

FATF



4TH FOLLOW UP REPORT

Mutual Evaluation of Hong Kong, China

19 October 2012





FINANCIAL ACTION TASK FORCE

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MUTUAL EVALUATION OF HONG KONG, CHINA - 4TH FOLLOW-UP REPORT

Application to move from regular follow-up to biennial updates

Note by the Secretariat

I. INTRODUCTION

1. The third mutual evaluation report (MER) of Hong Kong, China was adopted on 11 July 2008. At the same time, Hong Kong, China was placed in a regular follow-up process¹. Hong Kong, China reported back to the FATF in June 2010 (first follow-up report), and June 2011 (second follow-up report). In June 2012, Hong Kong, China indicated that it would report to the Plenary again in October 2012 concerning the additional steps taken to address the deficiencies identified in the report, and apply to move from regular follow-up to biennial updates.

2. This paper is based on the procedure for removal from the regular follow-up, as agreed by the FATF plenary in October 2008 and subsequently amended. The paper contains a detailed description and analysis of the actions taken by Hong Kong, China in respect of the core and key Recommendations rated partially compliant (PC) or non-compliant (NC) in the mutual evaluation, as well as a description and analysis of the other Recommendations rated PC or NC, and for information a set of laws and other materials (included as Annexes). The procedure requires that a country “has taken sufficient action to be considered for removal from the process – To have taken sufficient action in the opinion of the Plenary, it is necessary that the country has an effective AML/CFT system in force, under which the country has implemented the core² and key³ Recommendations at a level essentially equivalent to a Compliant (C) or Largely Compliant (LC), taking into consideration that there would be no re-rating”⁴. Hong Kong, China was rated PC or NC on the following Recommendations:

Core Recommendations rated PC (no core recommendations were rated NC):

R.5, R.10, SR.II

Key Recommendations rated PC (no key recommendations were rated NC)

R.3, SR.I, SR.III

Other Recommendations rated PC

R.6, R.9, R.11, R.17, R.29, R.33, R.34 SR.VI, SR. VII

Other Recommendations rated NC

R.12, R.16, R.24, SR IX

¹ www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Hong%20Kong%20full.pdf

² The core Recommendations as defined in the FATF procedures are R.1, SR.II, R.5, R.10, R.13 and SR.IV.

³ The key Recommendations are R.3, R.4, R.26, R.23, R.35, R.36, R.40, SR.I, SR.III, and SR.V.

⁴ FATF Processes and Procedures par. 39 (c)

3. As prescribed by the Mutual Evaluation procedures, Hong Kong, China provided the Secretariat with a full report on its progress. The Secretariat has drafted a detailed analysis of the progress made for Recommendations 3, 5 and 10, and Special Recommendations I, II and III (see rating above), as well as an analysis of all the other Recommendations rated PC or NC. A draft analysis was provided to Hong Kong, China (with a list of additional questions) for its review, and comments received. The final report was drafted taking into account some of the comments from Hong Kong, China. During the process Hong Kong, China has provided the Secretariat with all information requested.

4. As a general note on all applications for removal from regular follow-up: the procedure is described as a paper based desk review, and by its nature is less detailed and thorough than a mutual evaluation report. The analysis focuses on the Recommendations that were rated PC/NC, which means that only a part of the AML/CFT system is reviewed. Such analysis essentially consists of looking into the main laws, regulations and other material to verify the technical compliance of domestic legislation with the FATF standards. In assessing whether sufficient progress had been made, effectiveness is taken into account to the extent possible in a paper based desk review and primarily through a consideration of data provided by the country. It is also important to note that these conclusions do not prejudge the results of future assessments, as they are based on information which was not verified through an on-site process and was not, in every case, as comprehensive as would exist during a mutual evaluation.

II. MAIN CONCLUSIONS AND RECOMMENDATIONS TO THE PLENARY

CORE RECOMMENDATIONS

5. For R. 5 and for R. 10, all the technical deficiencies in the legislation were addressed with the entry into force of the relevant provisions of the new anti-money laundering legislation (AMLO). Positive progress has been made with the definition and implementation of a sectoral risk assessment, but questions remain on the justification for one of the exempted business sectors (money lenders). The overall compliance of Hong Kong, China with R. 5 can be assessed at a level essentially equivalent to LC. The regime put in place by the AMLO to monitor and supervise the money service sector will be kept under review with regard to effectiveness. Hong Kong, China's compliance with R. 10 can be assessed at a level essentially equivalent to LC. With regard to SR. II, all technical deficiencies have been addressed with the entry into force of the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO), with the exception of the potential broad application of the 'civil protest' exemption to certain classes of 'terrorist acts'. Hong Kong, China's compliance with SR II can be assessed at a level essentially equivalent to LC.

KEY RECOMMENDATIONS

6. On R.3, part of the technical deficiencies in the legislation was addressed with the entry into force of the relevant provisions of the UNATMO, and initiatives taken to improve the effectiveness of the restraint and confiscation framework. However, progress is not yet complete and does not fully address all the deficiencies. The restraint and forfeiture procedure is still limited by a threshold; the recognition of environmental crimes and piracy as predicate offences is not clearly established and this impacts the confiscation powers, including on instrumentalities, that can apply to these

offences. Hong Kong, China's overall compliance with R. 3 can be assessed at a level essentially equivalent to LC. With regard to SR. I, the UNATMO and the AMLO addressed most of the technical deficiencies. One of the remaining deficiencies noted for SR II ('civil protest' exemption, see par. 5) has an impact on Hong Kong, China's compliance with SR. I. Overall, compliance with SR. I can be assessed at a level essentially equivalent to LC. For SR. III, although some of the technical deficiencies were addressed with the entry into force of the UNATMO and the United Sanctions (Afghanistan) Regulations (UN SAR), there are some remaining deficiencies, with regard to the obligations required with respect to assets under the control of designated entities; the freezing requirements of terrorist property; and the effect which can be given to freezing mechanisms of other jurisdictions. In addition, Guidance provided to institutions concerning their obligations under freezing mechanisms is insufficient. The overall compliance of Hong Kong, China with SR. III can be assessed at a level essentially equivalent to PC.

OTHER RECOMMENDATIONS

7. Hong Kong, China has made significant progress with the other 13 Recommendations that were rated PC or NC. Hong Kong, China has achieved a sufficient level of compliance with Recommendations 6, 9, 11, 17, 29, and SR. VI and VII. Hong Kong, China has also made efforts to improve its compliance with Recommendations 12, 16, 24, 33 and 34 and SR. IX although deficiencies remain and implementation of these recommendations has not yet reached a level equivalent to an LC rating.

CONCLUSIONS

8. Overall, Hong Kong, China has reached a satisfactory level of compliance with all of the core Recommendations; and two of the three key Recommendations. It has not yet definitely reached a satisfactory level of compliance with SR. III.

9. The mutual evaluation follow-up procedures indicate that, for a country to have taken sufficient action to be considered for removal from the process, it must have an effective AML/CFT system in force, under which it has implemented all core and key Recommendations at a level essentially equivalent to C or LC, taking into account that there would be no re-rating. The Plenary does, however, retain some limited flexibility with regard to the key Recommendations if substantial progress has also been made on the overall set of Recommendations that have been rated PC or NC.

10. Hong Kong, China has made significant overall progress since the MER. 19 Recommendations were assessed as PC or NC in 2008. To the extent that this can be judged in a paper-based review which does not examine effectiveness, Hong Kong, China has taken sufficient action to bring its compliance to at least a level essentially equivalent to LC on relation to 12 of those (5 of the 6 core and key Recommendations rated PC, and 7 of the 13 other Recommendations). Of the other recommendations remaining, overall Hong Kong, China has made considerable efforts to strengthen its AML/CFT regime since 2008 across all areas of activity, though it can not be judged sufficiently compliant with recommendations 12, 16, 24, 33 and 34, and SR III and IX.

11. It is recommended that this would be an appropriate circumstance for the Plenary to exercise its flexibility and remove Hong Kong, China from the regular follow-up process, with a view to having it present its first biennial update in October 2014.

III. MAIN CONCLUSIONS AND RECOMMENDATIONS TO THE PLENARY

A. OVERVIEW OF THE MAIN CHANGES SINCE THE ADOPTION OF THE MER

12. Since the adoption of the MER in 2008, Hong Kong, China has focused its attention on strengthening its AML/CFT legislative framework, with the adoption of a set of preventive AML/CFT measures, and the revision and full entry into force of the anti-terrorism legislation.

13. Hong Kong, China has also developed a sectoral risk assessment methodology. It has been applied to a number of business sectors, and the scope of the AML/CFT regulatory regime has been consequently amended.

14. Hong Kong, China's competent authorities have also taken a series of measures to strengthen the implementation of the confiscation regime, through resources enhancement, training, revision of internal guidance and reorganization of administrative services. The overall objective was to improve the effectiveness of the restraint and confiscation regime.

15. Hong Kong, China also took a number of initiatives to raise awareness of the DNFBP sector on AML/CFT issues. In addition to the promulgation of circulars and guidelines, efforts to improve outreach to DNFBPs and capacity building among practitioners have been taken through seminars and interactive learning material.

