks, the Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, the Finance Houses Association and the Hong Kong S.A.R. Licensed Money Lenders Association Ltd.

This process hides the true nature of the funds and gives the loan repayments an appearance of legitimacy. There is no indication that this typology has been applied in Hong Kong as the cost of creating a “loan-back scheme” and bogus loans is high and therefore not cost effective.

5.6.8 The sector is required by the DTROP, the OSCO and the UNATMO to file STRs to the JFIU. Between 2012 and 2015, the sector filed 124 STRs, with seven requiring follow-up investigation in view of the suspicious sources of funds for loan repayment or the unusual repayment patterns<sup>160</sup>. The investigations mostly suggested early redemption due to remortgaging or refinancing and therefore did not lead to any prosecution. So far, there has been no prosecution case against money lender for ML or TF.

5.6.9 Money lenders are involved in various types of ML predicate offences, mostly being victims of fraud when criminals use false instruments to apply for loans. However, there is no intelligence or evidence to suggest that criminals exploit the money lending businesses to launder crime proceeds. The ML threat level of money lender is considered medium-low.

## Vulnerabilities

5.6.10 Under the MLO, applications for and renewal of money lenders’ licences are subject to approval by the Licensing Court. The Licensing Court, presided over by a magistrate, has the authority to grant licences and impose conditions, where necessary. Where the HKPF or the Registrar of Money Lenders objects to the application, the Licensing Court shall not grant a licence unless it is satisfied, *inter alia*, that the applicant is a fit-and-proper person to carry on a money-lending business and that the grant of such licence is not contrary to the public interest. Since 1 December 2016, the Licensing Court has imposed more stringent licensing conditions<sup>161</sup> on money lender licences and the Registrar has been conducting on-site inspections to ascertain compliance with the requirements. In 2017, 663 on-site inspections were conducted. The Registrar issued 182 advisory letters and 21 warning letters to money lenders where non-compliance had been identified, requiring them to ensure strict compliance with their licensing conditions.

5.6.11 In determining whether an objection to new or renewal application should be made, the Registrar and HKPF will carry out an investigation. The Registrar has the power to require an applicant to produce for inspection books, records or documents or to furnish information relating to the application or any business carried on or intended to be carried on by the applicant<sup>162</sup>.

5.6.12 Between 2012 and 2015, the HKPF objected to 155 applications, 149 of which were reaffirmed by the Licensing Court. Over the same period, the HKPF issued 43 warning letters to money lenders for breach of licensing conditions<sup>163</sup>. The Licensing Court revoked one money lender licence on the application of the HKPF.

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160 The patterns included settlement of loan within a very short period, application for a new loan upon settlement of a previous loan, and separating off loan repayments in small cash transactions via convenience stores.

161 The additional licensing conditions stipulate that money lenders must not accept a loan application referred by an intermediary if, *inter alia*, the intermediary:

- (a) charges any fees on the borrower;
- (b) is not its appointee registered on the Register of Money Lenders; or
- (c) refuses to provide a copy of the intermediary agreement to the borrower.

162 An applicant is required to give the details of each bank at which the business keeps or proposes to keep an account in connection with the business as a money lender.

163 The conditions are related to content of advertisement, collection of debt, protection of personal data, handling of complaints in respect of loan activities and record-keeping.

5.6.13 The MLO empowers the Registrar, persons authorised by the Registrar, police officers above the rank of superintendent, or any other police officers authorised by such police officers to enter premises of a money lender and inspect its books and records, if there is a reasonable suspicion that a money lender has committed an offence under the MLO. The HKPF is proactive in investigating and seeking prosecution of criminal activities in the sector.

5.6.14 Under the MLO, any change in the directorship and ownership of a licensed money lender must be reported to the Registrar and the change is subject to screening by the HKPF in a way similar to the screening process for a new licence application.

5.6.15 The MLO does not impose prudential regulation on money lenders. For employee recruitment, not every money lender verifies whether job applicants have criminal conviction records, and takes disciplinary actions against employees for failing to comply with the company's AML/CFT rules and regulations<sup>164</sup>. Although not every money lender has elaborate systems in place to mitigate ML/TF risk, money lenders have a very strong incentive, for the obvious reason to ensure loan repayment, to fulfill the principle of CDD by checking and verifying the identities of prospective borrowers and taking copies of their identity documents, bank documents, and property deeds. Loan payment and repayment in cash is uncommon as the sector tends to deposit loans into borrowers' bank accounts. For management of loan repayments, the sector maintains and keeps identification, loan application and transaction records that also serve to meet the requirements for record keeping under the IRO and the CO<sup>165</sup>. The sector adopts robust CDD and record-keeping measures in business practice, and the Registrar and the HKPF supervise and monitor such compliance.

5.6.16 Every year, the FSTB holds a large-scale AML/CFT education seminar to remind the sector of the importance of AML/CFT measures<sup>166</sup> and the participation rate has been increasing.

5.6.17 The licensing regime, coupled with the inherent incentives for money lenders to establish and verify the identity of customers, act as effective preventive measures against ML/TF. The ML vulnerability of the sector is assessed as medium-low.

## Risks

5.6.18 Taking into account the threat and vulnerability assessments, the overall ML risk for the sector is considered to be medium-low. The changing business landscape, however, calls for continuous monitoring of the AML/CFT competence of the sector. More relevant data are to be collected for analysis and evaluation<sup>167</sup>.

## Next Steps

5.6.19 In collaboration with the HKPF, the Registrar of Money Lenders will keep a close watch on the MLO licensing regime to ensure that only fit-and-proper persons will be granted licences. Continuous efforts will be made to review the ML/TF risk of money lenders and raise awareness through capacity-building initiatives.

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164 According to a survey conducted in late 2015, 4.7% of the respondents confirmed that they required job applicants to declare any criminal conviction records during recruitment and 32% confirmed they had taken disciplinary action against employees for failing to comply with AML/CFT rules and regulations.

165 The IRO requires business to keep sufficient records of income and expenditure for tax purposes for not less than seven years. The CO requires a company to preserve any accounting records, or any accounts and returns for seven years.

166 The measures are: (i) CDD, (ii) record keeping, (iii) reporting suspicious transactions, and (iv) known ML typologies and trends, through education or industry engagement programmes.

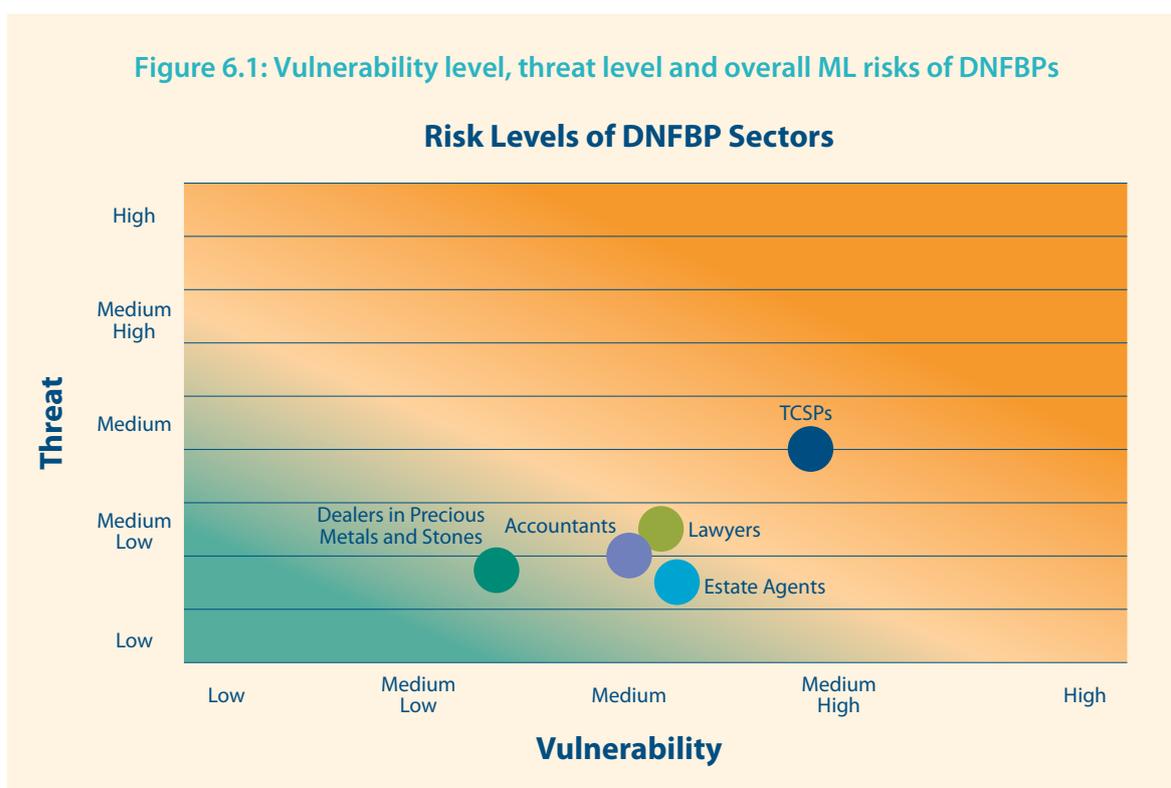
167 The supplementary information sheets required to be submitted for applications for or renewals of money lenders licences have been revised for collection of information from the applicants on AML/CFT measures.

# CHAPTER 6

## SECTORAL RISK ASSESSMENT – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

### 6.1 OVERVIEW

6.1.1 This Chapter discusses the results of the ML risk assessment in relation to the relevant DNFBPs and other sectors in Hong Kong. Most of these sectors are regulated by self-regulatory bodies, and guidelines are issued to remind businesses and professions of the requirements for CDD and record-keeping.



### 6.2 LAWYERS

6.2.1 Lawyers in Hong Kong are broadly divided into solicitors and barristers. Of the two, it is solicitors<sup>168</sup> that are predominantly engaged in activities identified by the FATF to be at risk for ML/TF, providing a range of services covered by the FATF Recommendations including conveyancing (real estate transactions), trustee services, services relating to the formation and administration of companies and entities, and the buying and selling of businesses. Practising barristers are prohibited under their Code of Conduct to accept any instructions to receive, disburse or otherwise handle clients' money, securities or other assets other than by receiving payment of his fees<sup>169</sup>, and are hence not involved in activities covered by the FATF Recommendations.

<sup>168</sup> Solicitors who have practised as such for not less than seven years and who have passed an examination prescribed by the Hong Kong Society of Notaries may also apply for appointment as notaries public. Notaries in such capacity are not involved in financial transactions or activities that would bring them under the scope of the standards of the FATF.

<sup>169</sup> Section 5.19(a) of the Code of Conduct of the Hong Kong Bar.

6.2.2 Solicitors are regulated by the Legal Practitioners Ordinance (“LPO”)<sup>170</sup>, under which the Law Society of Hong Kong (“LSHK”) is the statutory regulatory body for the profession<sup>171</sup>. A practising solicitor must be a member of the LSHK and hold a practising certificate. The LSHK is empowered by law to investigate breaches of and take disciplinary action against professional misconduct. On 31 January 2018, the LSHK had 10,752 members, of whom 9,299 held a current practising certificate and 7,021 (76%) were in private practice. There were 894 law firms, of which 48% were sole proprietorships and 41% were firms with two to five partners.

## Threats

6.2.3 Solicitors commonly provide trust or company services and are thus subject to the threat associated with TCSPs (see section 6.4). They also play a key role in processing real estate transactions, including stakeholding deposits and purchaser’s monies for their clients. As noted in Chapter 4, crime proceeds may be converted into different types of assets including real estates, presenting a risk that solicitors handling the transactions might be wittingly or unwittingly involved in ML.

