

Gazettal of the Hong Kong Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022 (“AML(A)O”)

[Reading time: 11 minutes]

On 1 April 2023, the AML(A)O shall come into force, leading to new requirements for certain businesses in Hong Kong, and potential updates to policies and procedures for many others.

Due to the complexity of some of the legislation and the potential difficulties for companies either to apply them or to wind up their affairs, some aspects will be come into effect from 1 June 2023. Transitional period legislation means that certain offences under the law could be excluded until 1 June 2024.

Among the changes are:

- Changing the definition of a politically exposed person (“PEP”) and allowing more flexibility when classifying PEPs who are no longer in a public position
- Updating the definition of the beneficial owner of a trust
- Allowing for digital identity technology to be used for domestic onboarding purposes
- Increasing the fine for operating an unlicensed money service operation
- Licensing requirements for virtual asset service providers (“VASP”)
- Licensing options for dealers in precious metals and stones (“DPMS”)
- Enhancing confidentiality legislation in line with anti-doxxing initiatives

Background

In September 2019, the Financial Action Task Force (“FATF”) released the 4th Round Mutual Evaluation Report on the findings of the 2018 on-site visit to Hong Kong SAR. Whilst the findings were generally very positive, some areas for improvement were highlighted, specifically in the anti-money laundering and countering the financing of terrorism (“AML/CFT”) regimes of DPMS and the classification of PEPs.

The period between the onsite inspection and release of the report coincided with increased interest and activity in the cryptocurrency sector, albeit before the acceleration of speculation and demand in the latter half 2020 and beginning of 2021. This caused FATF to issue general guidance to all Members and Associate Members of the need for jurisdictions to subject VASPs to the same range of AML/CFT obligations applicable to financial institutions and designated non-financial businesses and professions such as law firms, accountancy practices, and trust and company service providers.

As a consequence of both the FATF report and the rise of VASPs, the Financial Services and the Treasury Bureau of Hong Kong began a consultation process in respect of changes to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”) (aka Cap.615), the results of which were released in May 2021. The Legislative Council then began the process of drafting an Amendment to the AMLO, with the initial brief being gazetted in June 2022 and finally passing in December 2022.

What has changed?

PEPs

Prior to the amendment bill, a foreign PEP was defined by the AMLO as “*an individual who is or has been entrusted with a prominent public function in a place outside the People’s Republic of China [...]*” This extended to close relatives such as spouses, parents, and children, and to close associates.

The FATF report highlighted that this was inconsistent with worldwide practice and recommended that the scope of what is considered a domestic PEP be narrowed to one holding such a position within Hong Kong SAR. Therefore, as of 1 June 2023, a foreign PEP shall be “*an individual who is or has been entrusted with a prominent public function in a place outside Hong Kong [...]*”. Ergo, PEPs in Mainland China, Macau, and Taiwan, shall be deemed to be foreign PEPs.

In practice this is unlikely to change much for financial institutions who have generally been adopting the practice of viewing all PEPs, regardless of domestic or foreign, with equal levels of due diligence. One welcome addition, but which is also unlikely to cause massive changes, is the introduction in the AMLO of the concept of a “former politically exposed person”, i.e., one who no longer is entrusted with a prominent public function in a place outside Hong Kong.

The AMLO has not set a timescale as to when such an individual becomes a “former” PEP, however FATF guidance suggests 12 months; moreover, local industry standard often extends this to three years after they cease to have a prominent public function. A risk-based approach must still be taken, i.e., enhanced due diligence on a former PEP may still be required if the risks of ML/TF are not low.

Beneficial Ownership of Trusts

This is another change that may have limited impact upon AML policies and procedures since the industry standard is to identify and verify trustees on the same basis as the facing client. Moreover, trustees are often licensed trust companies, making them eligible for simplified due diligence, or else they are individuals, making identification a necessity based on their ability to act on behalf of the trust.

Beneficiaries will no longer mean just those entitled to more than 25% of the capital but anyone named as a being a beneficiary, and it now include classes of beneficiaries not just named ones. For example, a trust deed might name “the descendants of [the settlor]” as the beneficiaries without naming them. A KYC Analyst would then assess the ML risk of the children (and grandchildren and beyond) of the settlor. Equally, a trust deed may have altruistic aims, or be for the benefit of employees, or people in a certain sector of industry or society.