B. THE LEGAL AND REGULATORY FRAMEWORK

16. Since the adoption of the MER in 2008, Hong Kong, China has completed key AML/CFT legislative steps:

- The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (AMLO), was adopted on 29 June 2011, and entered into force on 1 April 2012⁵. Some of the main objectives of the AMLO were the introduction of CDD and record-keeping requirements for financial institutions, with relevant sanctions for failure to comply and enforcement powers for competent authorities; as well as the provision of a licensing regime for money service operators (money changing services and remittance services).
- The United Nations (Anti-Terrorism Measures) Ordinance (UNATMO) was adopted in August 2002. It was brought into full operation on 1 January 2011, with the promulgation of High Court rules and an administrative Code of Practice. Measures to implement the mechanisms for forfeiture and for freezing of terrorist property entered into force.
- The UNATMO was amended by the United Nations (Anti-Terrorism Measures) (Amendment) Bill 2012, passed by the Hong Kong Legislative Council on 3 July 2012 and entered into force on 13 July 2012⁶. It expanded the scope of the terrorist financing offence to cover assets of all kinds,

⁵ Available in Annex 2

⁶ Available as Annex 3

broadened the definition of terrorist acts and expanded the prohibition on assistance for terrorists and terrorist organizations to also cover the collection of their property.

- The United Nations Sanctions (Afghanistan) Regulation 2012 (UN SAR) was enacted and implemented in March 2012 to introduce the latest developments in the United Nations’ sanction regime against Afghanistan⁷, in particular the adoption of UNSCR 1988 in June 2011. UN SAR 2012 therefore targets individuals and organisations associated as decided by the Committee of the Security Council set up for the purpose of UNSCR 1988 (Taliban)⁸.

IV. REVIEW OF THE MEASURES TAKEN IN RELATION TO THE CORE RECOMMENDATIONS

RECOMMENDATION 5 –RATED PC

R5 (Deficiency 1): Key CDD obligations are not set out in law or regulation.

17. The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (AMLO) was adopted on 29 June 2011, and entered into force on 1 April 2012. The Ordinance is a national legislative act, approved by the Hong Kong Legislative Council (LegCo), which is the body responsible for enacting, amending and repealing laws. Section 6 prescribes that the Secretary for Financial Services and the Treasury may amend Schedule 2 to the AMLO by notice in the Gazette, and such amendments are subject to approval by LegCo.

18. The provisions of the AMLO are mandatory for financial institutions (section 5). The Ordinance contains sanctions for financial institutions, and their employees, who would contravene with the requirements: section 5. (5) to (8).

19. The key CDD obligations for financial institutions included in Schedule 2 are: the prohibition of anonymous accounts and accounts in fictitious names (section 16); identification of the customer and verification of identity (section 2. 1) (a); identification of the beneficial owner and reasonable measures to verify the identity of the beneficial owner (section 2. (b); for customers that are legal persons or arrangements, determination of the natural person that ultimately owns or controls the customer (section 1 a) i) C., b) i) C., c) iv), d) i); ongoing due diligence on the business relationship (section 5).

20. This deficiency has been addressed.

⁷ Available as Annex 4

⁸ UNSCR 1988 is a successor Resolution to UNSCR 1267, and introduces a consolidated list of “Taliban individuals and groups” which brings together the previous individual lists of persons and entities associated with Al Qaida and Taliban.

R5 (Deficiency 2): Only basic CDD obligations are in place for money remitters and money exchange companies and, due to the absence of a supervisor for these entities, it is not possible to determine the extent of implementation of the existing CDD obligations.

21. Under the AMLO, the definition of financial institutions covers money service operators (MSOs) (Part 2, Schedule 1, Section 1.) which as such are subject to the same set of CDD requirements as the other financial institutions.

22. The AMLO introduces specific provisions on money service operations (Part 5), defined as money changing services or remittance services (Part 2, Schedule 1, Section 1.). It organises the regulation of MSOs (Part 5, Division 1), requires money service operators to be licensed and defines conditions to get licensed (Part 5, Division 2). It also designates a relevant authority - the Commissioner of Customs and Excise (CCE) - , in charge of licensing and supervising the MSO sector (Part 5, Division 3). The CCE is granted a range of legal powers to supervise MSOs' compliance with the statutory requirements, including conducting routine inspections to ascertain compliance and investigations into suspected breaches, as well as imposing supervisory sanctions for breaches.

23. As at 24 August 2012, the CCE had granted 731 MSO licences and was processing 376 applications. The CCE has also deployed a total of 59 staff to launch the AML regime for MSOs and roll out the MSO licensing scheme. Resources have been provided to the CCE to establish a designated office for MSO supervision and licensing, and to develop an electronic data management system for the specific objective of supporting MSO licensing and supervision functions.

24. With money service operators falling within the scope of the AMLO, under the oversight of the CCE, the building blocks to monitor the implementation of CDD requirements by money remitters and money exchange companies are in place. It can be considered that this deficiency has been addressed.

R5 (Deficiency 3): The threshold for CDD on occasional customers in the banking sector (other than in relation to remittances and money changing) is not clearly specified

25. Schedule 2, Section 3(b) of the AMLO provides for a HKD120 000 threshold (USD 15 472) for occasional transactions, over which CDD measures are required. This threshold is applicable to all financial institutions falling within the scope of the AMLO, including banks.

26. This deficiency has been addressed.

R5 (Deficiency 4): Pending implementation of the new Hong Kong Monetary Authority (HKMA) Guidelines, there are no obligations on banks to obtain information on the purpose and nature of the account.

27. The AMLO requires financial institutions to obtain information on the purpose and intended nature of the business relationship (Schedule 2, Section 2. (c)). This requirement is applicable to all financial institutions falling within the scope of the AMLO, including banks.

28. Schedule 2, Section 2 (c) adds that this information has to be obtained “unless the purpose and intended nature are obvious” and the January 2012 HKMA Guidelines indicates that in a number

of cases, the purpose and intended nature “will be self-evident” (4.6.). In any event, financial institutions have to record the purpose and nature of the business relationship for all cases.

29. This deficiency has been addressed.

R5 (Deficiency 5): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from CDD requirements.

30. Hong Kong, China has developed a methodology to conduct sectoral risk assessments in May 2009⁹, endorsed by the Central Coordinating Committee on Anti-Money Laundering and Counter Financing of Terrorism chaired by the Financial Secretary. The methodology looks at the magnitude of the potential threat/hazard and at the probability that such threat/hazard would occur. Factors such as regulatory oversight, customer types and identification, record keeping arrangement, ranges of services provided, AML/CFT awareness are examined to determine the level of vulnerability of the sector. A qualitative assessment of the ML/TF risks of the business sector is then determined (low, medium, high).

31. It is taken good note of this methodology, which reflect that a coordinated and structured approach has been defined by Hong Kong, China, with a view to develop a consistent understanding of the risks which the various business sectors face, and adopt the relevant mitigation measures. It is recommended, however, that when other business sectors are assessed in the future:

- the methodology also considers, in addition to threat/hazard and the likelihood of an event, the consequence, in terms of cost and damage, that ML/TF may cause. This would be a useful factor to measure the impact of the identified risks on the given sector, but also to the financial system, as well as the economy and the population more generally;
- it would also be important to re-consider some of the criteria used to evaluate the potential vulnerabilities of a given sector. A number of the current criteria focus on the existence, or the absence, of elements directly connected to the AML/CFT system ie. customer identification, record keeping arrangements, AML/CFT awareness. However, it seems difficult to base a fair and balanced assessment of the ML/FT risks to which a business sector is exposed, using factors which are generally introduced as part of the ML/FT risk mitigation regime. It would therefore be appropriate to broaden the factors of vulnerability to external elements such as the geographic scope of transactions/activities, the types and sizes of business players, the level of competition within the sector, the exposure of the sector to criminal activities in general;
- finally, it would be useful for the methodology to expand further on the specific criteria according to which a given risk will be classified in one of the three categories (low, medium, high), and when the level of risks will

⁹ See Annex 5

result in an exemption from the AML/CFT scope, or the application of a simplified AML/CFT regime.

32. Hong Kong, China undertook formal assessments of sectors considered as low risks and as such exempted from the CDD requirements at the time of the MER – money lenders¹⁰, credit unions, and the Post Office (with regard to the provision of remittance services)¹¹:

- money lenders have been confirmed as low risks, and the exemption from CDD requirements maintained. The main FATF criterion to support the exemption is a proven low risk of AML/CFT. Although the argumentation provided by Hong Kong, China evidences the low volume of activities of money lenders (1,3 to 1,5% of the total financial sector), it seems that some of the other elements supporting the case show some inconsistencies or are quite weak arguments in favour of a full exemption. For example, Hong Kong, China mentions a low volume of STRs coming from money lenders to highlight the low level of risk of the sector, but at the same time notes the need to raise awareness of money lenders on AML/CFT matters. This raises questions on the underlying reasons for the low level of STRs: is it due to a low level of AML/CFT awareness, rather than to a low level of AML/CFT risk? Hong Kong, China also informs that as part of credit risk management, it is a practice for money lenders to put in place appropriate KYC arrangements. The fact that such KYC measures are conducted for other purposes than preventing ML/FT risks is presented as one of the underlying reasons for the sector's low exposure to ML/FT risks. Hong Kong, China's analysis is questionable, as it implies that because they apply voluntary risk mitigation measures, money lenders would present a low risk of ML/FT and should be fully exempted from the AML/CFT regime.