6.2.4 In 2016, the legal sector filed 969 STRs. In 2015, the sector filed 894 STRs, of which 136 were classified as high risk by the JFIU. The majority concerned fees or fund arrangements relating to legal proceedings or legal services, pointing to possible ML threats arising from sources of funds. Nearly one-fifth concerned real estate transactions without any mortgage or financial assistance. The STRs involved natural persons or companies from over 16 different jurisdictions, reflecting that the legal sector in general has a diverse clientele and is subject to a cross-border ML threat.

## Vulnerabilities

6.2.5 Solicitors in Hong Kong are generally known to have strong ethics, integrity and a culture of compliance with professional rules and standards. Admission as a solicitor is subject to stringent qualification and practice requirements. To ensure the integrity of the staff of a law firm, solicitors are legally prohibited from employing or remunerating any person, who, to his or her knowledge, has been convicted of a criminal offence involving dishonesty unless the LSHK so permits. The LSHK issues Practice Directions and Circulars, and has issued a Guide to Professional Conduct for mandatory compliance by members.

6.2.6 Recognising the ML/TF risk in the sector, the LSHK introduced in 2008 Practice Direction P which makes application of essential AML/CFT preventive measures mandatory for all law firms and solicitors. The Practice Direction P provides a framework of compliance, including CDD, record-keeping, staff awareness and training measures, and further guidelines on how firms should apply an RBA, client identification, verification and CDD (including of beneficial owner) and recognition and reporting of suspicious transactions. Failure to comply with Practice Direction P can result in disciplinary proceedings and a range of sanctions, including warnings and, in more serious cases, disqualification as a solicitor. A breach of Practice

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<sup>170</sup> Chapter 159 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap159>.

<sup>171</sup> Under the LPO, LSHK is also empowered to register a person as a foreign lawyer who, not being a solicitor or a barrister who holds a relevant practising certificate, is qualified to practise foreign law. Foreign lawyers are not permitted to provide or offer any legal service which, having regard to all the circumstances of the case, can properly be regarded as a service customarily provided by a solicitor in his capacity as such. They are allowed to give advice on or handle any matter which (a) is expected to be subject to the law of a jurisdiction other than Hong Kong, or (b) involves private or public international law or conflict of laws. As at 31 January 2018, there were 85 foreign law firms and 1,458 registered foreign lawyers in Hong Kong.

Direction P amounts to a breach of the code of conduct. The LSHK investigates all breaches and make referrals as appropriate to the Solicitors Disciplinary Tribunal which has the power to impose penalties. It acts upon information which it obtains in the course of carrying out obligations as regulator of the solicitors' profession and upon information received from third parties by way of complaints.

6.2.7 Although Practice Direction P does not have the force of law, it is binding and imposes AML/CFT obligations on all law firms and solicitors, through the LSHK's disciplinary powers. It has proved effective and AML/CFT awareness of solicitors is considered high and is rising, given the profession's nature and as reflected by the number of STRs made. The LSHK has also been working with the Government to raise the AML/CFT awareness of solicitors.

6.2.8 To enhance the robustness of the regime, the Government decided to enshrine the AML/CFT obligations for legal professionals in law by introducing amendments to the AMLO. Starting from 1 March 2018, legal professionals<sup>172</sup>, among other DNFBPs, have to observe statutory CDD and record-keeping requirements under the AMLO. The LSHK is designated as the regulatory body for monitoring and supervising the compliance of legal professionals with the AMLO requirements. Powers are given to the LSHK under the LPO to investigate breaches and discipline non-compliant legal professionals.

## Risks

6.2.9 Based on the methodology described in Chapter 2, the level of ML risk for lawyers is assessed to be medium, comprising a medium-low level of ML threat and a medium level of ML vulnerability.

## 6.3 ACCOUNTANTS

6.3.1 The Hong Kong Institute of Certified Public Accountants ("HKICPA") is authorised by the Professional Accountants Ordinance ("PAO")<sup>173</sup> to issue practising certificates to certified public accountants ("CPAs"), which enable them to perform auditing work for companies. The HKICPA is also responsible for regulating the professional conduct and standards of its members (including conducting practice reviews, taking disciplinary actions and imposing sanctions), setting codes of ethics and standards of accounting and auditing, regulating entry to the profession through its qualification programme, providing continuing education and other services to members, and promoting the accountancy profession in Hong Kong and overseas. As at 1 January 2018, membership of the HKICPA stood at 42,237, including 5,531 fellow members. There were 4,735 members holding practising certificates, and 1,292 firms and 555 corporate practices.

6.3.2 CPAs provide a range of services beyond statutory auditing work. These include assurance, tax advisory, company listing, corporate finance, liquidation and restructuring services, trust or company services, and forensic accounting.

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<sup>172</sup> Under the AMLO, a legal professional means a solicitor or a foreign lawyer under the LPO.

<sup>173</sup> Chapter 50 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap50>.

## Threats

6.3.3 CPAs commonly provide trust or company services, although predominantly through separate legal entities because of the need to maintain independence from their statutory auditing duties. They are thus also subject to the ML threat associated with TCSPs (see section 6.4). The three cases of CPAs being complicit in ML since 2010 all involved transactions for or on behalf of their TCSPs' clients. Typologies however do not suggest any noticeable threat to such "traditional" activities as auditing or tax advisory services. CPAs are also generally not involved in real estate transactions in the services provided in their professional capacity.

## Vulnerabilities

6.3.4 CPAs are members of a profession generally known to place considerable emphasis on ethics, integrity and a culture of compliance. The threshold for entry is stringent as reflected by the HKICPA's qualification requirements. The HKICPA also makes continuous and consistent efforts to oversee the professional conduct of its members and their compliance with its rules and regulations, and promote good practices, including outreach efforts in collaboration with the Government to promote awareness of AML/CFT.

6.3.5 Prior to 1 March 2018, there were no statutory requirements for CPAs to conduct CDD and record-keeping measures. However, certain professional rules issued by the HKICPA are relevant. The Code of Ethics for Professional Accountants, the Standards on Quality Control, and Standards on Auditing, though not specific to AML/CFT, broadly require CPAs to be circumspect against threats of illegality or misconduct while establishing and continuing client relationships, and to maintain records of transactions. The HKICPA has also issued a set of advisory guidelines on the FATF's preventive AML/CFT measures and questions and answers on suspicious transaction reporting, which are regularly brought to the attention of members.

6.3.6 Most of the large CPA firms have already established stringent and comprehensive AML/CFT measures, particularly on the acceptance of clients from outside Hong Kong. Practices which are part of international networks of firms commonly embrace AML/CFT policies and controls designed to meet the FATF's requirements. On the other hand, the level of AML/CFT controls among smaller firms, including sole proprietorships, varies.

6.3.7 Accountants are subject to statutory requirements to file STRs. The JFIU speaks at AML/CFT seminars regularly to keep the accountancy sector up-to-date with developments in the STR regime, and increase awareness of the sector's role in combating ML/TF and other illicit activities. Professionals in the sector generally believe that the low STR numbers<sup>174</sup> are a positive outcome of the stringent screening process of onboarding. Dubious clients would have already been screened out before establishing a business relationship, thus substantially reducing the likelihood of suspicious transactions. Meanwhile, as accounting professionals engage in the more risky TCSPs business usually operate in separate entities, the STR numbers might have been counted under the TCSP category.

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<sup>174</sup> Three in 2016.

6.3.8 To enhance AML/CFT regulation of the sector, starting from 1 March 2018 accounting professionals<sup>175</sup> have been subject to the statutory CDD and record-keeping requirements under the AML(A)O. The HKICPA is designated as the regulatory body for monitoring and supervising the compliance of accounting professionals with the AMLO requirements. Powers are given to the HKICPA under the PAO to investigate breaches and discipline non-compliant accounting professionals. The HKICPA has promulgated guidelines to facilitate compliance with the statutory requirements.

## Risks

6.3.9 Based on the methodology described in Chapter 2, the level of ML risk for accountants is assessed to be medium, comprising a medium-low level of ML threat and a medium level of ML vulnerability.

## 6.4 TRUST OR COMPANY SERVICE PROVIDERS

6.4.1 In Hong Kong, there was no licensing or registration requirement for companies operating as TCSPs, except for trust companies incorporated under the CO or registered under the Trustee Ordinance (“TO”)<sup>176</sup>, before the commencement of the AML(A)O on 1 March 2018. Thus the type of providers falling within TCSPs was not legally defined. However, many individuals and corporate practitioners in this sector are members of professional associations such as the Hong Kong Institute of Chartered Secretaries (“HKICS”), the Hong Kong Trustees Association (“HKTA”) and the Society of Trust and Estate Practitioners. These associations provide training and guidance to members on corporate governance and AML/CFT preventive measures, and a forum for members to raise issues concerning the sector. The HKICS also supervises the conduct of its members (who are Chartered Secretaries) and imposes disciplinary proceedings in the event of members not complying with its AML/CFT Guidelines and Code of Professional Conduct. Solicitors and CPAs are also known to be active in the TCSP market, although they commonly provide services under separate legal entities.

6.4.2 The types of activities or businesses in which TCSPs typically engage include company formation and establishment of businesses; arranging for bank accounts to be opened; acting as nominee shareholders and directors; providing registered office facilities; ongoing corporate administration and secretarial work, liquidation and dissolution of companies; trust and estate administration services; establishment and administration of charitable trusts and foundations; and acting as escrow agents.

6.4.3 There is a strong demand for trust or company services in Hong Kong given its open economy and status as an international financial centre. Apart from the growing fund management industry, this is also reflected by the number of new companies registered in Hong Kong every year: around 160,229 in 2017. Hong Kong also sees a steady flow of investment to and from offshore financial centres<sup>177</sup>, and is an active market for forming and operating offshore companies.

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175 Under the AMLO, an accounting professional means a CPA or CPA (practising), a corporate practice or a firm of CPAs (practising) under the Professional Accountants Ordinance (Chapter 50).

176 Chapter 29 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap29>.

177 Offshore financial centres such as the British Virgin Islands and the Cayman Islands are among the major investors and recipients of Hong Kong's inward and outward direct investment.

## Threats

6.4.4 Some segments of the TCSP sector (e.g. providing trustee and administrative services to unit trusts and mandatory provident fund schemes) face minimal ML risks due to the nature of their clientele, the mode of the businesses (e.g. as retirement schemes), and the transparency and regulatory requirements of the products concerned. The major focus of the ML risk for TCSPs is the abuse of shell companies and their bank accounts as repositories of crime proceeds. Services provided by TCSPs, such as selling shelf companies and assisting in new incorporations, may be misused for ML purposes. In 2015, 16 out of 97 ML conviction cases involved the use of TCSPs' services in incorporating shell companies. In 2016, 10 out of 85 ML conviction cases involved the use of TCSP sector. Cases of TCSPs being complicit in illegal activities were detected but isolated.

6.4.5 The ML threat posed to TCSPs has a noticeable cross-border element. It is not uncommon for shell companies engaged in ML to be under the direct or indirect control of transnational or regional syndicates and used to launder proceeds of predicate crimes (e.g. fraud schemes) committed outside Hong Kong. In the 22 STRs filed by TCSPs in 2015, nearly two-thirds of the persons reported as suspicious were non-Hong Kong residents from more than 10 jurisdictions.

## Vulnerabilities

6.4.6 In 2016, the TCSP sector filed 27 STRs. STRs filed by TCSPs accounted for about 0.04% of the overall STR submissions for 2016. Whilst the legal requirements for TCSPs to undertake CDD, record-keeping and other ML/TF preventive measures only commenced operation in March 2018, AML/CFT controls by the sector is improving. The HKICS, for example, has issued voluntary guidelines for its members' compliance, which are as comprehensive as those issued by regulatory authorities in the financial sector. In May 2016, the HKICS introduced an AML/CFT Charter for TCSPs, incorporating the FATF's essential AML/CFT measures, to accredit firms which have demonstrated compliance. A professional panel was set up to supervise participants' compliance. The Charter, which is intended for voluntary adoption by any company service provider, was signed by six leading firms in the trade, expanding to eight in 2017. The HKICS also works with the Government to promote AML/CFT awareness among its members through a series of outreach activities, such as seminars.