The reason for this change is to align it with the definition of a controlling person under the Inland Revenue Ordinance.

These changes come into force on 1 June 2023.

Use of Technology and Digital Identification in Onboarding

This is an item that will be of great importance to companies looking to practice digital onboarding using facial recognition technology.

Prior to the amendment bill, the Securities & Futures Commission (“SFC”) had included options in respect of the use of technological solutions for non-face-to-face onboarding of overseas customers in a circular from June 2019. This circular did not, however, apply these principles domestically, companies would still have to go down the certification route when practicing non-face-to-face onboarding.

The AML(A)O now allows for enhanced measures to be dropped (i.e., no need for certification), regardless of whether the customer is overseas or in Hong Kong, if financial institutions (or designated non-financial businesses and professions) can carry out verification measures using a digital identification system. We can expect an updated circular from the SFC in due course in relation to how this will be applied to securities or futures intermediaries.

These changes also come into force on 1 June 2023.

Virtual Asset Service Providers

The sections on VASPs are extremely long and complex and account for most of the amendments to the Ordinance. As of 1 April 2023, the register of licensed persons under the VASP regime shall become effective. The relevant Authority shall be the Securities & Futures Commission.

There are several tracts issued by local law firms on the minutiae of the new requirements; however, the most salient point is that businesses conducting virtual asset services must be licensed to carry on business as of 1 June 2023, with transitional arrangements available for those in existence now who do or do not wish to continue operating such services in Hong Kong after that date.

VASPs who were carrying on virtual asset services prior to 1 June 2023 will have 12 months to wind down their businesses or become licensed, provided the application is made with the 9 months immediately succeeding 1 June 2023.

VASPs will be licensed along similar lines as other SFC licensed corporations, including assessment on the fitness and properness of the applicant and relevant individuals, and shall be subject to the same codes and guidelines, along with any additional codes and guidelines the SFC publishes specific to VASPs. The licence may also be subject, at the SFC’s discretion, to conditions on criteria ranging from financial resource to cybersecurity.

This point about being subject to additional codes and guidelines is very important. Our own research indicates that most VASPs, if they have any compliance, are focused almost entirely on outward looking AML. The Commission’s other codes cover issues such as client rights, conflicts of interest and duties to the market as a whole, as well as the reporting of breaches, the requirements to address client complaints and, of course, the SFC investigation and inspections regime. In theory this should mean the days of reckless client abuse within the wider virtual assets industry are coming to an end in Hong Kong.

Increased Penalties for Unlicensed Money Service Operations

The penalty for being convicted on indictment (i.e. at the Court of First Instance, usually before a jury) of operating a money service without a licence has been increased to a fine of HK\$1,000,000 and 2 years imprisonment (up from HK\$100,000 and 6 months imprisonment).

The penalty for being summarily convicted (i.e. at a magistrate's court) of operating a money service without a licence has been set at HK\$100,000 and 6 months imprisonment.

Previously, there was no distinction between convictions on indictment and summary convictions. The provision whereby the individual face disqualification from holding a licence still applies.

Dealers in Precious Metals and Stones

The purchase of precious stones and precious metals has long been on the FATF's radar, and numerous mutual evaluation reports worldwide have highlighted failings by many jurisdictions, not just Hong Kong, in ensuring DPMS are subject to appropriate ML/TF legislation.

As of today, 1kg of gold is valued at approximately US\$60,000. It is around about the same size as the average smartphone, albeit about 5~6 times heavier. A one carat diamond weighs 200mg (milligrams) yet can be worth anywhere between US\$2,000 and US\$16,000 depending on the other three C's. As a way of converting cash into something that can be easily and almost undetectably transported, precious stones and metals are a gift (maybe not literally) to money launderers and financiers of terrorism.

The solution arrived at by the Financial Services and the Treasury Bureau was to create a two-tier licensing system, designated Category A and Category B, aligned to a threshold of whether the firm will accept cash for transactions above or below HK\$120,000 (just over US\$15,000). Category A firms will agree not to transact above this amount and will be subject to a lighter regulatory regime. Category B firms can transact in cash above this threshold but will be subject to more stringent regulatory requirements.

DPMS supervision would fall under the purview of the Customs & Excise Department ("C&ED"), who already supervise money service operators or MSOs in Hong Kong.