On the basis of the information provided by Hong Kong, China and through a desk-based review, it seems that the full exemption granted by Hong Kong, China to money lenders is not backed by sufficiently strong evidence;

- credit unions have been confirmed as low risks, and the exemption from CDD requirements maintained. This approach seems justified, in particular given the low AML/CFT risk profile of credit unions; the membership restrictions to credit unions which are limited to persons having a common bond –usually based on their employment or trades- and whose full identity information is screened when they apply for membership; the limited range of financial services offered by the credit unions (savings by share subscription and lending); and the monthly share savings caps generally in force.
- remittance services of the Post Office have been assessed as medium risks. Despite the fact that the Post Office is not a major player in the local

¹⁰ which in Hong Kong's context include factoring and financial leasing companies

¹¹ See Annex 6

remittance market, its volume of e-remittance transactions has been on the rise. In addition, the remittance services offered by the Post Office to the general public are essentially the same as those provided by commercial remittances providers, which under the AMLO, are now submitted to AML/CFT requirements. The Post Office should therefore be subject to comparable ML/FT measures as its commercial counterparts. It is also useful to note that the Post Office offers remittances services, acting as an agent for Western Union, and as such is already subject to some AML/CFT requirements (appointment of a compliance officer, customer identification etc).

Consequently, the remittances activities of post offices are now subject to the AMLO requirements. The Postmaster general (PMG), who is the head of the Post Office, is part of the definition of financial institutions (Part 2, Schedule 1).

33. This deficiency has been partially addressed.

Recommendation 5, Overall conclusion

34. Hong Kong, China has made significant progress in improving its compliance with R. 5. The technical deficiencies in the legislation were addressed with the entry into force of the relevant provisions of the AMLO. Positive progress has been made with the definition and implementation of a sectoral risk assessment, but questions remain on the justification for one of the exempted business sectors (money lenders).

35. The overall compliance of Hong Kong, China with R. 5 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 10 –RATED PC

R10 (Deficiency 1): Only general record-keeping requirements are embedded in law or regulation.

36. Part 3, Schedule 2, Section 20 of the AMLO introduces some specific record-keeping requirements for financial institutions:

- in relation to each transaction carried out, the original or the copy of the documents, and a record of CDD data and information obtained in connection with the transaction must be kept by the financial institution;
- in relation to each customer, the financial institution must keep the original or a copy of the documents and a record of the data and information obtained in the course of identifying and verifying the identity of the customer or any beneficial owner of the customer, in relation to CDD requirements, as well as the original or a copy of the files relating to the customer's account and business correspondence with the customer and any beneficial owner of the customer.

37. Those documents must be kept for a period of 6 years, as of the date when the transaction is completed (Section 20 (2)), or the date when the business relationship ends (Section 20 (3)).

38. This deficiency has been addressed.

R10 (Deficiency 2): In the securities sector the obligation to maintain identification records, account files and business correspondence for a minimum of five years is recommended but not mandatory.

39. The requirements of Part 3, Schedule 2, Section 20 of the AMLO (see R10 Deficiency 1) are applicable to all financial institutions falling within the scope of the AMLO. This includes securities institutions (“licensed corporations”) (Part 2, Schedule 1, Section 1).

40. The AMLO record-keeping requirements include the obligation to maintain identification records (Section 20 (1) (b) (i)), account files and business correspondence (Section 20 (1) (b) (ii)).

41. This deficiency has been addressed.

R10 (Deficiency 3): The record keeping requirements for remittance agents are incomplete: records must only be kept for transaction of HKD8 000 or more and there is no requirement that remittance agents or money changers obtain and keep verification data for non-face-to-face transactions.

42. Under the AMLO, the definition of financial institutions covers money service operators (MSOs) (Part 2, Schedule 1, Section 1), which include money changing services and remittance services (Part 1, Schedule 1, Section 1) (see R5 Deficiency 2). MSOs are subject to the same set of record-keeping requirements as the other financial institutions. Record-keeping requirements apply to all transactions performed by financial institutions, irrespective of their amount. There is no minimum threshold below which records of transactions should not be kept.

43. Regarding obtaining and keeping verification data for non-face-to-face transactions by remittance agents or money changers, the duty to keep records provisions of the AMLO (Part 3, Schedule 2, Section 20) applies irrespective of the delivery channel used by the customers, ie. including in non face-to-face situations.

44. This deficiency has been addressed.

R10 (Deficiency 4): The level of implementation of record keeping requirements by remittance agents and money changers cannot be determined.

45. Money service operators, ie money changing service and remittance services, are included in the scope of application of the AMLO (Part 2, Schedule 1, Section 1). The AMLO also designates a relevant authority - the Commissioner of Customs and Excise (CCE)- , in charge of licensing and supervising the MSO sector (Part 5, Division 3) (see R.5 Deficiency 2).

46. The requirements of Schedule 2, Section 20 of the AMLO on duty to keep records are applicable to all financial institutions falling within the scope of the AMLO. Since 1 April 2012, the CCE is the authority responsible to ensure that MSOs comply with their record keeping obligations.

47. Relevant measures have been taken to address this deficiency, although it is difficult at this point in time to evaluate their effectiveness, given the recent entry into force of the MSO supervisory and monitoring regime.

R10 (Deficiency 5): Competent authorities may only demand that remittance agents and money changers provide them with records and information where they have a reasonable suspicion that an offence has been committed and this may limit the timely provision of information to competent authorities by remittance agents.

48. Part 3, Section 9 of the AMLO defines the supervisory and investigation powers of relevant authorities over financial institutions. It empowers relevant authorities, including the Commissioner of Customs and Excise (CCE) in relation to licensed MSOs, to conduct routine inspections, access to business premises, books and records, and make inquiries of the licensees or other persons for the purpose of ascertaining compliance with the statutory requirements by financial institutions.

49. Failure to comply with such requirements made by the relevant authority is subject to criminal liability under Part 3, Section 10 of the AMLO.

50. The CCE will therefore be in a position to request information to remittance agents and money changers in all circumstances. This deficiency has been addressed.

R10 (Deficiency 6): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from the preventive measures and corresponding regulatory regime.

51. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

52. This deficiency has been partially addressed.

Recommendation 10, Overall conclusion

53. Hong Kong, China has made significant progress in improving its compliance with R. 10. The technical deficiencies in the legislation were addressed with the entry into force of the relevant provisions of the AMLO. Positive progress has been made with the definition and implementation of a sectoral risk assessment, but questions remain on the justification for one of the exempted business sectors (money lenders).

54. The regime put in place to monitor and supervise the MSO sector will be kept under review with regard to effectiveness. The overall compliance of Hong Kong, China with R. 10 can be assessed at a level essentially equivalent to LC.

SPECIAL RECOMMENDATION II –RATED PC

SR II (Deficiency 1): The TF offence does not encompass provision/collection of assets other than “funds”.

55. Section 7 of the UNATMO, in force since 2005, introduced the prohibition or collection of funds to commit terrorist acts. The amendments brought to UNATMO in 2012 expanded the scope of the terrorist financing offence to cover assets of all kinds. The definition of “funds” is repealed under Section 2(1) and Schedule 1 of the UNATMO, and replaces the term “funds” by “property” throughout the UNATMO. “Property” is defined in the Interpretation and General Clauses Ordinance (IGCO), Cap.1 to include:

- (a) money, goods, choses in action and land; and
- (b) obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incident to property as defined in (a).

56. This deficiency has been addressed.

SR II (Deficiency 2): The TF offence under UNATMO does not cover provision/collection for an individual terrorist or terrorist organisation and the offence under UNSAR extends only to those individuals and entities designated by the 1267 Committee.

57. The UNATMO, as amended in 2012, introduces a new Section 8 “Prohibition on making property, etc. available to or collecting property, etc. for terrorists and terrorist associates”, which explicitly prohibits:

- (a) the making available of property or financial (or related) services for terrorists or terrorist associates; and
- (b) the collection of property or the solicitation of financial (or related) services for terrorists or terrorist associates.

58. The definition of “terrorist associate” means “an entity owned or controlled, directly or indirectly, by a terrorist”, and “entity” means “any body of persons (including individuals) whether corporate or unincorporated”. These definitions together appear broad enough to cover terrorist organisations, as defined in the FATF Recommendations.

59. The United Nations Sanctions (Afghanistan) Regulation 2012 (UNSAR) was enacted and implemented in March 2012 to introduce the latest developments in the United Nations’ sanction regime against Afghanistan in the legal framework of Hong Kong, China¹², in particular the adoption of UNSCR 1988 in June 2011. UNSAR 2012 therefore targets individuals and organisations associated as decided by the Committee of the Security Council set up for the purpose of UNSCR 1988 (Section 29 of UNSAR and par. 30 of UNSCR 1988). A new prohibition against the dealing of funds, either directly or indirectly, owned by or otherwise belonging to, or held by relevant persons/entities has been introduced (Section 6), in addition to the existing prohibition against

¹² Available as Annex 4

making funds available to relevant persons or entities. This new prohibition would effectively disallow relevant persons/entities from using, altering, moving or transferring their funds. The combined effects of the two prohibitions would be to provide an effective and comprehensive regime to freeze funds of relevant persons/entities.

60. As part of the analysis of the TF offence, it was also checked if the whole range of terrorist offences described in international conventions were covered by Hong Kong, China's penal system. The table attached as Annex 7 confirms that Hong Kong, China has introduced the relevant provisions. It would however be useful to clarify the provisions of UNATMO on prohibition against bombing on two aspects:

- the prescribed objects targeted by the bombing attacks should include the notion of *“places for public use, State or government facility, a public transportation system or an infrastructure facility”*
- the results of the bombings to be taken into consideration should take include *“death or serious bodily injury”*, and not only major economic loss.