6.4.7 The HKTA also issues Best Practice Guides, covering corporate trusts, pension schemes, private trusts and charitable trusts, which include AML/CFT principles to educate its members and raise industry standards in relation to trustee activities. HKTA members are asked to confirm their adoption of the Guides as minimum standards of practice on joining or renewing their membership. The HKTA has also issued sample CDD forms for corporate and pension trustees, which serve as Practice Guidelines on how the Guide's principles may be met by trustees. Practice Guidelines for CDD procedures for private client trustees (which follow international requirements and standards as prescribed by the OECD and the FATF) will be issued soon. In addition, the HKTA has been working with the Hong Kong Securities and Investment Institute to launch a training and accreditation programme in 2018 to raise professional standards.

6.4.8 A substantial number of TCSPs are professionals such as solicitors, CPAs or experienced Chartered Secretaries qualified with the HKICS, particularly at the senior management level. These professionals generally exercise caution to mitigate reputational risks and adhere to a good level of professionalism and integrity. TCSPs associated with law firms, CPA practices and FIs commonly follow stringent CDD rules and procedures prescribed in relevant practice directions and regulatory requirements, non-compliance with which may lead to heavy disciplinary penalties and serious reputational consequences. Further, some TCSPs in Hong Kong are subsidiaries or associates of TCSPs in other jurisdictions subject to mandatory licensing and regulation and comply with the statutory rules and regulations of their parents' or associates' home jurisdictions in the conduct of their businesses in Hong Kong.

6.4.9 To enhance AML/CFT regulation of the TCSP sector, the AMLO was amended, through an amendment bill enacted by LegCo in January 2018, to subject TCSPs to statutory CDD and record-keeping requirements starting from 1 March 2018. Meanwhile, a licensing regime has been instituted requiring any person aspiring to carry on trust or company service as a business in Hong Kong to obtain a licence from the Registrar of Companies, subject to the fulfilment of a fit-and-proper test for the applicant and any beneficial owners. Guidelines have been published to facilitate compliance with the statutory requirements.

## Risks

6.4.10 Based on the methodology described in Chapter 2, the level of ML risk for TCSPs is assessed to be medium-high, comprising a medium level of ML threat and a medium-high level of ML vulnerability.

## 6.5 ESTATE AGENTS

6.5.1 The Estate Agents Authority ("EAA") is an independent, self-financing statutory body established in November 1997 under the Estate Agents Ordinance ("EAO")<sup>178</sup> to regulate and control the practices of the Hong Kong estate agency trade, to promote the integrity and competence of estate agents, and enhance the status of the trade. An individual or company carrying on estate agency work must hold a valid licence, or otherwise commits an offence and is liable on conviction upon indictment to a fine of HK\$500,000 and to imprisonment of two years. On 31 January 2018, there were 38,552 individual estate agent or salesperson licences and 3,601 company licences. In 2017, the number of property transactions<sup>179</sup> stood at 108,793, and the total value of agreements for sale and purchase of building units and land stood at around HK\$723 billion.

6.5.2 In Hong Kong, the main role of estate agents in property transactions is acting as a middleman between potential purchasers and sellers, arranging property viewings and the signing of provisional agreements for sale and purchase. Estate agents commonly have face-to-face contact with purchasers and sellers, allowing them to acquire knowledge of the background of their clients.

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<sup>178</sup> Chapter 511 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap511>.

<sup>179</sup> "Property transactions" include the assignments of units in a building and assignments of land.

6.5.3 In most, if not all, cases, the estate agents' role in handling clients' money is confined to passing the purchaser's personal cheque for the initial deposit<sup>180</sup> to the seller or the seller's solicitors upon signing of the provisional agreement for sale and purchase. Payment of the initial deposit in cash is rare. After the provisional agreement for sale and purchase is signed, payment of the further deposit and balance of the purchase price invariably involves conveyancing solicitors and banks.

6.5.4 In the first-hand sale of residential properties, prospective purchasers usually submit a registration of intent together with a payment (usually by way of a cashier order) to the seller (the property developer) to express intent to purchase when the sale commences. It is quite common for estate agents to assist prospective purchasers to participate in the lot drawing for purchasing these properties. In doing so, they may, on receipt of the same amount of money from a prospective purchaser (usually paid by credit card or cheque), arrange issuance of a cashier order by a bank for submission to the seller. Dealing with cash is rare in such circumstances.

## Threats

6.5.5 It is not uncommon for crime proceeds to be converted into different types of assets including real estate. Based on the Confiscation Orders granted between 2011 and 2015, around 10% of crime proceeds confiscated were real estate (see Table 4.2). In 2016, around HK\$129 million crime proceeds confiscated were real estates. Typologies suggest that estate agents may be unwittingly involved in ML. In 2015, STRs filed by estate agents were generally not classified as high-risk, but around one-fifth of the high-risk STRs filed by solicitors were related to real estate transactions without mortgage or other financial assistance. The ML threat posed to solicitors thereby extends to estate agents in that the latter also facilitate transactions, although the degree of threat may differ since estate agents are generally not part of the fund-flow chain.

6.5.6 Hong Kong's property market is open to investors from all over the world. In the fourth quarter of 2017, such purchasers accounted for around 1.2% of the total residential property transactions.

## Vulnerabilities

6.5.7 While estate agents play an important role in property transactions, they are inherently less vulnerable than other facilitators such as conveyancing solicitors and banks, as they are generally not involved in the fund-flow chain. Where estate agents do handle funds, the amount only constitutes around 3% to 5% of the transaction value, and even those are seldom made in cash.

6.5.8 For some years the EAA has prescribed AML/CFT preventive measures in its Practice Circulars<sup>181</sup>, which require licensees to verify the identity of clients and keep records for five years and the management of estate agencies to establish internal procedures against ML/TF. No violation of the AML/CFT Practice Circulars was found between 2014 and 2016 during the EAA's random compliance checks.

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180 The amount of the initial deposit usually constitutes 3-5% of the purchase price.

181 Primarily Practice Circulars 08-05 and 04-01.

6.5.9 The EAA also issued a Practice Circular<sup>182</sup> in October 2016 setting out further guidelines on verification of sellers' identity to guard against fraud, and launched TV and radio announcements in February 2017 to remind the public to arrange for stakeholding of deposits in real estate transactions by solicitors. These initiatives aim to raise the defence against ML by subjecting transactions to additional layers of scrutiny.

6.5.10 The Government has been working with the EAA to raise the awareness of the sector through outreach programmes such as seminars promoting the FATF's international standards. In the absence of statutory requirements and with the highly competitive market in which estate agents operate, the level of AML/CFT controls varies among estate agents.

6.5.11 To enhance AML/CFT regulation of estate agents, the AMLO was amended, through an amendment bill enacted by LegCo in January 2018, to subject estate agents to statutory CDD and record-keeping requirements starting from 1 March 2018. The EAA is designated as the regulatory body for monitoring and supervising the compliance of estate agents with the AMLO requirements. Powers are given to EAA under the EAO to investigate breaches and discipline non-compliant estate agents. The EAA has promulgated guidelines to facilitate compliance with the statutory AML/CFT requirements.

## Risks

6.5.12 Based on the methodology described in Chapter 2, the level of ML risk for estate agents is assessed to be medium, comprising a medium-low level of ML threat and a medium level of ML vulnerability.

## 6.6 DEALERS IN PRECIOUS METALS AND STONES

6.6.1 Dealers in precious metals and stones ("DPMS") in Hong Kong can be roughly divided into three categories: retail, wholesale and metal exchange. In 2017, retail sales of jewellery, watches and precious metals accounted for about 17%<sup>182</sup> of total retail sales by value, at HK\$75 billion. The retail business is supported by clientele from Hong Kong and elsewhere. According to a Hong Kong Tourism Board survey in 2016, overnight visitors spent HK\$15.3 billion on jewellery, accounting for 16% of their total spending on shopping.

6.6.2 The jewellery industry is largely export-oriented. Hong Kong manufactures and exports jewellery, with jewellery and precious metals accounting for around 12% of the total exports in 2017, at HK\$466 billion. Hong Kong also organises annual jewellery trade fairs for local and overseas buyers.

6.6.3 Hong Kong operates a precious metal exchange market, with paper or physical precious metals available as investment products. Besides FIs, the Chinese Gold and Silver Exchange Society ("CGSE") is a major exchange of precious metals. In January 2018, the CGSE had 171 corporate members which provide precious metal trading services for individual or corporate clients.

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<sup>182</sup> Practice Circular 16-03.

<sup>183</sup> Source: Census and Statistics Department – retail sales by type of outlet.

6.6.4 The import and export of gold, precious metals and stones are governed by the IEO and associated regulations. Controls are in place with respect to (i) declaration and manifestation for imports and exports; (ii) registration and certification of the rough diamond traders; (iii) regulation of the standard of fineness of precious metals (i.e. gold, gold alloy, and platinum); and (iv) protection of intellectual property rights. The regulatory regime helps reduce the risk of misuse of the sector for ML/TF purposes as, for instance, an audit trail of the precious metals and stones can be established as and when necessary.

## Threats

6.6.5 While crime proceeds can be converted into precious metals and stones, a review on the Confiscation Orders granted between 2011 and 2015 shows that only about 3% (HK\$89 million) of the assets confiscated were related to precious metals and stones, jewellery and watches (see Table 4.2). In 2016, around HK\$800,000 worth of proceeds confiscated were precious metals and stones. The amount is low compared with other forms of assets such as cash in bank accounts. Further conversion of crime proceeds from precious metals and stones to other forms would be less common in view of the costs involved<sup>184</sup>. While crime proceeds may be embedded in precious metals and stones, no dealer was linked to or convicted of ML/TF between 2010 and 2016.

## Vulnerabilities

6.6.6 Large cash transactions are a key facet of the risk for DPMS. In the retail sector, while cash transactions can still be found, they are increasingly being substituted by credit card payments<sup>185</sup>. Lower-value jewellery is also understood to dominate the retail market<sup>186</sup>. According to members of the retail sector, the larger establishments have commonly taken steps against ML/TF activities, such as identifying risky transactions and verifying customers' identity, especially for transactions that involve large amounts of cash.

6.6.7 On the wholesale side, dealers tend to trade with reputable and reliable business partners with whom they have established long-term relationships. On the precious metal exchange, settlements are generally not cash-based. While FIs are required by law to carry out CDD and record-keeping, the CGSE has been promoting good practices among corporate members and their staff. In 2010, a registration system was introduced requiring responsible persons and traders among corporate members to be fit-and-proper persons<sup>187</sup>. All responsible persons and traders are also required to undergo continued professional development programmes, in which AML/CFT is a key topic.

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184 Our discussion with dealers of precious metals and stones indicated that dealers were reluctant to buy precious metals and stones from unknown sources, or if they did so, would bargain for a hefty discount on the purchase sum, which significantly reduced incentives.

185 As revealed by several major retailers of precious metals and stones in Hong Kong, sales to retail customers nowadays comprise mainly cash sales and credit card sales. In one stakeholder meeting for this risk assessment report, the trade reported that the percentage of using credit cards could be up to 60%.

186 For example, according to the annual report of one major, publicly listed local DPMS in 2015, around 75% of its retail sales value in the Hong Kong and Macao markets is from jewellery products priced under HK\$30,000.