DPMS who decide not to accept cash payments for HK\$120,00 or more, will not be subject to the new reporting regulations but will have to register as a "Category A Registrant". DPMS incorporated before January 1, 2023, will have to complete a form with the C&ED and together with their business registration certificate, fee, and a separate declaration of lawful intent. They would also need to submit the addresses of branches where they intend to carry out the business.

A Category A registration continues indefinitely until terminated by regulatory action or given up.

For those who shall accept cash payments of HK\$120,000, a fitness and properness test shall be applied to the relevant persons, namely, ultimate owners, partners in a partnership, and directors. These requirements shall be reassessed on renewal of the licence every three years.

Once licensed, Category B registrants will have to adhere to C&ED AML/CFT regulations. This will include client due diligence procedures applicable to cash transactions of HK\$120,000 such as identifying and verifying customers, conducting regular sanctions screening, and retaining client records for five years after the expiry of the business relationship. This would not apply to cash transactions exclusively between two Category B registrants.

Category B registration is for a period of 3 years before consideration of renewal.

There are approximately 8,000 DPMS in Hong Kong. The C&ED expects the split of Category A and B registrants to be approximately 50/50.

AML/CFT infrastructure, such as screening tools, policies and procedures for record keeping and reporting, and training will become the norm for DPMS firms.

Confidentiality

The AML(A)O has addressed the issue of doxxing in new powers which make it an offence to share, or make public, private personal documentation obtained while performing duties under the act, that is, a compliance office or MLRO would be committing an offence if they shared with a non-involved third-party personal data pertaining to a subject which was acquired during the process of performing due diligence.

Naturally, there are exemptions in respect of providing information to government bodies, regulators, law enforcement agencies, and to solicitors or other legal professionals when that person is acting in a professional capacity or for the purpose of judicial proceedings.

The Future...?

Having a global perspective on AML/CFT matters helps to identify trends abroad which are not applied domestically. We can certainly expect fitness and properness tests to be expanded, however, without more transparency around criminal records, alongside the unwillingness of companies to acknowledge potential bad hiring practices, Hong Kong still faces an extended period of status quo, allowing more bad apples to roll.

We suspect it will take quite a while, like it is within the real estate industry in Hong Kong, for precious metal dealers to recognise the importance of these changes and implement new processes.

We also suspect that source of funds information will at some point become a normalised enquiry, as opposed to being just a prerequisite of enhanced due diligence, as AML becomes more information and data driven versus the current emphasis on documentary requirements.

Internal controls have been the subject of audit planning requirements from regulators in common correspondent jurisdictions such as Singapore and the Cayman Islands, and it is likely that in the next two years, the SFC shall require more information and disclosure from licensed corporations on their internal audit and review practices in addition to the new BRMQ requirements coming into effect for SFC regulated firms with a financial year end after 30 November 2023.

Internal audits could be performed by an independent internal department, independent senior managers or non-executives, or an independent service provider; however, the scale of operations alongside the skills and availability of those involved would often dictate that these would need to be conducted by an external party.

Use of ID technology will now theoretically be able to proliferate in Hong Kong, allowing more companies with ambitious app-based products to provide retail investors even easier access to the market. This will lead to operators of these apps to introduce greater safeguards in respect of transaction monitoring and to identify potential fraudulent use of the app, or the use by proxies of criminal organizations. We would hope that new entrants also realise that compliance is a lot more than just AML and that AML is a lot more than just box ticking – but at the moment we are not holding our breath on that one.

Recent events in the cryptocurrency sector, notably the collapse of FTX, the hasty withdrawal of the Mazars crypto “audit” reports, but also crashes in other coins such as Terra, will only see regulation in this sector tighten on a global scale.

The amount of fraud in and associated with crypto is bigger than anything the world has seen before in relation to financial crime. Theft in the billions has become common place. Regulation is long overdue; we hope that robust enforcement gets cracking as well.

Finally, as a key regional transit hub for illegal wildlife trading, Hong Kong is likely to promote awareness, especially among money service operators, of the existence and growth of the trade, and the devastating impact on local communities and of course biodiversity in Asia.

The AMLO amendments are a very important step towards mitigating financial crimes in Hong Kong.

Our Services

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