61. This deficiency has been addressed.

SRII (Deficiency 3): Terrorist acts as defined in UNATMO do not extend to intended coercion of an international organisation.

62. The 2012 UNATMO in Section 3 (1) expands the definition of “terrorist act” (Section 2 (1) of the UNATMO) to cover acts done to compel international organisations, in addition to Government (a) (ii) (A)).

63. This deficiency has been addressed.

SRII (Deficiency 4): The ‘civil protest’ exemptions to certain classes of terrorist acts as defined in UNATMO are potentially of broad application.

64. The definition of “terrorist act” in Section 2 of UNATMO excludes the use or threat of action in the course of any “advocacy, protest, dissent or industrial action”. The MER considered that the extent of the “civil protest” exemptions should be prescribed more clearly, to limit its scope of application.

65. No legislative action was taken by Hong Kong, China to address this problem. But Hong Kong, China mentions that the “civil protest” exemption does not apply to serious acts of violence which would have the effect of causing serious violence against a person, serious damage to property, or endangering another person's life (Section 2. (1), definition of “terrorist act” (c)(i)(A)(B)(C)).

66. According to Hong Kong, China, a clear line can be drawn to distinguish between civil protests (which may result in scuffles and cases of injury or damage to property) and acts of “terrorism”.

67. This deficiency was not addressed.

Special Recommendation II, Overall conclusion

68. Hong Kong, China has made significant progress in improving its compliance with SRII. The technical deficiencies in the legislation were addressed with the entry into force of the provisions of the UNATMO. However, a “civil protest” exemption to certain classes of terrorist acts remains, which scope of application has not been clearly defined.

69. The overall compliance of Hong Kong, China with SRII can be assessed at a level essentially equivalent to LC.

V. REVIEW OF THE MEASURES TAKEN IN RELATION TO THE KEY RECOMMENDATIONS

RECOMMENDATION 3 –RATED PC

R3 (Deficiency 1): The Organized and Serious Crimes Bill (OSCO) restraint and forfeiture is limited to cases where benefits exceed HKD100 000.

70. The OSCO targets post-conviction penalties representing the value of benefits of “specified offences”, ie. offences other than drug trafficking offences which are directly covered by DTROP, the Drug Trafficking Recovery of Proceeds Ordinance. The OSCO supplies a fairly comprehensive criminal forfeiture regime. However, there is a HKD100,000 (US\$ 12 892) benefits threshold, below which no restraint or forfeiture procedure can apply. This provision of OSCO (Section 8 (4)) has not been modified.

71. At the time of the Mutual Evaluation, Hong Kong, China considered that this approach was reasonable to enable the defendant to take legal and living expenses out of the assets under restraint. In the MER, assessors mentioned their concerns that “these policy assumptions are not universally valid – as where, for example, an accused person has sufficient other (unrestrained) assets to fund litigation and living expenses. In such circumstances, the mandatory threshold might well preclude an appropriate exercise of prosecutorial discretion to undertake restraint and forfeiture action”.

72. Hong Kong, China maintains the argument that defendants should be entitled to reasonable legal and living expenses from the restrained assets. In addition, the threshold was set after thorough discussion in the Bills Committee set up by LegCo to scrutinize the OSCO Bill in 1992-1994 and in response to very strong support from the LegCo to set the threshold at a level not lower than HKD100,000.

73. Hong Kong, China also mentions that Courts can confiscate all realisable property of a defendant. Nevertheless, the existence of the threshold on the benefits of the Terrorist Financing offence amounts to a deficiency *per se*, and this provision has not been amended.

74. This deficiency has not been addressed.

R3 (Deficiency 2): Confiscation powers under OSCO are not available for all predicate offences.

75. Confiscation under OSCO requires conviction of a ‘specified offence’ as listed in Schedule 1 or 2, or the offences of conspiracy, incitement, attempt, aiding/abetting/counselling/procurer

commission of any of the offences listed in those Schedules (Section 2). The MER noted that while the range of scheduled offences was broad, it did not extend to all predicate offences for ML. More specifically, it did not cover environmental crimes, piracy and insider trading and manipulation.

76. No legislative amendments have been made to Schedules 1 and 2 of OSCO. Hong Kong, China mentions that its criminal confiscation regime has been operating well on the basis of the current framework. Hong Kong, China also informs that:

- Criminal proceedings for environmental crimes and piracy can be brought against a defendant under various categories of offences, eg. criminal damage of Crimes Ordinance (Cap.200), theft or robbery of Theft Ordinance (Cap.210), and import and export of prohibited articles of Import and Export Ordinance (Cap. 60) which are offences listed in Schedules 1 and 2 of OSCO. However, there is no evidence brought that these large and generic categories of offences would specifically include environmental crimes and piracy, or that all cases of environmental crimes and piracy activities would meet the criteria required to qualify as one of these criminal offences.
- According to Section 25(1) of OSCO, predicate offences for money laundering would refer to all “indictable” offences, not just the FATF-designated categories of predicate offences. Hong Kong, China adds that confiscation of proceeds from other indictable offences not listed in the OSCO Schedules can still be effected through conviction of money laundering offences. Although Section 25(1) potentially has a broad scope of application, there is no implicit indication that on this basis, predicate offences for money laundering would refer to all indictable offences, and would therefore cover all the FATF-designated categories of predicate offences, and beyond. In any case, there is no indication that the confiscation powers introduced by OSCO and required by Recommendation 3 would extend to those “indictable offences”.
- The Securities and Futures Ordinance will be amended during the legislative exercise starting in October 2012 to add market misconduct and manipulation offences into the Schedules of OSCO.
- Regarding terrorism related offences, the MER noted that there were no confiscation powers in place, as Section 13 of the UNATMO (United Nations (Anti Terrorism Measures) Ordinance) was not in force. Section 13 of the UNATMO entered into force on 1 January 2011, and provides for the forfeiture of terrorist financing property.

77. This deficiency has been partially addressed.

R3 (Deficiency 3): No mechanisms exist for confiscation of the proceeds of TF.

78. Section 13 of the UNATMO, entered into force on 1 January 2011, provides for the forfeiture of property of a terrorist or terrorist associate, which represents any proceeds arising from a

terrorist act, is intended to be used to finance or to commit a terrorist act, or was used to commit such act.

79. This deficiency has been addressed.

R3 (Deficiency 4): Powers to confiscate instrumentalities do not extend to property that does not come into the possession of a court or police or customs agencies.

80. The Criminal Procedure Ordinance (CPO) provides for general powers of confiscation of instrumentalities, which cover property that comes into the possession of a court or the law enforcement agencies concerned (court, Police, Customs and Excise Department), in connection with all types of offences. This power is exercisable irrespective of the fact whether an offence has been committed or whether there is a conviction (Section 102). Similarly, the power under Section 103 of the CPO is exercisable when there is reason to believe that the property is provided or prepared with a view to committing an indictable offence. This general power does not depend on conviction of any offence. The provisions of the CPO have not been modified.

81. Hong Kong, China reports that under OSCO (Organised and Serious Crimes Ordinance) and DTROP (Drug Trafficking Recovery of Proceeds Ordinance), upon conviction of any specified offences or drug trafficking offences, the Department of Justice (DoJ) may apply to the court for the confiscation of the realizable property of the defendant, which includes all instrumentalities of value, regardless of whether they have come into the possession of a court, police, Independent Commission Against Corruption (ICAC) or customs agencies. The confiscation under DTROP covers drug trafficking offences while that under OSCO is applicable to offences listed in Schedules 1 and 2 of OSCO. Given that OSCO does not seem to appropriately cover all ML predicate offences (*see R.3 Deficiency 2 above*), instrumentalities from environmental crimes and piracy would be missing from the existing confiscation of instrumentalities framework.

82. Hong Kong, China adds that Sections 73 and 84 of CPO empower the court to order convicted persons to pay compensation or return properties (including instrumentalities) to crime victims or aggrieved persons. These may be paid out of property not in possession of the Police, ICAC or court. These compensation procedures do not seem, however, to involve a confiscation order.

83. Hong Kong, China indicates that, in practice, the current mechanisms operate well with no major operational problem encountered, and that it will be kept under review.

84. This deficiency has been partially addressed.

R3 (Deficiency 5): Effectiveness: Given the risk of money being laundered in Hong Kong (including the proceeds of foreign predicate offences), the number of restraint and confiscation applications made each year are low.

85. Hong Kong, China informs that it has developed a number of actions to improve the effectiveness of its restraint and confiscation framework, and is committed to maintain its efforts for further progress:

- The Financial Investigation Division (FID) and the Joint Financial Intelligence Unit (JFIU) have enhanced their enforcement capability in

financial investigation and analysis of financial intelligence (26 additional posts with effect in December 2009). Financial investigation and confiscation of crime proceeds are one of the Hong Kong Police Force's enforcement priorities. FID has organized regular and focused training and outreach to regional and district crime units to enhance their awareness and knowledge on asset restraint and confiscation (23 courses/seminars for police officers between June 2008 and April 2012, financial investigation training attended by 845 police officers). In addition, the Police has revised its internal guideline and manual to provide more details on the procedures and put in place standard protocol in respect of asset tracing, restraint and confiscation to provide enhanced guidance to officers in dealing with this specific area of work.