187 There are 15 criteria for considering whether a person can satisfy the fit-and-proper tests. These include, amongst others, previous criminal conviction; convictions for fraud or dishonesty by Courts of Hong Kong; any prosecution in Hong Kong or elsewhere; previous condemnation, suspension of registration, fines, refusal to issue registration or life-long prohibition of re-entry to the industry administered by the SFC or other local regulatory bodies; reprimand/condemnation, or refusal/cancellation of membership by professional bodies, etc.

### Box 6.1: CGSE's licensing and registration system

The only means to become a member of the CGSE is by transfer of membership. All applications for transfer must be made to the Executive and Supervising Committee. The transferee is required to submit all necessary documents for consideration (a total of 20 categories), which include a group chart of the company showing the percentage of shares of each director; documents showing the share structures and appointment of Directors, e.g. Return of Allotment; Annual Return and Instrument of Transfer; audited financial statements; if the company is an offshore company, the original of Certificate of Incumbency or Certificate of Compliance as appropriate; if the company is a trust company, undertaking of the ultimate beneficial owners to notify the CGSE of any changes of the trust arrangements, and that the trustee must be a bank, a law firm, a CPA firm or a trust company.

The CGSE has established a registration system for three types of practitioners: Registered Manager, Registered Dealer and Registered Account Executive. The registration of practitioners is overseen by a Registration Committee of the CGSE, comprising 15 members, with seven representatives from the Executive and Supervising Committee of the CGSE, seven external parties and one representative of the Administration Division of the CGSE.

All practitioners who have been successfully registered are given a designated registration number. The name and registration number, together with the business details of the practitioners, are kept in a Register which is open for public inspection.

6.6.8 The Government has been reaching out to the DPMS sector through capacity-building seminars and meetings and the issuance of AML/CFT guidelines for DPMS.

## Risks

6.6.9 Based on the methodology described in Chapter 2, the level of ML risk for DPMS is assessed to be medium-low to medium, comprising a medium-low level of ML threat and a medium-low to medium level of ML vulnerability.

6.6.10 Although the ML risk of the DPMS sector is assessed as relatively low among the DNFBPs, it needs to be continuously monitored. For instance, in 2017 the C&ED detected 26 suspected cases involving smuggling of about 665 kg of precious metals, mainly gold and silver. This happened amid rising precious metal prices in the past couple of years. Whether – and if so, how – the smuggling activities are related to predicate offences and laundering of crime proceeds remain to be further investigated and studied. The LEAs will keep a close watch on the situation.

## 6.7 NEXT STEPS

6.7.1 Relative to FIs, DNFBPs have a lower ML risk due to the size and nature of their businesses. ML risks in the DNFBP sectors are mitigated by professional registration requirements, codes of ethics and industry guidelines promulgated by the relevant regulatory bodies, as well as the capacity-building initiatives of the Government. An enhanced AML/CFT awareness of the DNFBP sectors is evident in the increasing number of STRs filed by DNFBPs in the recent years. However, the compliance culture of DNFBPs varies due in part to the absence of statutory CDD and record-keeping requirements. To enhance AML/CFT regulation of DNFBPs, in June 2017, the Government introduced a bill to amend the AMLO to codify the CDD and record-keeping requirements for legal professionals (including solicitors and foreign lawyers), accounting professionals, estate agents and TCSPs. Powers are given to the LSHK, the HKICPA and the EAA under the relevant Ordinances<sup>188</sup> to investigate breaches and discipline their members found to be non-compliant. At the same time, a requirement is introduced under the AMLO for TCSPs to obtain a licence from the Registrar of Companies, subject to the meeting of a fit-and-proper test. Unlicensed provision of TCSP services becomes a criminal offence liable to a fine at HK\$100,000 and to imprisonment for six months. The Registrar is given powers to investigate breaches and discipline licensees found to be non-compliant with the CDD and record-keeping requirements under the AMLO.

6.7.2 With the commencement of the AML(A)O on 1 March 2018, DNFBPs are placed under a more solid and comprehensive AML/CFT regulatory framework in accordance with the FATF standards. The Government will keep in view implementation of the enhanced regime, and continue to monitor the ML risks of the DPMS sector to see if further expansion of the AMLO coverage is required.

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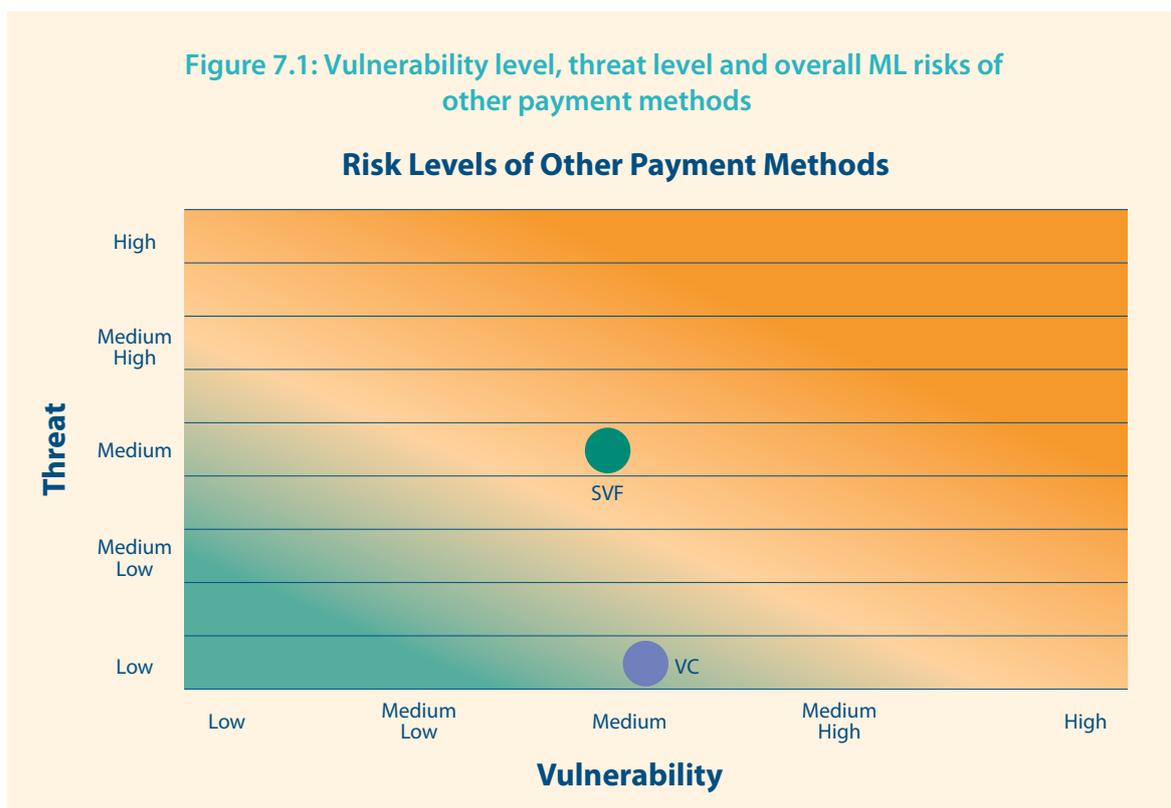
<sup>188</sup> The LPO, the PAO and the EAO.

# CHAPTER 7

## OTHER PAYMENT METHODS

### Overview

7.1 Proceeds of crime can be transferred through payment methods provided by various types of businesses other than FIs. This Chapter assesses the ML risks of such payment methods, including multi-purpose SVFs<sup>189</sup> and VCs. The table below summarises the assessment results for these two payment methods.



### Stored Value Facilities

7.2 The global retail payment landscape has been developing rapidly. Technological advances and increasing acceptance of new technologies have led to the emergence of new retail payment products, such as SVFs and Internet and mobile payment services. The Government is committed to developing Hong Kong into a knowledge-based economy and innovation hub for technology and its application. Given growing public acceptance and use of SVFs and innovative retail payment products and services, and taking into account the international regulatory trend towards protecting consumers and preventing misuse of new technologies, the Government introduced a regulatory regime for SVF, among other things, in November 2015 under the Payment Systems and Stored Value Facilities Ordinance (“PSSVFO”)<sup>190</sup>.

<sup>189</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 (e.g. prepaid coupons issued by a cake shop or a coffee shop).

<sup>190</sup> The PSSVFO commenced full operation in November 2016. See Chapter 584 of the Laws of Hong Kong (<https://www.elegislation.gov.hk/hk/cap584>).

7.3 As noted in Chapter 2, because the SVF regime was only introduced in 2015 and only became fully effective in November 2016, at the time of writing this risk assessment only limited data are available on the business operations of some SVF licensees and supervisory experience is relatively short. The following assessment is therefore preliminary, although the AML/CFT controls of SVF licensees were reviewed by independent third parties as part of the licensing process. A further assessment will be conducted in 2018 and as required thereafter to verify the threat, vulnerability and risk levels.

### Threats and vulnerabilities

7.4 In general, SVFs cover prepaid cards and mobile and Internet-based payment services that allow the storing of value. Some SVF products (e.g. Octopus card, Alipay and PayPal) have existed in the market for a number of years, while an increasing number of new ones (e.g. Tap & Go, TNG Wallet, WeChat Pay) have been introduced more recently.

7.5 The Octopus card<sup>191</sup> is the most common multi-purpose stored-value card, introduced in the early 1990s for travel on public transport. It was later extended to small-value payments in retail merchants in Hong Kong as well as in Shenzhen and Macao. An Octopus card requires a HK\$50 deposit at the time of purchase while the maximum value that can be stored on the card is HK\$1,000. Each Octopus transaction is traceable with records maintained of both the amount and location of use. The low maximum stored value and auditable use lessen its attractiveness as means for ML and other illicit activities.

7.6 Social media and online platforms have been increasingly used in fraud and blackmail cases with cash and bank transfers used to collect the proceeds of crime. However, there has also been an upsurge in exploitation of multi-purpose SVFs for collection of proceeds of crime. Internet-based SVFs were the most affected and the victims would either transfer money to the online SVF accounts or buy value top-up (recharging) cards from the retail market and deposit them into the SVF accounts of the fraudsters. While the average amount involved is usually small, ranging from several hundreds to several tens of thousands of Hong Kong dollars, the aggregate loss through SVFs in online fraud cases<sup>192</sup> amounted to HK\$6.4 million in 2015 and 2016.

7.7 Given the increasing acceptance of multi-purpose SVFs as means of payment, the inherent threat of these facilities being used as a vehicle for ML should not be underestimated. The functionality and geographical reach of certain SVF products, such as cash withdrawal or cross-border fund transfers increases the vulnerability to ML. The threat level of SVF is assessed as medium.

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191 The issuer of Octopus cards, Octopus Cards Ltd., was licensed and regulated as an AI under the BO prior to the introduction of the SVF regime.

192 There were 788 and 113 online fraud cases involving SVFs in 2015 and 2016 respectively.

7.8 Under the PSSVFO, the HKMA has implemented a mandatory licensing system for multi-purpose SVF and performs supervision and enforcement functions. Part 2 of Schedule 3 to the PSSVFO stipulates the minimum licensing criteria for SVF businesses, including that each chief executive, director and controller of the SVF licence applicant must be a fit-and-proper person and the applicant must have prudential and risk management in place. Applicants must also have adequate and appropriate AML/CFT systems of control. As part of the application process, applicants are required to submit independent assessment reports performed by independent, competent and qualified experts, covering key areas, including AML/CFT systems. At the end of 2017, there were 13 SVF licensees.

7.9 SVF licensees are required to fulfill the minimum criteria on a continuing basis. The HKMA monitors SVF licensees through supervisory activities including ML/TF risk profiling, on-site examinations (the frequency and depth of which depend on the risk profile of individual licensees), off-site reviews, independent assessments, review of auditors' reports, and meeting with the management of the licensee. The HKMA can also suspend or revoke the licence or impose licensing conditions at any time.