- The establishment of a dedicated Proceeds of Crime Section by the Independent Commission Against Corruption (ICAC) in June 2010 has been conducive to the effective implementation of the restraint and confiscation of assets in relation to corruption-related cases. In an effort to enhance the knowledge of investigators in relation to restraint and confiscation of assets, workshops on asset recovery have been conducted by counsels from DoJ and in-house training sessions have been regularly organized.
- In 2010, DoJ re-organised its Prosecutions Division with the aim of enhancing the latter's efficiency and effectiveness as a modern prosecution service. A new Proceeds of Crime Unit was created under the Office of the Director of Public Prosecutions. The new set-up has enabled DoJ to focus its resources and priority on recovering action in relation to the proceeds of crime and advising on terrorist financing matters for law enforcement agencies to deal with cases involving proceeds of crime under senior-level steer and direction.

86. Concerned competent authorities have kept up their efforts and co-ordination to sustain the improvements in restraint and confiscations. Both the number of restraint and confiscation orders as well as the value of assets involved has increased significantly. The number of restraint orders has increased threefold from an annual average of 6 during 2003-2006 to an annual average of 18 during 2007-2011. Similarly, the number of confiscation orders has increased significantly from an annual average of 4 during 2003-2006 by 175% to annual average of 11 during 2007-2011.

87. The continuous improving trend and the increase in numbers and value demonstrate that effectiveness was enhanced. This deficiency has been addressed.

Table 1. Restraint Orders

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 ¹
Number of orders obtained	5	7	9	3	11	16	17	17	31	5
Value of orders (HKD in million)	105	63	277	40	737	405	1799	901	1364	467

Table Note:

1. Up to 30 April 2012

Table 2. Confiscation Orders

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 ¹
Number of orders obtained	1	3	3	7	4	8	13	11	17	4
Value of orders (HKD in million)	0.3	1.01	2.6	6.4	19.8	19.9	119	104	1752.4 ²	3

Table Notes:

1. Up to 30 April 2012

2. Out of the Confiscation Order amounting to HKD1752.4 million, the enforcement of Confiscation Orders amounting to HKD112.90 are pending due to outstanding appeal proceedings.

88. In addition to the above, the statistics on assets restrained in relation to corruption offences under section 14C of the Prevention of Bribery Ordinance, Cap.201 (POBO) are set out as follows:

Table 3.

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012 ¹
Assets restrained (HKD in million)	197.2	6.1	355.5	28.6	291.7	NIL	74.1	91.1	8.1
Value of restitution orders (HKD in million)	NIL	5.3	140.6	NIL	NIL	15.48 ²	NIL	NIL	NIL
Assets restrained and paid to the Gvt through civil settlement (HKD in million)	NIL	NIL	140	NIL	NIL	330 ³	NIL	NIL	NIL

Table Notes:

1. Up to 30 April 2012

2. This amount represents restitution orders awarded during the year, which have been/will be settled from assets restrained under section 14 of POBO in earlier years.

3. This amount was paid, from assets restrained in the year 2006, to the Macao Special Administrative Region Government pursuant to civil proceedings.

Recommendation 3, Overall conclusion

89. Hong Kong, China has made significant progress in improving its compliance with R.3. Part of the technical deficiencies in the legislation was addressed with the entry into force of the relevant provisions of the UNATMO, and initiatives taken to improve the effectiveness of the restraint and confiscation framework.

90. However, progress is not yet complete and does not fully address all the deficiencies. The restraint and forfeiture procedure is still limited to cases where benefits exceed HKD100 000, which does not seem justified in all circumstances; the recognition of environmental crimes and piracy as predicate offences is not clearly established and this impacts the confiscation powers, including on instrumentalities, that can apply to these offences.

91. Hong Kong, China' overall compliance with R. 3 can be assessed at a level essentially equivalent to LC.

SPECIAL RECOMMENDATION I –RATED PC

SRI (Deficiency 1): Considerable shortcomings exist in implementation of the Terrorist Financing Convention: the TF offence does not extend to 'funds' as broadly defined by the Convention; the definition of 'terrorist act' does not extend to acts or threats directed at international organisations; the 'civil protest' exemption to certain classes of 'terrorist acts' are of potentially broad application; there is no current capacity to effect forfeiture of funds used or allocated for the purpose of committing terrorist offences; and not all customer due diligence requirements have been implemented.

- On the extension of the TF offence to 'funds', see SR II Deficiency 1.
- On the extension of the definition of 'terrorist act' to acts or threats directed at international organisations, see SR II Deficiency 3.
- On the potential broad application of the 'civil protest' exemption to certain classes of 'terrorist acts', see SR II Deficiency 4.
- On the capacity to effect forfeiture of funds used or allocated for the purpose of committing terrorist offences, see R3 Deficiency 3.
- On the implementation of customer due diligence requirements, see R5.

92. Significant progress has been made to address this deficiency, with the exception of the "civil protest" exemptions in SR II Deficiency 4).

SRI (Deficiency 2): S/RES/1373(2001) has not been implemented and shortcomings exist in relation to implementation of S/RES/1267(1999); Hong Kong lacks the capacity to implement express freezes on terrorist property and has no capacity to forfeit "funds used or allocated for the purpose of committing" terrorist offences other than those associated with Al Qaeda and the Taliban.

93. The UNATMO, as amended in 2012, introduced the requirements of S/RES/1373(2001), especially through section 6 on the freezing of terrorist property, section 8 on the prohibition on

making funds, etc available to terrorists and terrorist associates, and section 13 on the forfeiture of terrorist property. See specific aspects as part of SR II.

94. With regard to the implementation of S/RES/1267(1999), section 6 of the United Nations Sanctions (Afghanistan) Regulation (UN SAR) provides for prohibition against making available to relevant persons, entities, groups or undertakings funds or other financial assets or economic resources, and also prohibition against dealing with funds or other financial assets or economic resources of relevant persons, entities, groups or undertakings. See specific aspects as part of SR II Deficiency 2 and SR III Deficiency 1.

95. This deficiency has been partially addressed.

Special Recommendation I, Overall conclusion

96. Hong Kong, China has made significant progress in improving its compliance with SR. I. The technical deficiencies in the legislation were addressed with the entry into force of the relevant provisions of the UNATMO and the UN SAR, as well as of the AMLO.

97. One of the remaining deficiencies noted for SR II (the potential broad application of the 'civil protest' exemption to certain classes of 'terrorist acts') has an impact on Hong Kong, China's compliance with SR I.

98. Overall, Hong Kong, China compliance with SR. I can be assessed at a level essentially equivalent to LC.

SPECIAL RECOMMENDATION III –RATED PC

SR III (Deficiency 1): Obligations under S/RES/1267(1999) with respect to assets under the control of designated entities have not been implemented.

99. Section 6 of UN SAR 2012 prohibits making available to certain persons, entities, groups or undertakings fund or other financial assets or economic resources, or dealing with funds or other financial assets or economic resources of certain persons, entities, groups or undertakings. The persons, entities, groups or undertakings targeted are those targeted by the Committee of the Security Council set up for the purpose of UNSCR 1988 (Section 29 of UN SAR and par. 30 of UNSCR 1988).

100. There is also a process under s.4 of UNATMO which allows the Chief Executive to publish a notice in the Government Gazette of persons designated by the Committee of the Security Council set up for the purpose of applying UNSCR 1989. Such notices designate persons as terrorists or terrorist associates, or property as terrorist property. The effect is that the criminal offences in the Ordinance then apply, thus preventing the making available or property to such persons, but there is no automatic freezing of property. This would require a notice to be issued by the Secretary of Security under s.6 of UNATMO freezing the identified terrorist property (see below for a description of the powers and requirements under s.6). No notices have been issued under s.6 to date.

101. There is an important concern with regard to the prohibition and freezing measures in UN SAR, as there is no clear requirement that the process should be conducted promptly. Hong Kong,

China states that upon the enactment of relevant regulations which implement sanctions imposed by the United Nations Security Council, it is the standing practice of the Government to disseminate such information to all government bureaux/departments concerned. These bureaux/departments will then notify the stakeholders under their purview.

102. However, there is nothing in UNSAR or in the above processes that ensures that the freezing order takes place “*without delay and without prior notice to the designated persons involved*”. Although SRIII (and c. SRIII 1.) does not require that the notion of “*without delay*” is explicitly mentioned in the legislation, Hong Kong, China has not demonstrated that specific instructions or initiatives have been taken to ensure that competent authorities dealing with the new designations and freezing orders without delay. Moreover, no action has been taken under UNATMO to freeze any property of designated persons, thus leading to the designation process having little effect.

103. This deficiency has been partially addressed.

SRIII (Deficiency 2): The freezing requirements of S/RES/1373(2001) have not been implemented.

SRIII (Deficiency 3): Hong Kong does not have a system for examining and giving effect to actions initiated under freezing mechanisms of other jurisdictions.

104. Sections 5 and 6 of the UNATMO provide a framework to specify persons and properties as terrorists, terrorist associates and terrorist property by Court, and to freeze terrorist property.

105. There are important concerns with regard to Sections 5 and 6:

- Section 6 prescribes that the freezing of funds can be initiated by the Secretary for Security through a notice specifying the targeted property. This would require that the first step for a successful freezing procedure would be to identify properties which could be owned or controlled by listed persons or entities.

Hong Kong, China indicates that Section 4 of UNATMO (designation procedure for persons or property listed by a UN Committee) and Section 5 (national designation in respect of other persons) both give rise to statutory presumptions deeming property of the designated persons to be terrorist property with consequent prohibitions on making such property available regardless of whether the property is identified or not, but not freezing all the property of the designated terrorist.

Section 6 is described as a freezing provision, but it only operates against identified property i.e. there has to be a process to identify property as that of a terrorist before s.6 can operate. The freezing process in this case requires first that the Secretary for Security issues a notice specifying the property (Section 6 (1)), and second that this notice is given to the person holding the property concerned (Section 6 (7)) who in turn has to approach the owner (Section 6 (8)). These successive steps also raise questions regarding the timeliness of the whole process, as compared for example to the publication of a notice in a national gazette ordering the freezing of the

identified property, in parallel to what is requested as part of Section 4. Thus the need to (a) identify terrorist property and (b) take the further procedural steps, would be their nature lead to significant delays that undermine the objective of the requirements to freeze the property without delay and without notice.

- According to Section 6 (3), the freezing notice will automatically expire after two-years, unless an application is lodged with the Court for forfeiture of the property. Forfeiture can occur if the court is satisfied on the balance of probabilities that the property is the proceeds of a terrorist act, or was used or intended to be used to finance or assist in the commission of a terrorist act. This could raise a specific problem for designations made under UN Security Council Resolution 1989¹³, for which it is less likely that applications for forfeiture will be filed.

If a forfeiture application is lodged, the freezing order will continue to run indefinitely until all proceedings relating to the freezing application (including appeals) have been completed.

However, the net result of these requirements is that the evidential requirements to obtain forfeiture are significant, and it is likely that if ever a notice was to be issued under s.6, there is a real risk that the notice would expire after 2 years. No notices have been issued as yet.

106. Hong Kong, China explains that requests from foreign jurisdictions will be assessed by the relevant law enforcement agencies as to the credibility of the information provided. The Department of Justice will be consulted for legal advice. The matter will then be put before the Security Bureau for a decision by the Secretary for Security, whether there are reasonable grounds to seek a domestic designation under Section 5 of the UNATMO and/or to impose an asset freeze under Section 6 of the UNATMO.

107. If a domestic designation of a person as a terrorist or terrorist associate is made under Section 5 of the UNATMO, then it will be an offence under Section 8 of the UNATMO to collect or make available property to or for the benefit of the terrorist or terrorist associate. Property may also be designated as terrorist property in which case in any forfeiture proceedings under Section 13 of the UNATMO, it shall be presumed to be terrorist property in the absence of evidence to the contrary.

108. Where the Secretary for Security has reasonable grounds to suspect that any property held by any person is terrorist property, the Secretary may direct that an asset be frozen under Section 6 of the UNATMO. It will be an offence to deal in such property without a licence issued by the Secretary. Such administrative freeze may remain in force for 2 years pending application to the court under Section 13 of the UNATMO for forfeiture of the property.

¹³ Reaffirms the assets freeze, travel ban and arms embargo affecting all individuals and entities on the Committee's Al Qaida Sanctions List

109. The procedure put in place by Hong Kong, China will evidence if reasonable grounds exist to initiate a freezing action, following a request by a foreign jurisdiction. Although this procedure involves many successive steps and requires decisions from different bodies and administrative services, clear operational guidelines requiring Law Enforcement Authorities to accord a high priority to overseas freezing requests and take prompt follow-up actions have been issued.

110. These deficiencies have not been adequately addressed.

SRIII (Deficiency 4): There are no provisions concerning jointly held property or property derived from funds or assets owned or controlled by designated entities.

111. Hong Kong, China considers that the UNATMO and the Court Rules are capable of dealing with property which is jointly held or derived from funds or assets owned or controlled by designated entities, and thus no amendment to the UNATMO was introduced in this respect:

- the definition of “property” in the UNATMO has a very wide scope and is not exhaustive (see par. 56). It is sufficiently broad to cover both property derived from property owned or controlled by terrorists or terrorist associates, and property of a terrorist or terrorist associate, whether owned solely or jointly by the terrorist or terrorist associate -although there is no specific reference to these terms in the definition. In addition, the freezing requirement under Section 6 of the UNATMO prohibits the dealing of terrorist property both directly and indirectly;
- the Rules of the High Court (Order 117A, Rules 9 to 12) which govern procedures for making forfeiture applications make provisions with respect to applications involving terrorist property which is jointly owned. In particular, the relevant Rules relate to a holder or holders of property and provide that the court may direct that the applications be heard in the absence of a holder whose whereabouts are not known to the applicant.

112. Although there is no explicit provision in the UNATMO which indicates that “property” covers “jointly held property or property derived from funds or assets owned or controlled by designated entities”, the extensive definition used by reference to IGCO (see par. 56) seems to be broad enough to include all interests in or arising out of property, present or future. This deficiency has been addressed.

SRIII (Deficiency 5): Guidance is not provided to institutions and other natural or legal persons concerning obligations under freezing mechanisms.

113. Guidelines for institutions regarding their obligations under the freezing mechanisms can be found in Chapter 6 (6.11 and s.) of the relevant guidance books, dated July 2012:

- Hong Kong Monetary Authority (HKMA)
- Securities and Futures Commission (SFC)
- Office of the Commissioner of Insurance (OCI)

- Commissioner for Customs and Excise (CCE)

114. In addition, specific guidelines for institutions regarding the freezing obligations were provided by the Security Bureau.

115. Both sets of guidelines describe the administrative freezing process led by the Secretary for Security and inform about the offence linked to making funds available for a person or entity designated as a terrorist or terrorist associate, on the basis of the provisions of the UNATMO. They also present the legal obligations in respect of the freezing under the UNATMO. The Security Bureau guidelines include an example of a freezing Notice which provides some general information to the recipient of the Notice on what he/she is expected to do upon receipt of the Notice, including sending a copy of the Notice without delay to each owner of the property concerned and the relevant arrangement for sending the notice. It also draws the recipient's attention on the meaning of "deal with" under section 6 of UNATMO, which are the specific acts the recipient is directed not to do. However, the guidelines do not include clear guidance regarding the practical steps expected from financial institutions and other entities that may be holding targeted funds or other assets.

116. This deficiency has been partially addressed.

SR III (Deficiency 6): There are no mechanisms enabling challenges to freezing actions or enabling access to frozen funds or assets.

117. Mechanisms for enabling challenges to freezing actions or access to frozen funds or assets are provided under the UNATMO:

- Section 17 provides that any person affected by such freezing orders could apply to the courts for the revocation or variation of such orders,
- Section 15 provides broad discretion for the Secretary for Security to provide access to frozen property so as to allow for uses such as reasonable living expenses, reasonable legal expenses, etc.

118. This deficiency has been addressed.

SR III (Deficiency 7): There are no provisions with respect to confiscation of funds or other assets of designated entities.

119. Section 13 of the UNATMO provides for a mechanism for forfeiture of terrorist property.

120. This deficiency has been addressed.

Special Recommendation III, Overall conclusion

121. Hong Kong, China has made progress in improving its compliance with SR. III. Some of the technical deficiencies in the legislation were addressed with the entry into force of the relevant provisions of the UNATMO and the UNSAR. However, there are some remaining deficiencies, with regard to the obligations required with respect to assets under the control of designated entities; the freezing requirements of terrorist property; and the effect which can be given to freezing

mechanisms of other jurisdictions. In addition, Guidance provided to institutions concerning their obligations under freezing mechanisms is insufficient.

122. The overall compliance of Hong Kong, China with SR. III can be assessed at a level essentially equivalent to PC.

VI. REVIEW OF THE MEASURES TAKEN IN RELATION TO THE OTHER RECOMMENDATIONS RATED PC OR NC

RECOMMENDATION 6 –RATED PC

R6 (Deficiency 1): The banking and insurance guidelines do not specify explicitly that senior management approval is required to continue a business relationship with a customer subsequently discovered to be a PEP.

123. Section 10 (2) (a) of Schedule 2 of the AMLO specifically requires financial institutions to obtain senior management approval for carrying out an occasional transaction or establishing a business relationship with a politically exposed person (PEP); or for continuing the business relationship with an existing customer who is a PEP or has subsequently become a PEP.

124. This deficiency has been addressed.

R6 (Deficiency 2): There are no enforceable provisions regarding the identification and verification of PEPs for remittance agents and money changers.

125. Under the AMLO, Money Services Operators (MSOs) are financial institutions and subject to all the AMLO requirements (*see R5 Deficiency 2*), including for PEP issues.

126. As other financial institutions, MSOs are consequently explicitly required, under section 19(1) of Schedule 2 of the AMLO to establish and maintain effective procedures for determining whether a customer or a beneficial owner of a customer is a PEP. They are also required to conduct enhanced due diligence on PEPs (section 10 of Schedule 2) and conduct enhanced ongoing monitoring of such business relationships (section 5(3)(b) of Schedule 2).

127. This deficiency has been addressed.

R6 (Deficiency 3): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from CDD requirements.

128. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

129. This deficiency has been partially addressed.

Recommendation 6, Overall conclusion

130. The overall compliance of Hong Kong, China with R. 6 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 9 –RATED PC

R9 (Deficiency 1): In the banking and securities sectors, reliance may be placed on introducers who are not regulated for AML/CFT purposes.

131. Acknowledging the requirement to prohibit reliance on third parties who are not regulated for AML/CFT purpose, Hong Kong, China plans to introduce formal AML/CFT regulation on specific non-financial sectors.