7.10 Under the PSSVFO, it is a criminal offence for a licensee not to report to the HKMA its inability to meet obligations or any material change in its circumstances. If the HKMA considers the licensee is unable to meet its obligations, insolvent or is about to suspend payments, it has the power to require the licensee to take immediate action relating to its affairs, give direction for the licensee to seek advice on management of its affairs or give direction for licensee's affairs to be managed by a person appointed by the HKMA. Failure to comply with the HKMA's direction is a criminal offence.

7.11 The HKMA may impose sanctions on an SVF licensee for any contravention of a provision, a requirement imposed or a condition attached to a licence under the PSSVFO. The sanctions include imposing a pecuniary penalty, giving a caution, warning, reprimand and/or remedial order. The HKMA may also suspend or revoke a licence in certain circumstances, including where the licensee fails to meet any of the licensing criteria or contravenes a condition attached to the licence.

7.12 To assist SVF licensees to meet their legal and regulatory obligations, the HKMA has issued the *Guideline on Anti-Money Laundering and Counter-Terrorist Financing (For SVF Licensees)*, which provides guidance on the requirements for AML/CFT controls, including CDD, ongoing monitoring, financial sanctions and TF, STRs, and record-keeping, which is broadly similar to the requirements for AIs and is risk-based. The application of measures and controls is commensurate with the risks of ML/TF and the size of the SVF licensee's business. For example CDD measures may be required depending on the maximum stored value, annual transaction amounts and features of the SVF product (e.g. whether it is reloadable or can be used for person-to-person fund transfer or cash withdrawal etc.).

7.13 The SVF licensing and supervisory regime is comprehensive and sufficiently robust to prevent and deter ML/TF activities. AML/CFT preventive measures and the HKMA's supervisory powers over SVF licensees are equivalent to those stipulated under the AMLO. The legal and supervisory regime enacted in 2015 is able to address vulnerabilities identified above.

7.14 Taking into account the threats and vulnerabilities described above, the ML risk for SVF sector is assessed to be medium. At the time of writing, the new regime has only recently commenced full operation and there is a shortage of operating data from the SVF sector and experience in regulation. This assessment is therefore regarded as preliminary and will be kept under review in light of developments and increasing regulatory experience.

## Virtual Currencies

7.15 As in most jurisdictions, there is no specific regulation over VCs, such as Bitcoin, which are regarded as virtual commodities but not as a legal tender in Hong Kong. Transactions with VCs are in essence bilateral contractual arrangements between service vendors and users for bartering specific goods or services. Some VCs are highly speculative and prices may fluctuate widely due to speculation. They may not be backed by any physical item, issuers or the real economy and investors or consumers may suffer significant monetary losses as a result of the volatile prices.

7.16 Under the AMLO, any person who operates a money service business (i.e. money changing and remittance transactions) is required to obtain an MSO licence from the Commissioner of Customs and Excise. This requirement applies to VC operators if they are also involved in the money service business. Under the PSSVFO, the HKMA is empowered to declare something to be a medium of exchange and bring it into regulation if it can be used as an SVF. Digital tokens that are offered or sold may fall under the regulatory ambit of the SFC if they meet the statutory definition of "securities" under the SFO. Various pieces of legislation provide sanctions against ML, TF, fraud, cybercrimes and offer client assets protection in general, whether or not VCs are involved.

## Threats and vulnerabilities

7.17 Hong Kong is one of the world's freest economies with a vibrant foreign currency exchange market and no capital controls. VCs are therefore not as attractive as in economies where people may try to circumvent currency controls or seek refuge from a high inflation rate.

7.18 VCs are not legal tenders and not accepted for payment in Hong Kong. The exchange of Bitcoin in person is not popular. The market for VCs, in particular for Bitcoin, has undergone notable fluctuations triggered by speculation, as well as the introduction of regulatory framework over Bitcoin in Japan. Domestically, the use of Bitcoin remains at a negligible level.

7.19 The HKPF monitoring indicates no apparent sign of organised crime or ML/TF concerning trading of VCs, but VCs have been used as a pretext in a Ponzi scheme<sup>193</sup> or as payments in cybercrimes. Between 2013 and 2017, there were 167 Bitcoin-related reports to the HKPF. Most of the reports involved blackmail using ransomware (such as the recent “WannaCry” attack), and the figure is comparatively low compared with that in other jurisdictions. Investigations and intelligence do not suggest VCs were used or intended to be used in other prevalent predicate offences (e.g. drugs, dutiable goods smuggling) or TF. The threat level is low.

7.20 The anonymous and decentralised nature of some VCs poses potential ML/TF risks. At present, there are seven automated teller machines in five locations in Hong Kong for buying Bitcoin electronically<sup>194</sup>. The identity of the buyer or seller is unrecorded or non-traceable. There are also four known online Bitcoin exchange platforms allegedly based in Hong Kong. They are not popularly used by people in Hong Kong. The HKPF and the C&ED monitor closely these operations as part of their AML/CFT and crime prevention work.

7.21 To raise public awareness of the inherent risk of VCs, the Government and the financial regulators have issued warnings of consumer, ML/TF and cybercrime risks associated with VCs. The financial regulators and the C&ED have issued circulars to remind regulated institutions of the risks associated with potential or existing customers that may use their services for activities relating to VCs, and that regulated institutions should ensure vigilance when considering whether to establish or maintain relationships with operators of schemes related to VCs.

7.22 The current legal and regulatory provisions relating to ML, TF, fraud and other crimes are wide enough to catch offences involving the use of any general property, including VCs. As regards prevention of ML/TF, all natural and legal persons have statutory obligations to file STRs in relation to any property.

7.23 Although there is inherent ML/TF vulnerability related to VCs, there does not seem to be any visible impact affecting the overall risk in Hong Kong so far. The risk of VCs is assessed as medium-low.

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193 In 2015, the HKPF investigated a case of investment fraud using Bitcoin as a pretext. About 192 victims claimed to have invested in Bitcoin mining and lost HK\$285 million. Actual Bitcoin transfers or purchases were minimal and monies were lost through bank transfers and cash to the fraudsters.

194 After inserting bank notes, confirming the exchange rate, and showing the automated teller machine scanner the QR code of the user's Bitcoin address, the new Bitcoin balance will be shown in the user's Bitcoin wallet.

## Next Steps

7.24 Hong Kong will continue to review the ML/TF risk of SVFs and VCs. The risk assessment for SVFs will be reviewed in the light of regulatory experience and operational data for the sector as it becomes available. The Government and financial regulators will monitor further developments, including the usage of VCs in Hong Kong, the evolving international regulatory consensus, and regulatory and enforcement actions in comparable jurisdictions. A landscaping exercise will be conducted to assess ML/TF risk and recommend action if necessary to ensure public protection and prevention of crime.

# CHAPTER 8

## LEGAL PERSONS AND ARRANGEMENTS

8.1 Corporate vehicles can be misused for illicit purposes. The FATF Recommendations 24 and 25 deal with the transparency of legal persons (such as companies) and arrangements (such as trusts). The FATF also requires members to understand the associated risks of such entities under their jurisdiction.

8.2 As discussed in Chapter 4, typologies suggest that shell companies, either in Hong Kong or offshore, are a common conduit for ML. The misuse of corporate bank accounts features in cases of online fraud, email/telephone scams and investment fraud. International drug cartels use local bank accounts opened by stooges and shell companies to dissipate drug proceeds. Local bank accounts and offshore companies as well as corporate vehicles, trusts, and non-profit entities are used to hide proceeds of corruption. Complex corporate structures and trusts are used to conceal ownership and control of proceeds of foreign tax evasion. 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 is known for efficient company-formation procedures and 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. There is less available data on the misuse of trusts in Hong Kong compared to the misuse of companies, although the risk of abuse of foreign trusts through linked complex structures cannot be discounted. In addition, recent international incidents such as the Panama Papers have highlighted the possible abuse of corporate structures and legal arrangements at the international level. This Chapter therefore examines the position of companies and other entities and trusts in Hong Kong and their transparency in the context of ML.

### Legal Persons and Other Entities

8.3 A major update to the CO came into operation on 3 March 2014. Since then, an average of 150,000 companies have been newly incorporated each year. In December 2017, over 1.38 million companies were registered with the CR. There were also 10,434 registered non-Hong Kong companies.

#### Business registration

8.4 Unless exempted under the Business Registration Ordinance<sup>195</sup>, every person carrying on business in Hong Kong must apply for business registration within one month of commencing business. A company is deemed to have simultaneously applied for business registration at the time of an incorporation submission, or in the case of a non-Hong Kong company, a company registration application, is made at the CR. Other types of entities, including sole proprietorships, partnerships and unincorporated bodies of persons, foreign companies (other

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<sup>195</sup> Chapter 310 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap310>.

than a non-Hong Kong company) and branch businesses, are required to be registered at the Business Registration Office under the IRD for carrying on a business<sup>196</sup> in Hong Kong.

8.5 As at end-2017, there were 1,527,285 business registrations. The difference between this and the number of registered companies is mainly attributable to firms (mostly sole proprietorships and partnerships, such as law and accounting firms<sup>197</sup>) which operate with a business registration certificate without registering as a company under the CO<sup>198</sup>.

## Legal Arrangements

8.6 The law of trusts in Hong Kong is based on and derived from the English law of trusts<sup>199</sup>. The common law concept of trust is in use in Hong Kong. A trust may be defined as “the relationship which arises whenever a person (called the trustee) is compelled in equity to hold property, whether real or personal, and whether by legal or equitable title, for the benefit of some persons (of whom he may be one and who are termed beneficiaries) or for some object permitted by law, in such a way that the real benefit of the property accrues, not to the trustees, but to the beneficiaries or other objects of the trust”<sup>200</sup>. The common law rule is that a trustee must execute the trust with reasonable diligence, and conduct its affairs in the same manner as an ordinary prudent man of business would conduct his own affairs. A higher standard of care applies to a trust corporation or similar body which carries on a specialised business of trust management<sup>201</sup>.

8.7 The principal legislation relating to trusts in Hong Kong is the TO. It governs, *inter alia*, the powers and duties of trustees. The TO has been amended with effect from 1 December 2013 to introduce a statutory duty in relation to certain functions a trustee carries out, including investment, delegation, appointing nominees and custodians, taking out insurance and powers in relation to accepting property, valuations and audit<sup>202</sup>. Where the statutory duty applies, the trustee must exercise the care and skill that is reasonable in the circumstances, having regard to (a) any special knowledge or experience that the trustee has or holds out as having; and (b) if the trustee is acting in that capacity in the course of a business or profession, any special knowledge or experience that is reasonably expected of a person acting in the course of that kind of business or profession<sup>203</sup>. The duty of care imposed on trustees under the general law continues to govern the administration of trusts where the statutory duty of care does not apply.

8.8 Trusts can be used for both private (e.g. personal inheritance) and commercial purposes (e.g. fund management). Any company incorporated in Hong Kong (which is not a private company) may apply to the Registrar of Companies to be registered as a trust company under

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196 Business includes any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain; any club which provides facilities, services and exclusive club premises to its members for social intercourse or recreation; and every non-Hong Kong company that has a representative or liaison office in Hong Kong, or has let out its property situated in Hong Kong, regardless of whether it has established a place of business in Hong Kong.

197 Law firms and accounting firms may be required to first obtain the relevant professional practicing certificates before commencement of business.

198 Sole proprietorships and partnerships are not separate legal persons from proprietors or partners. For a sole proprietorship, the business is owned and operated by a person who is entitled to all the profits but also solely and personally responsible for all liabilities. Partnerships are businesses established and co-owned by two or more persons (who may be individuals or corporations). General partnerships make every partner personally liable for the debts and liabilities of the business, as well as the actions of another partner conducted in the course of the partnership business. Limited partnerships constitute both general and limited partners. A general partner has unlimited liability for the firm's debts and is responsible for day-to-day running of the business, while limited partners' liability is limited to the amount of their contribution. Limited partners cannot participate in the management of the partnership.