132. In the interim, section 18(3)(a) of Schedule 2 of the AMLO allows for a short transitional period permitting financial institutions to rely only on certain local professional sectors (solicitor, certified public accountant, member of the Hong Kong Institute of Chartered Secretaries, trust company) to carry out CDD on the condition (as a safeguard measure) that the financial institution is satisfied that the third party has put in place adequate procedures to prevent money laundering and terrorist financing. As provided under section 18(5) of Schedule 2, this transitional arrangement will expire 3 years after commencement of the AMLO (*i.e.* on 31 March 2015).

133. This deficiency has been addressed, but the issue will remain under review to make sure that a permanent solution is applicable after 31 March 2015.

R9 (Deficiency 2): Financial institutions may rely on intermediaries incorporated in or operating from "equivalent" jurisdictions but the list of equivalent jurisdictions is not derived from an objective, qualitative assessment.

134. The AMLO provides a specific definition on “equivalent jurisdiction” under section 1 of Schedule 2. It is defined as (a) a jurisdiction that is a member of FATF, other than Hong Kong; or (b) a jurisdiction that imposes requirements similar to those imposed under this Schedule (*i.e.* Schedule 2 which provides for customer due diligence and record-keeping requirements for financial institutions).

135. The financial regulators have provided guidance in the guideline issued under the AMLO to financial institutions on the factors to consider in determining jurisdictional equivalence (section 4.20.3 and s. of HKMA, SFC, OCI, CEE Guidelines dated July 2012).

136. This deficiency has been addressed.

R9 (Deficiency 3): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from the preventive measures.

137. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

138. This deficiency has been partially addressed.

Recommendation 9, Overall conclusion

139. The overall compliance of Hong Kong, China with R. 9 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 11 –RATED PC

R11 (Deficiency 1): Banking institutions are not currently required to record in writing their findings and analysis of the background and purpose of complex, unusual large transactions or unusual patterns of transactions that have no apparent or visible economic or lawful purpose.

140. Section 5(1)(c) of Schedule 2 of the AMLO requires financial institutions to identify transactions that are complex, unusually large in amount or of an unusual pattern that have no apparent economic or lawful purpose, and examining the background and purposes of those transactions and setting out its findings in writing.

141. This deficiency has been addressed.

R11 (Deficiency 2): There are no requirements for remittance agents and money changers to pay special attention to complex, unusual large transactions or unusual patterns of transactions that have no apparent or visible economic or lawful purpose.

142. Section 5(1)(c) of Schedule 2 of the AMLO provides for a specific requirement for financial institutions, including Money Service Operators, to pay special attention to complex and unusually large transactions or unusual patterns of transactions (*see R.11 Deficiency 1 above*).

143. This deficiency has been addressed.

R11 (Deficiency 3): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from the preventive measures.

144. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

145. This deficiency has been partially addressed.

Recommendation 11, Overall conclusion

146. The overall compliance of Hong Kong, China with R. 11 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 12 –RATED NC

R12 (Deficiency 1): With very limited exceptions, no relevant CDD or other obligations (as required under R.5, 6 and 8-11) have been imposed on any of the DNFBP sectors.

147. Hong Kong, China has taken progressive steps to extend CDD and record-keeping obligations to designated non-financial business and professions (DNFBPs).

148. (1) As a first step, the relevant regulatory/professional body/the Government have issued practice circulars/guidelines for compliance by the respective practitioners in the relevant DNFBP sectors. These practice circulars/guidelines draw practitioners' attention to the relevant FATF requirements, the importance of the CDD and record-keeping measures and address sector-specific issues with a view to assisting practitioners' compliance.

Lawyers

149. The Law Society of Hong Kong (LSHK) issued Guidelines on Anti-Money Laundering and Terrorist Financing, referred to as Practice Direction P, which took effect from 1 July 2008. The CDD and record-keeping requirements under Practice Direction P are mandatory. Practitioners who fail to comply with the requirements are liable to disciplinary actions by LSHK ranging from a fine to forbidding a solicitor to practice in Hong Kong. The Practice Direction P covers the essential FATF requirements on CDD and record-keeping. It consists of a list of mandatory requirements on client identification and verification, CDD measures and record keeping; a summary of the relevant legislation on money laundering and terrorist financing; basic policies and procedures required of law firms; relevant legal issues on legal professional privilege; examples of suspicious transaction indicators and risk areas; and suspicious transaction reporting.

150. The Legal Practitioners Ordinance (LPO), Cap.159 empowers the Council of the LSHK to verify compliance by solicitors, foreign lawyers, trainee solicitors or employees of solicitors or foreign lawyers with the provisions of LPO and any Practice Direction issued by the LSHK, and to determine whether such conduct should be inquired into or investigated.

Estate agents

151. In Hong Kong, China, the role of estate agents in property transaction is limited to acting as a "middleman" between potential buyers and sellers by arranging "property viewing" and the signing of provisional agreements for sale and purchase (PASP). Immediately after the signing of the PASP, lawyers will be involved in the financial and legal aspects of the property transactions, and therefore lawyers, who are subject to the Practice Direction P, would serve as the "gate-keepers".

152. Notwithstanding that, the Estate Agents Authority (EAA) issued a Practice Circular in 2004 and another in June 2008 which, inter alia, requires estate agents operating in Hong Kong to attend to CDD and internal control requirements. Practitioners are required to identify the client using reliable documentation and keep the relevant records for at least 5 years. Management of the estate agencies should, in accordance with risk assessment, establish necessary procedures of internal control for identifying and reporting suspicious transactions, and review AML procedures and policies regularly. Staff training and monitoring are also emphasized.

153. The Code of Ethics issued by the EAA in 2002 states that estate agents should be fully conversant with the guidelines including the Practice Circulars issued by the EAA. Practitioners who fail to comply with the requirements of the Code of Ethics and/or the Practice Circulars are liable to disciplinary actions by EAA which include reprimand, fines, attaching/varying conditions to licence and revocation of licence.

Accountants

154. To prepare for the implementation of FATF's Recommendations on certified public accountants, the Hong Kong Institute of Certified Public Accountants (HKICPA) issued an advisory Legal Bulletin in July 2006. The Legal Bulletin covers CDD, record-keeping and suspicious transaction reporting requirements.

155. Although the Legal Bulletin is advisory in nature, in view of the fact that the HKICPA is the leading professional body in the sector and the only statutory organisation of the profession incorporated under the Professional Accountants Ordinance, Cap.50, guidelines issued by the HKICPA enjoy a broad readership and recognition, and are widely accepted as the best practice and standard in the profession. On the other hand, there are provisions in the Code of Ethics for Professional Accountants relevant to AML/CFT, in particular to the reporting of suspicious transactions. Failures by members to comply with the Code are liable to disciplinary actions by HKICPA which may include an order to remove the name of the member from its membership register, which means that the person concerned cannot obtain the practicing certificate for performing statutory auditing in Hong Kong.

Trust and company service providers (TCSPs)

156. As for TCSPs, the Hong Kong Institute of Chartered Secretaries issued advisory AML/CFT guidelines in February 2009 introducing the core counter-measures of money laundering formulated by the FATF, including measures on CDD. A comprehensive checklist on CDD and filing of STRs was published in March 2010 as addendum to the guidelines to provide guidance to TCSPs in customer identification and verification. In addition, the Hong Kong Trustees' Association (HKTA), the leading professional body representing the trust industry in Hong Kong, will promulgate within 2012 Best Practice Guides for its members as one of its initiatives to promote amongst its members best practices and corporate governance and high standard of professionalism. The Best Practice Guides will set out the principles of best practices which should be observed by practitioners and will highlight specifically the need and fiduciary duty to know the customer. Further to the promulgation of Best Practice Guides, the HKTA will prepare Practice Guideline on AML to elaborate in greater details on how to achieve the best practices set out in the Best Practice Guides.

Dealers of precious metals and precious stones

157. The Security Bureau (SB) has conducted extensive consultations with the relevant trades, following which a sector-specific guideline was issued by the Bureau for dealers in precious metals and precious stones in December 2008 drawing their attention to the risk of being abused by money launderers and the importance of the AML/CFT measures, including CDD and record-keeping. This

guideline has also placed specific emphasis on the need to conduct on-going monitoring, the application of risk-based approach regarding politically exposed persons and the establishment of internal control.

158. (2) Steps have been taken to build awareness and understanding of practitioners regarding AML/CFT requirements. In addition to the promulgation of practice circulars/guidelines for practitioners, efforts to improve outreach to DNFBPs and capacity building among DNFBP practitioners have been taken through seminars. These seminars elaborate the CDD and record-keeping requirements, raise practitioners' awareness of AML/CFT requirements under existing legislation and relevant practice circulars/guidelines applicable to the respective sector, and encourage DNFBPs to enhance internal control and compliance programs as appropriate. These seminars have been accredited by the regulatory/professional bodies as their Continuous Professional Development programmes, demonstrating the importance attached to the need to comply with relevant FATF recommendations by the DNFBP sectors.

159. In collaboration with the relevant regulatory/professional bodies and trade associations, SB will continue to step up efforts to reach out to as many DNFBP practitioners as possible to enhance their vigilance against the risks of money laundering and terrorist financing posed to their respective sector.