199 Halsbury's Laws of Hong Kong, [400.001].

200 Law of Trusts (12th edn), p3; quoted in Lewin on Trusts (19th edn), 1-003.

201 Halsbury's Laws of Hong Kong, [400.332].

202 Schedule 3 to the TO.

203 Section 3A of the TO.

the TO, subject to certain requirements (including restriction of the company's objects to trust businesses and its issued share capital being not less than HK\$3 million). Registration by a trust company under the TO is voluntary. Although there is no registration requirement for express trusts<sup>204</sup>, the common law principle requires trustees of any express trust to discharge a number of duties in the administration of the trust. Such duties include acquaintance with the terms of the trust and its affairs, conforming to and carrying out the terms of the trust, taking possession and preserving trust property, keeping an accurate account of the trust property and rendering the account when required<sup>205</sup>.

8.9 There is little in the way of typologies or data to suggest domestic trusts are being abused for ML/TF purposes in Hong Kong. The risks posed by foreign trusts are, however, more significant particularly when they form part of complex multi-jurisdictional structures with links to or through Hong Kong. Complex corporate and trust-related structures are frequently used to evade tax, but they can also be used to launder illicit funds. Such foreign trust structures thus pose medium to medium-high ML risks to the financial sector and DNFBPs in Hong Kong. The risk of trusts being misused for TF purposes is assessed as low.

## Company Formation and Legal Requirements

### Company formation

8.10 The CR is primarily responsible for the administration of the CO. The major roles of the CR include incorporating and registering new companies, registering documents filed by companies, providing public search services, and enforcing the CO. An application for company incorporation will only be approved if all the statutory requirements under the CO are complied with. The CR may reject an application for incorporation if, for example, the proposed company is not formed for a lawful purpose. The incorporation form contains a statement of compliance and the founder member who signs the form is accountable for the accuracy of the information reported therein.

### Bearer shares and directors

8.11 Bearer shares are unregistered shares wholly owned by whoever holds the physical stock certificate. The issuing company neither registers the owner nor tracks transfers of ownership. The company pays dividends when a physical share warrant is presented. Transferring ownership involves only delivering the physical document. Such shares are anonymous and easily transferrable which presents a threat of misuse for ML and TF.

8.12 The new CO, which commenced operation in 2014, removed the power of companies to issue share warrants to bearer<sup>206</sup>. The bearer of a share warrant issued before the commencement date is entitled to surrender it for cancellation, and to have the bearer's name entered in the register of members of the company.

8.13 To enhance transparency and accountability, it has also been a requirement since 2014 for private companies to have at least one director who is a natural person. This has had a significant impact on companies formerly established with corporate directors, with 110,994

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204 An express trust is usually formalised by an agreement or deed.

205 Halsbury's Laws of Hong Kong [400.326] to [400.328] and [400.340] to [400.432] and Equity and Trust Law in Hong Kong, Lawrence Yan-Kwok Ma, LexisNexis, 2006, [19-30] to [19-56], in particular, [19-35] and [19-50].

206 Section 139 of the CO.

applications for deregistration of defunct companies (which could be shell companies) received between October 2014 and December 2016. In 2017, around 60,000 further applications were received.

### Transparency and beneficial ownership information

8.14 All companies are required by the CO to keep registers of directors, members and company secretaries. Other than listed companies, which are required to disclose beneficial ownership information under the SFO, companies incorporated in Hong Kong were not required to record such information before March 2018. Under the Companies (Amendment) Ordinance 2018, which commenced operation on 1 March 2018, companies incorporated in Hong Kong<sup>207</sup> are required to maintain beneficial ownership information by way of keeping a significant controllers register (“SCR”). Significant controllers include registrable persons and registrable legal entities exercising significant control over the company. A registrable person is a natural person or specified entity that ultimately has significant control over the company and a registrable legal entity is a legal entity (whether or not incorporated in Hong Kong) which has significant control over the company and is a member of the company. Specified conditions to determine significant control over the company comprise any of the following: (i) directly or indirectly holding more than 25% of the issued shares of the company; (ii) directly or indirectly holding more than 25% of the voting rights of the company; (iii) directly or indirectly holding the right to appoint or remove a majority of the board of directors of the company; (iv) having the right to exercise or actually exercising significant influence or control over the company; (v) having the right to exercise or actually exercising significant influence or control over the activities of trust or a firm that is not a legal person, but whose trustees or members meet any of the foregoing conditions in relation to the company. A company must maintain the SCR at the company’s registered office or a prescribed place in Hong Kong, keep the information up-to-date and make it available to a law enforcement officer for inspection and copying.

8.15 Basic ownership information of companies can be accessed by any person through the CR’s electronic search services. Information submitted to the CR is subject to a system validation and some manual verification before registration. Such records can be readily accessed by FIs performing CDD, making legal persons and arrangements sufficiently transparent.

8.16 Although the CR does not keep beneficial ownership information of companies, this information can now be accessed by law enforcement officers including the CR through the SCR. The SCR must also contain the name and contact details of a person designated by the company as its representative to provide assistance to the law enforcement officer. The designated person must be a member, director or employee of the company who is a natural person resident in Hong Kong; an accounting professional; a legal professional; or a licensed TCSP. Law enforcement officers also have powers under relevant Ordinances to obtain beneficial ownership information from FIs, which are required to keep such information under the AMLO.

### Information verification and enforcement

8.17 Sometimes, the subjects of ML investigation have been found to be shell companies with no actual business in Hong Kong. Although the director or shareholder who controls a shell

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<sup>207</sup> Listed companies are exempt and remain subject to the more stringent disclosure requirements under the SFO.

company is normally a non-resident, the OSCO and the DTROP empower LEAs to seek restraint and confiscation of the proceeds of the shell company in Hong Kong pursuant to absconder proceedings.

8.18 Although the CR is not required to verify the contents of documents under the CO, the CR adopts an RBA in conducting checks of applications for company incorporation delivered by company service providers to ensure that accurate information on identities of individuals is provided. In these cases, certificates of incorporation will only be issued after the identity documents and any other documentary evidence are checked.

8.19 The CR has set up an Inspection Unit to carry out on-site inspections at registered offices of companies, including secretarial firms/company service providers, to check the correct location of companies and the existence of relevant companies, ensure compliance with the requirements for publication of company names and the keeping of proper registers. In 2016 and 2017, the Inspection Unit conducted 5,563 on-site inspections and 101 summonses were issued for failure to comply with the statutory requirements.

8.20 To ensure that information in the Companies Register is accurate, up-to-date and reliable, the CR has a well-established mechanism to strike off companies that are not in operation. In 2017, 64,128 companies were struck off.

8.21 To ensure availability and transparency of information, the CR has identified cases of non-compliance with filing obligations, such as annual returns, for enforcement action. There is a system programme for issuing compliance notices to companies for delivery of annual returns. Companies that do not comply face prosecution and/or being struck off. In 2016 and 2017, 2,169 and 2,304 summonses for failure to deliver annual returns or accounts were issued respectively.

8.22 To facilitate public scrutiny of information on the Companies Register, an e-Monitor Service was introduced in December 2011. Subscribers receive instant electronic notification when a document is registered in the public records of a specified company. On 31 December 2017 there were 73,363 subscribers.

8.23 As a financial centre with efficient company formation and banking sectors, Hong Kong remains an attractive location for local and foreign criminal elements to abuse corporate entities in order to disguise the flow of illicit proceeds and beneficial ownership and control. Typologies and data confirm that the risk of companies being abused for ML purposes in Hong Kong is high. Recent steps taken to regulate TCSPs and to introduce an SCR for companies incorporated in Hong Kong should help mitigate the risk, combined with enhanced law enforcement powers and efforts. The risk of companies being abused for TF is assessed as low.

## Next Steps

8.24 Hong Kong has recognised the need to improve the transparency of beneficial ownership of Hong Kong companies in line with the FATF standards. The Companies (Amendment) Ordinance 2018 has introduced a statutory regime requiring all companies incorporated under the CO to keep an SCR, which will be available for inspection by LEAs. The provisions came into effect on 1 March 2018 and the authorities will monitor the new statutory requirements to assess their effectiveness in mitigating risk for Hong Kong's AML/CFT regime.

8.25 The CR will continue its efforts to ensure the integrity of the Companies Register through vigorous checks on reported information before registration of documents, on-site inspections to check compliance with statutory requirements, and enforcement including prosecution and striking off where appropriate. To ensure the integrity of the SCR, the CR will also conduct regular inspection to the companies under registration especially those with high risk. In response to recent reports about the DPRK allegedly using front companies based in Hong Kong to evade sanctions imposed by the UNSC, the CR will conduct a thematic inspection of companies and connecting parties that are at higher risks of being abused for involvement in prohibited activities. Follow-up actions will be taken where regulatory breaches are found.

8.26 Besides, under the AML/CFT Guideline which underpins the AMLO, FIs are required, for customers other than natural persons, to ensure that they fully understand the customer's legal form, structure and beneficial ownership, and to obtain information on the nature of its business and the reasons for seeking the product or service, unless the reasons are obvious. Such measures will lessen the incentive of abusing corporate vehicles for ML/TF purpose.

8.27 In view of the key role played by TCSPs in the company/trust formation regime in Hong Kong, a statutory regime for regulating TCSPs has been newly introduced. Under the AML(A)O which came into force on 1 March 2018, anyone aspiring to carry on TCSP business in Hong Kong has to apply for a licence from the Registrar of Companies, subject to the meeting of a fit-and-proper test (with AML/CFT record being one determinant). The fit-and-proper test applies to applicants as well as their beneficial owners where applicable. It is a criminal offence to conduct unlicensed TCSP business in Hong Kong, liable to imprisonment of six months and a fine of HK\$100,000. Meanwhile, TCSPs must observe statutory CDD and record-keeping requirements when they engage in specified transactions, including forming corporations or other legal persons; acting, or arranging for another person to act as a trustee of a legal arrangement or a nominee of a corporation, or as a director, secretary, partner or similar position of a legal person; and providing a registered office, business address, correspondence or administrative address for a legal person or legal arrangement.

8.28 The CR has set up a dedicated TCSP Registry to oversee the licensing regime, ensuring that only fit-and-proper persons are allowed to conduct TCSP business in Hong Kong. A TCSP Register containing up-to-date information of licensees will be published for public access. As the statutory regulator for TCSPs, the Registrar of Companies will oversee the compliance of licensees with the statutory CDD and record-keeping requirements and impose effective and dissuasive sanctions (including public reprimand, remedial order, fine, and suspension or revocation of licence) where regulatory breaches are found. The CR has issued AML/CFT guidelines to facilitate compliance, launched capacity-building efforts to raise awareness of the new statutory requirements, and conducts regular site inspections to check compliance.

8.29 The introduction of the corporate beneficial ownership regime and the TCSP licensing regime will go a long way towards mitigating the risk of companies or trusts being abused for ML/TF purposes. The Government will keep a close watch on the implementation of the two regimes to assess their effectiveness and any need for further refinement.

# CHAPTER 9

## TERRORIST FINANCING

9.1 This Chapter discusses the overall TF risk in Hong Kong. The assessment has taken into account all relevant considerations, including the extent of terrorism threat in Hong Kong, the risk of the place being abused for TF activities, and the strength of CFT work in Hong Kong.

### Terrorism Threat

9.2 The HKSAR Government is committed to combating terrorism and ensuring the city a safe place for all. It adopts a counter-terrorism policy that focuses on prevention and maintains comprehensive contingency plans for response to terrorist incidents. Counter-terrorism is an operational priority of the HKPF, with emphasis being placed on prevention, preparedness, response and recovery.

9.3 As noted in Chapter 1, Hong Kong has a population of over 7.4 million, of whom over 90% are ethnic Chinese. Non-Chinese ethnic groups constitute around 8% of the population, over half of which are FDHs from the Philippines or Indonesia. There are many other ethnic minority groups, including communities from various parts of the world. The world's major religions are all practised in Hong Kong, with no particular religion dominating. Given this diversity, some in the community may have links to areas where there is a higher threat of terrorism. Hong Kong is also geographically not too distant from certain areas in Asia where terrorist incidents are frequent<sup>208</sup>.

9.4 Hong Kong is a leading international financial and trade centre. Given its location and the fact that it is an international transport hub with visa-free entry for around 160 countries, Hong Kong is within easy reach of visitors from all around the world. In 2017, over 14 million foreign visitors<sup>209</sup> were recorded. These strengths attract visitors as well as overseas firms to set up operation in Hong Kong.

9.5 Recent years have seen the emergence of groups such as ISIL and Al-Qaeda which have perpetrated terrorist attacks in conflict zones as well as advanced economies, through home-grown terrorists or foreign terrorist fighters<sup>210</sup> operating alone or in small cells. Hong Kong borders the Guangdong province of Mainland China, which may face terrorist threats<sup>211</sup> from the East Turkestan Islamic Movement and other extremists. By virtue of its demographic, geographic and economic position, no one can guarantee that Hong Kong is immune from terrorist activities. However, there have been no terrorist attacks in Hong Kong or known activities of domestic or foreign-based terrorist groups. There has also been no specific intelligence or information to suggest that Hong Kong is likely to be a target of terrorist attacks. There is no intelligence indicating signs of self-radicalisation. The Government assesses that the

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208 According to the Global Terrorism Index (GTI) 2016 by the Institute for Economics and Peace, among the top 20 countries having the highest impact of terrorism (which is a function of such factors as the number of terrorist incidents, the fatalities and injuries, and the property damage), five are in Asia (except the Middle East): Afghanistan, Pakistan, India, the Philippines and Thailand.

209 Excluding visitors from Mainland China.

210 UNSCR 2178 defines foreign terrorist fighters as "individuals who travel to a State other than their State of residence or nationality for the purpose of the perpetration, planning or preparation of, or participation in, terrorist acts or the providing or receiving of terrorist training, including in connection with armed conflict".

211 China ranked 23 out of 163 countries in GTI 2016, Institute for Economics and Peace.

overall level of terrorism threat in Hong Kong is “moderate”<sup>212</sup> (meaning that there is a possibility of terrorist attack, but there is no intelligence suggesting that Hong Kong is likely to become a target).

## TF Threat

9.6 The prevalence of terrorism worldwide has propelled the international community to make the fight against TF a priority. The FATF has identified that terrorist groups or organisations use funds for five broad purposes:

- (a) Operations;
- (b) Propaganda and recruitment;
- (c) Training;
- (d) Salaries and member compensation; and
- (e) Social services.

9.7 According to the FATF, traditional TF methods and techniques – abuse of donations and NPOs, funding from criminal or legitimate activities, physical transportation of cash, the use of bank accounts and MSOs – are still prevalent. In addition, the financing of foreign terrorist fighters has become a prominent issue, and social media platforms and new payment products and services have been exploited for TF<sup>213</sup>. A recent assessment on Australia, Indonesia, Malaysia, the Philippines, Singapore and Thailand<sup>214</sup> found that terrorist funds in the region are more likely to be used for operational than organisational expenditure. Self-funding through legitimate sources for TF (particularly for foreign terrorist fighters travelling to or operating in conflict zones), raising funds through NPOs and cash smuggling to move funds are areas prone to high TF risks.

## TF in Hong Kong

9.8 Given the “moderate” level of terrorism threat in Hong Kong, the threat of financing domestic terrorism is low. The threat of financing terrorism abroad (including for foreign terrorist fighters) may be greater, given Hong Kong’s advanced and open financial system, as well as the cultural and economic connectedness between certain segments of the community and regions affected by terrorism. TF-related STRs and investigations are mainly concerned with the use of corporate bank accounts in suspicious movement of funds. STRs and investigations as well as TF-related MLA requests have not led to confirmation of any TF activity in Hong Kong, or discovery of high-risk patterns such as self-funding from legitimate sources, abuse of NPOs, or physical movement of cash across boundaries in Hong Kong. There have not been any cases that require the invoking of the freezing power or the TF offences provisions under the UNATMO. Nevertheless, as an international financial centre, Hong Kong must guard against possible TF by persons locally or from abroad.

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212 When assessing the terrorist threat, a wide range of factors, including international/regional/local situations, ideologies and motives of international terrorism, the trend of terrorist activities, recent incidents, the source of such threats as well as intentions and capabilities of terrorists, have been taken into account for assessing authenticity and degree of terrorist threat to the city and determining the overall threat level of Hong Kong.

213 FATF’s Report *Emerging Terrorist Financing Risks*, published in October 2015.

214 Terrorist Financing Regional Risk Assessment 2016 – South-East Asia and Australia.

9.9 As regards the use of technology for TF purposes, available information does not indicate that social media platforms, VCs, online payment systems, prepaid cards, crowdfunding or other new payment methods in Hong Kong have been exploited. But as these platforms and products are evolving very fast, it is important to keep a close watch on their potential to be misused for TF.

### TF-related STRs, investigations and MLA requests

9.10 TF-related STRs are filed to the JFIU as a mandatory requirement under the UNATMO. Between 2012 and 2016, there were 59 TF-related STRs. These mainly involved false-positive name or alias hits of known terrorists or terrorist associates<sup>215</sup>, or financial transactions related to entities in high-risk jurisdictions. From time to time, the JFIU received intelligence from FIUs of other jurisdictions on fund transfers to Hong Kong by persons suspected to be linked to TF. All TF-related STRs and other information were disseminated to the designated units for immediate investigation as a matter of priority. The JFIU's manpower will be further strengthened to combat TF starting from 2018.

9.11 Investigation of suspected TF cases, including those arising from STRs, revealed that most were primarily related to fund transfers from overseas companies through banks or MSOs to company accounts in Hong Kong for settlement of invoices or logistics expenses. However, after thorough investigation, there was insufficient evidence to link the funds with any terrorist groups, terrorists or terrorist acts or to confirm any TF activity in Hong Kong.

9.12 Hong Kong received two MLA requests relating to TF between 2013 and 2017, both for obtaining movement records, chat records and records of Internet Protocol addresses. The HKPF assisted with these requests including conducting preliminary background enquiries, and did not find actual TF taking place in Hong Kong.

### Overall TF threat level

9.13 The TF threat of Hong Kong is assessed as medium-low. There is no confirmed case of TF activity in Hong Kong. The very small number of MLA or other information requests bears out this understanding. But in view of the moderate terrorism threat, the global and regional TF landscape, and the nature of Hong Kong being an international financial and logistics hub, the threat of TF taking place in or through Hong Kong cannot be completely ruled out and must be constantly monitored with vigilance.

## TF Vulnerability

### Implementation of UNSC sanctions in Hong Kong

9.14 The UNATMO and the UNSO are the two main pieces of legislation implementing counter-terrorism and sanction measures imposed by the UNSC respectively. The UNATMO implements, *inter alia*, a decision of the UNSCR 1373 requiring states to freeze the assets of terrorists and prohibit their nationals and persons within their jurisdiction from making funds, resources or financial services available to them. The UNSO implements targeted financial sanctions and other sanction measures against places designated by the UNSC, including Afghanistan, Iran and DPRK, through the making of place-specific regulations.

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<sup>215</sup> Such as entities designated in the UN terrorist list or sanction list of the UN or similar lists maintained by other bodies/countries such as the US Office of Foreign Assets Control and the European Union.

9.15 Certain gaps existed in the UNATMO vis-à-vis the FATF standards. The FATF's Recommendation 6 requires jurisdictions to freeze without delay the funds or other assets of a person or entity designated as a terrorist or terrorist associate. In a follow-up report on the 3<sup>rd</sup> Mutual Evaluation of Hong Kong in 2012, the FATF observed that section 6 of the UNATMO was insufficient, in that it only operates against property specified in the freezing notice, and the freezing process involves several procedural steps which would lead to delays. Another gap emerged in 2015 when the FATF expanded the ambit of its Recommendation 5 to mirror UNSCR 2178, by extending the criminalisation of terrorist financing to include financing the travel of foreign terrorist fighters.

9.16 Having regard to UNSCR 2178 which affirms the need to combat threats by foreign terrorist fighters and the FATF's recommendation to enhance the freezing mechanism of terrorist property, the Government introduced the United Nations (Anti-Terrorism Measures) (Amendment) Bill 2017 into LegCo in June 2017. The Bill was passed by LegCo in March 2018, and the amended Ordinance will come into operation on 31 May 2018 to prohibit –

- (a) Any Hong Kong permanent resident from leaving, or going on board a conveyance with the intent to leave, Hong Kong, or a place outside Hong Kong, for a foreign state for the purpose of the perpetration, planning or preparation of, or participation in, terrorist acts, or the provision or receiving of terrorist training;
- (b) Any person from providing or collecting, directly or indirectly, property, with the intention or knowing that the property will be used, in whole or in part, to finance the travel of individuals between states for the purpose of the perpetration, planning or preparation of, or participation in, terrorist acts, or the provision or receiving of terrorist training (whether or not the property is actually so used);
- (c) Any person from organizing or facilitating, directly or indirectly, the travel of individuals between states with the intention or knowing that the travel is for the purpose of the perpetration, planning or preparation of, or participation in, terrorist acts, or the provision or receiving of terrorist training; and
- (d) Any person, except under the authority of a licence granted by the Secretary for Security, from directly or indirectly dealing with any property, knowing that, or being reckless as to whether the property is -
  - (i) terrorist property specified under section 4 or 5 of UNATMO;
  - (ii) wholly or jointly owned or controlled, directly or indirectly, by a terrorist or terrorist associate specified under section 4 or 5 of UNATMO; or
  - (iii) held by a person on behalf of, or at the direction of, a terrorist or terrorist associate specified under section 4 or 5 of UNATMO.

9.17 As regards the UNSO, it provides an enabling structure for implementation of UNSC sanctions against places through the making of regulations. Currently, the regulations made under the UNSO cover 15 places, including the DPRK, which are subject to sanctions or restrictions imposed by the UNSC. A major challenge for the UNSO lies in translating the often succinct UNSC resolutions into implementable local laws, and more recently in catching up with the sanction regime maintained by the UNSC against the DPRK. Since 2016, the UNSC has adopted a number of resolutions imposing tightened sanctions against the DPRK. Among them, five resolutions are pending formal adaptation into local law, covering sanctions which are unique to the DPRK and hence the drafting of such measures for local legislation has become extremely complex. The CEDB is working closely with the DoJ with a view to enacting the related legislation in a few months' time.

9.18 The legislative framework is backed by close collaboration among LEAs in investigation and intelligence sharing and analysis, and cooperation with external counterparts. The HKPF and the DoJ maintain close liaison with counterparts in other jurisdictions and provide assistance in intelligence, investigation and legal matters. As yet, Hong Kong has not received any request from other jurisdictions to freeze terrorist property but the mechanism for doing so is well established. The HKPF has designated channels for exchange of information with counterparts in other jurisdictions on TF.

9.19 With the increased supervisory and capacity-building efforts by the Government, regulatory authorities, self-regulatory bodies and professional groups, the CDD and record-keeping mechanisms of FIs and other sectors have improved significantly in the recent years. The ability of such mechanisms to detect and deter ML applies equally to TF. Awareness of potential TF activities in general has also increased, following recent acts of terrorism elsewhere in the world. The level of awareness of AML/CFT is generally high for the financial sectors regulated under the AMLO. These sectors use multiple sources such as terrorist lists promulgated by the UN and other jurisdictions, specific AML/CFT databases, open sources and ongoing transaction monitoring to identify suspicious transactions. As for DNFBPs, the level of awareness varies depending on the nature of the business or profession, and the size or resources of a firm. To raise awareness among reporting entities, the JFIU includes AML/CFT-related information in the *STR Quarterly Analysis* circulated on an encrypted platform, when appropriate<sup>216</sup>. The JFIU also accords top priority to analysing TF-related STRs and promptly disseminates information to investigation units for action. There is a well-established mechanism among the JFIU, intelligence units and investigation units for sharing information and intelligence. Comments from intelligence and investigation units indicate that the quality of STRs was generally reasonable with sufficient information provided on fund flows and transaction parties, and reporting entities were able to provide supplementary information when required.

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216 A case in point is the circulation of an article called *Detecting Terrorist Financing* published by the FATF in June 2016 which identified risk indicators to help government agencies and selected private sector entities detect and disrupt the financial flows of terrorists and terrorist organisations.

## Vulnerability to international TF trends

9.20 Self-funding from legitimate sources for financing terrorist activities is a growing issue for TF internationally. In Hong Kong, there could be concerns that banks and MSOs are at risk, as foreign workers remit monies to their homelands. The financial regulators continue to monitor compliance by banks and MSOs with the AML/CFT obligations, and to promote awareness of TF among FIs, which already use multiple sources such as terrorist lists issued by the UN and other jurisdictions, specific AML/CFT databases, open sources and transaction monitoring to identify suspicious transactions.

9.21 The risks of NPOs<sup>217</sup> being misused to move funds to terrorist organisations in other jurisdictions have been well recognised by the FATF<sup>218</sup>. There has been no report of NPOs or charities in Hong Kong being misused for TF purposes, or found to sympathise with or condone terrorism, or linked to known or suspected terrorist groups. There has been no intelligence or evidence from STRs, investigation or MLA requests suggesting that NPOs in Hong Kong are being exploited for raising or moving funds for TF. On this basis, there is no apparent TF threat identified for the NPO sector in Hong Kong.

9.22 In Hong Kong, NPOs may exist in various forms including organisations subvented by the Social Welfare Department, companies, trusts, charitable bodies with or without tax-exempt status, statutory bodies<sup>219</sup>, societies registered under the Societies Ordinance<sup>220</sup>, and educational institutes. NPOs are subject to the regulatory and governance requirements under various Ordinances depending on their activities, funding sources, legal structures etc. The regulatory regimes are not mutually exclusive. Where public funding is involved, there is stringent control (e.g. submission of regular reports or audited statements by NPOs to regulators) to ensure transparency and accountability. In relation to those charities whose tax exemption status are recognised, the IRD conducts periodic reviews to ascertain whether they continue to be eligible for tax exemption status under the IRO. The Government has published CFT-specific guidelines for charities<sup>221</sup> and been drawing NPOs' attention to the designated names of terrorists or terrorist associates. LEAs have the powers to obtain information from Government departments concerned if necessary for counter-terrorism or CFT purposes.

9.23 The inherent TF vulnerability of NPOs in Hong Kong is low, having regard to the current regulatory regimes and governance, the landscape of terrorism and TF threats in Hong Kong as well as the inward focus of the majority of NPOs in Hong Kong. With reference to international TF typologies and the local context, organisations operating and raising funds in Hong Kong for the purpose of supporting humanitarian services in conflict zones could be susceptible to TF risk. Nevertheless, these NPOs are commonly part of the international charities network to which the funds raised are disbursed, and have to a large extent put in place internal due diligence controls on their own. Banks are also aware of the potential TF risks associated with

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217 Under the FATF's Recommendation 8, NPO refers to "a legal person or arrangement or organization that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of 'good work'".

218 FATF Report – Emerging Terrorist Financing Risks, October 2015.

219 i.e. bodies established by specific legislation.

220 Chapter 151 of the Laws of Hong Kong. See <https://www.elegislation.gov.hk/hk/cap151>.

221 "Advisory Guideline on Preventing the Misuse of Charities for Terrorist Financing". Available at <http://www.nd.gov.hk/pdf/guideline-e.pdf>.

the NPO sector and monitor closely for funding or transactional patterns which may give rise to higher risks and the need for enhanced monitoring. Updated FATF guidance was circulated to banks in 2015 to assist the proper application of an RBA.

### Overall TF vulnerability

9.24 Hong Kong has a sound legal and institutional framework to counter TF activities which is commensurate with the threat identified. While some gaps from full compliance with the FATF's recommendations still exist, these are being addressed. The overall TF vulnerability is assessed as medium-low.

### TF risk

9.25 Hong Kong has a medium-low TF risk, with threat and vulnerability both rated as medium-low.

### Next Steps

9.26 While Hong Kong faces a relatively low TF risk, the situation must be closely monitored, with current preventive measures kept under constant review. Policy bureaux, financial regulators, professional bodies and associations, the JFIU and LEAs will continue to raise awareness of TF activities and emerging issues.

9.27 The legislative initiatives pursued by the Government over the past year will greatly strengthen the CFT framework and further alleviate the TF risk. The bill to amend the UNATMO was passed by LegCo in March 2018, and the amended Ordinance will come into operation on 31 May 2018. The AML(A)O, which extends statutory CDD and record-keeping requirements to legal professionals, accounting professionals, TCSPs and estate agents; the amended CO, which requires companies to keep beneficial ownership information; and the new R32 Ordinance on the declaration/disclosure regime for the cross-boundary movement of CBNIs will also help strengthen the defences against TF.

9.28 Meanwhile, drafting is in process for the relevant legislation to implement the outstanding UNSC resolutions against the DPRK to be introduced in the coming months. Before the legislative exercise is completed, the Government will continue to implement the sanction measures within the available power. The relevant trades have also been alerted to the sanction measures and advised not to engage in prohibited activities.

9.29 Pending gazettal of the UNSC-designated lists of sanctioned persons/entities and adaptation of UNSC resolutions into local legislation, the Government has instituted a mechanism of issuing early alerts to FIs and DNFBPs about TF/PF-related resolutions adopted by the UNSC as well as new individuals and entities designated by the UNSC or its Sanctions Committees. Under the mechanism, the relevant policy bureaux monitor on every working day the adoption of UNSC resolutions and designation of sanctioned entities or individuals related to TF and PF, which are then disseminated within the same day to FIs and DNFBPs for their immediate attention and necessary action. This enables the implementation of targeted financial sanctions "without delay", in accordance with the FATF recommendation.

9.30 In response to reports about secretarial firms and front companies in Hong Kong allegedly being abused for evading sanctions against the DPRK, additional enhancement measures have been undertaken to guard against the risk of companies being abused for TF or PF purposes. Among other things, the CR has expanded its inspection unit to conduct more site inspections on companies incorporated in Hong Kong. A thematic inspection team has been formed to conduct site inspections on incorporated companies or secretarial firms which have a higher risk of being abused, based on relevant intelligence support and risk analysis. LEAs have taken follow-up actions on companies which are found to be in breach of law, and strike-off actions are taken in appropriate cases. Through outreaching efforts of various forms such as circular letters, seminars and site inspections, TCSPs are alerted to UNSC sanctions against the DPRK and reminded of the new licensing requirements under the AML(A)O which demand a clean AML/CFT record as a prerequisite for the granting of a licence.

9.31 Coupled with ongoing efforts to monitor and mitigate risk of FIs and DNFBPs as discussed in Chapters 5 and 6, the above initiatives will ensure the resilience and responsiveness of the CFT regime in Hong Kong. The Government will continue to monitor closely the terrorism threat and TF risk in Hong Kong, the effectiveness of the various counter-measures, and adjust the counter-terrorism and CFT strategy as appropriate having regard to the changing security landscape and risk factors.

# ANNEX A

## LIST OF ABBREVIATIONS

ADCC	Anti-Deception Coordination Centre
AEOI	Automatic Exchange of Financial Account Information in Tax Matters
AI	Authorised institution – an institution licensed under section 16 of the BO
AML	Anti-money laundering
AMLO	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap 615)
AML(A)O	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018
APG	Asia/Pacific Group on Money Laundering
BEPS	Base erosion and profit shifting
BO	Banking Ordinance (Cap 155)
CBNIs	Currency and bearer negotiable instruments
CCB	Commercial Crime Bureau
CCC	Central Coordinating Committee on AML/CFT
CDD	Customer due diligence
CDTAs	Comprehensive Double Taxation Agreements
CEDB	Commerce and Economic Development Bureau
C&ED	Customs and Excise Department
CFT	Counter-financing of terrorism
CGSE	Chinese Gold and Silver Exchange Society
CO	Companies Ordinance (Cap 622)
CPA	Certified public accountant
CR	Companies Registry

DNFBPs	Designated non-financial businesses or professions
DoJ	Department of Justice
DPMS	Dealers in precious metals and stones
DPRK	Democratic People's Republic of Korea
DTROP	Drug Trafficking (Recovery of Proceeds) Ordinance (Cap 405)
EAA	Estate Agents Authority
EAO	Estate Agents Ordinance (Cap 511)
FATF	Financial Action Task Force
FDHs	Foreign domestic helpers
FIs	Financial institutions
FIUs	Financial Intelligence Units
FMLIT	Fraud and Money Laundering Intelligence Taskforce
FOO	Fugitive Offenders Ordinance (Cap 503)
FSTB	Financial Services and the Treasury Bureau
GDP	Gross domestic product
HKICPA	Hong Kong Institute of Certified Public Accountants
HKICS	Hong Kong Institute of Chartered Secretaries
HKMA	Hong Kong Monetary Authority
HKPF	Hong Kong Police Force
HKSAR	Hong Kong Special Administrative Region
HKTA	Hong Kong Trustees Association
IA	Insurance Authority

ICAC	Independent Commission Against Corruption
IEO	Import and Export Ordinance (Cap 60)
ILAS	Investment-linked assurance scheme
INTERPOL	International Criminal Police Organisation
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance (Cap 112)
JFIU	Joint Financial Intelligence Unit
LC	Licensed corporation – a company licensed to conduct regulated activities under section 116 of the SFO
LEAs	Law enforcement agencies
LegCo	Legislative Council
LPO	Legal Practitioners Ordinance (Cap 159)
LSHK	Law Society of Hong Kong
MCV	Mainland China visitors
ML	Money laundering
MLA	Mutual legal assistance
MLAO	Mutual Legal Assistance in Criminal Matters Ordinance (Cap 525)
MLO	Money Lenders Ordinance (Cap 163)
MOU	Memorandum of Understanding
MSOs	Money service operators
MSSB	Money Service Supervision Bureau
NPOs	Non-profit organisations
OECD	Organisation for Economic Co-operation and Development

OSCO	Organized and Serious Crimes Ordinance (Cap 455)
PRC	People's Republic of China
PSSVFO	Payment Systems and Stored Value Facilities Ordinance (Cap 584)
PAO	Professional Accountants Ordinance (Cap 50)
R32 Ordinance	Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance (Cap 629)
RBA	Risk-based approach
RI	Registered institution – a bank registered to conduct regulated activities under section 119 of the SFO
RMB	Renminbi
SB	Security Bureau
SCR	Significant controllers register
SMEs	Small-and-medium-sized enterprises
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance (Cap 571)
STRs	Suspicious transaction reports
SVFs	Stored value facilities
TBML	Trade-based money laundering
TCSPs	Trust or company service providers
TO	Trustee Ordinance (Cap 29)
TF	Terrorist financing
TID	Trade and Industry Department
UNATMO	United Nations (Anti-Terrorism Measures) Ordinance (Cap 575)

UNSC	United Nations Security Council
UNSCR	United Nations Security Council Resolution
UNSO	United Nations Sanctions Ordinance (Cap 537)
VC	Virtual currencies
WMD	Weapons of mass destruction



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