160. (3) To better equip DNFBP practitioners with AML/CFT knowledge and to draw their attention to the importance of AML/CFT, SB published a revised interactive training kit comprising a DVD/ROM and a practical guide for all the DNFBP sectors (except lawyers as LSHK has already issued its own mandatory practice directions) for distribution to practitioners in 2010. Ongoing review and update of the practical guide will be carried out as appropriate and when so warranted. The next update will be in late 2012, taking into account the feedbacks received during the AML/CFT seminars organised for practitioners of DNFBPs. The revised practical guide will also reflect the latest FATF 40 Recommendations published in

161. February 2012, update the international AML/CFT landscape, and address issues raised by DNFBP sectors during previous outreach and capacity building work. Work with the regulatory and professional bodies to enhance capacity building among practitioners will be pursued.

162. (4) As illustrated above, there are well-established industry practices among the DNFBP sectors stipulating the required professionalism of the practitioners in the guard against money laundering and terrorist financing. Together with the government's ongoing outreach effort, practitioners of the DNFBPs are now more aware of their AML/CFT obligations and their role as the gate-keepers. To bring the AML/CFT regime in full compliance with FATF's requirements, overseas models have been examined and views exchanged with DNFBPs in Hong Kong, China on the most suitable way to establish and implement the AML/CFT regulatory system for them. Discussions have also been initiated with the other concerned government departments on the legislative requirements in implementing the AML/CFT regulatory system. Taking into account the information gathered, further deliberation will be engaged with the DNFBPs on the way forward.

163. A number of initiatives have been taken to raise AML/CFT awareness of DNFBPs, and some voluntary initiatives launched taken to encourage them to comply with basic preventive ML/FT measures. More progress is nevertheless required to develop an appropriate AML/CFT regulatory

framework for DNFBPs, and ensure, as it is already the case for lawyers and real estate agents, that non-compliant DNFBPs are sanctioned. This deficiency has been partially addressed.

Recommendation 12, Overall conclusion

164. The overall compliance of Hong Kong, China with R. 12 can be assessed at a level essentially equivalent to PC.

RECOMMENDATION 16 –RATED NC

R16 (Deficiency 1): Some deficiencies in Hong Kong's list of predicate offences (re environmental crimes) impact on the scope of the suspicious transaction reporting requirement.

165. In Hong Kong, specified serious environmental crimes of transnational nature such as illegal whaling, pollution by sewerage etc are indictable offences, and are already subject to the suspicious transaction reporting obligation under OSCO.

166. A number of environmental crimes are already covered by provisions of the offences in Schedules 1 and 2 of OSCO *e.g.* criminal damage of Crimes Ordinance (Cap.200), theft, handling stolen goods of Theft Ordinance (Cap.210), and import and export of prohibited articles of Import and Export Ordinance (Cap. 60). Criminal proceedings for environmental crimes can be brought against a defendant under the above category of offences. Confiscation can therefore be made on conviction of any of these offences.

167. For example, for illegal felling of trees of high economic values, *e.g.* Incense Trees and Buddhist Pines, criminal proceedings have been brought against a defendant under the Theft Ordinance, who was subsequently convicted.

168. It seems that the limited list of specific offences mentioned would not cover the broad spectrum targeted by the generic category of “environmental crimes”. This deficiency has consequently only been partially addressed.

R16 (Deficiency 2): The requirement to report transactions suspected of being related to terrorism only arises where there is a link to terrorist acts, and not where the financing is for a terrorist organisation or individual terrorist in the absence of a link to a terrorist act.

169. Hong Kong, China considers that there is no material gap in the reporting requirement. Normally, a person who makes a STR does not have sufficiently detailed knowledge of the transaction to draw a distinction between a transaction related to terrorist acts and one that is related to terrorist financing.

170. In any event, irrespective of whether or not the transaction appears to have a link to a terrorist act, Hong Kong, China believes that the person would most probably have a general suspicion that the funds may be related to terrorism and report the transaction.

171. It seems that the basis of the requirement to report suspicious transactions remains too narrow, as it focuses on terrorism act, and does not consider the case of activities connected to the

financing of individual terrorists or terrorist organizations, even in the absence of a link to a terrorist act. This deficiency has not been addressed.

R16 (Deficiency 3): The prohibition on tipping-off does not apply in all cases where an STR is being considered, but has not yet been submitted to the JFIU.

172. The tipping-off offence under OSCO covers both STRs made to an authorized officer (*i.e.* the JFIU) and STRs made to a compliance officer within the institution concerned. Therefore, as and when a front-line staff member makes an STR to the compliance officer in his/her institution through the chain of command, even before the STR reaches the compliance officer or before the STR reaches the JFIU, if anyone tips off another party, he/she will be caught by the tipping off offence. The offence is committed irrespective of whether the compliance officer finally forwards the STR to the JFIU. Besides, tipping off at any stage may also constitute other offences, *e.g.* conspiracy to pervert the course of justice under the common law, or assisting an offender or concealing an offence under sections 90 and 91 of the CPO.

173. This deficiency has been addressed.

R16 (Deficiency 4): There are serious concerns about the effectiveness of the reporting system as most DNFBPs rarely submit reports.

174. The statutory obligation to submit STRs is universally applied to all persons and entities in Hong Kong. Therefore, DNFBPs are required by law to submit an STR to JFIU in case they have knowledge or are suspicious that any property relating to crime proceeds. With enhanced government efforts in capacity building with the different DNFBP sectors, there has been continued improvement in the effectiveness of the STR system, as reflected in the continued increased in the number of STRs submitted by DNFBPs since 2007 when the FATF made its ME on-site visit to Hong Kong, with the latest figures representing nearly 10-fold increase over the 2007 figure –

Table 4.

Year	Lawyers	Accountants	TSCPs	Total
2007	9	3	5	17
2008	35	6	4	45
2009	70	11	19	100
2010	99	10	47	156
2011	116	10	32	158
2012 (up to 30 April)	37	1	26	64

175. In collaboration with the relevant professional/regulatory bodies, government agencies continue to intensify focused outreach and capacity building on AML/CFT compliance, including

elaborating the legal requirements in respect of STR and giving more guidance for DNFBPs on STR filing and establishing internal control and compliance programmes. The increasing number of STRs submitted by DNFBPs suggests that such efforts have brought positive effects.

176. Substantial progress has been made regarding the reporting of STRs by DNFBPs. Efforts will need to be pursued, to ensure that there is continuous improvement, coming from all DNFBPs. This deficiency has been partially addressed.

R16 (Deficiency 5): DNFBPs are not obliged to have compliance officers or internal control programmes.

177. In respect of STRs, the relevant prevailing anti-money laundering and counter-terrorist financing Ordinances in Hong Kong, China including the DTROP, the OSCO and the UNATMO have provided that it is a legitimate act for employees to make STRs to a designated officer in an office. These Ordinances stipulate that an employee who has made a disclosure of suspicious transactions to an appropriate person in accordance with the procedure established by his/her employer has the effect of making an STR to the relevant law enforcement unit. In addition, the relevant regulatory authorities / self-regulatory organisations / professional bodies have issued guidelines to direct / encourage their members to establish internal programmes for effective AML control. In light of the legal requirements and the relevant guidelines issued by the respective sectors, it is not uncommon for DNFBPs to designate an appropriate officer (who in effect serves as a compliance officer) for the purpose of reporting suspicious transactions and put in place internal control measures in accordance with the risk profile of their businesses. The need for internal control measures has also been one of our major themes in our on-going outreaching and capacity building work with the DNFBPs in Hong Kong, China since 2009.

178. For solicitors, “Practice Direction P” promulgated by the Law Society of Hong Kong (LSHK) advises law firms that they should develop and implement policies and procedures of internal control for identifying and reporting money laundering and terrorist transactions, and that all solicitors and staff of the firm should be made known of such procedures and the firm should review and update the procedures on a regular basis to ensure effectiveness.

179. For estate agents, the Estate Agents Authority (EAA) issued a “Practice Circular No. 08-5 (CR)”, the non-compliance of which may subject the estate agent to disciplinary action. The Practice Circular has also promulgated preventive measures on money laundering to be observed by all estate agents. Among others, management of estate agencies should establish procedures of internal control for identifying and reporting suspicious money laundering transactions, and to review the policies and procedures on a regular basis. The management should also devise measures for monitoring staff’s compliance with the guidelines and requirements on AML and consider the appointment of a compliance officer for receiving suspicious transactions reports filed by its staff.

180. For Certified Public Accountants (CPAs), the Hong Kong Institutes of Certified Public Accountants (HKICPA) advises member practices to establish appropriate policies and procedures to enable them to comply with the relevant legislative requirements. Member practices should also monitor the effectiveness of those policies and practices and ensure that their staffs are aware of their responsibilities. Moreover, member practices should ensure that their internal audit /

compliance function includes verifying adherence to policies and procedures that the practice has established to ensure compliance with the relevant requirements against money laundering and terrorist financing.

181. For trust and company service providers (TCSPs), the Hong Kong Institute of Chartered Secretaries (HKICS), one of the leading professional bodies of the TCSP sector, recommended in one of its AML guidelines “A Companion to the Anti-Money Laundering and Counter-Terrorist Financing Guidelines – 1”, issued in March 2010, that the first recommended best practice for TCSPs is to appoint a compliance officer. The HKICS also sets out the responsibilities of a Compliance Officer in those Guidelines.

182. For precious metals and precious stones dealers, the Narcotics Division of the Security Bureau compiled a sector-specific guideline for practitioners’ reference in 2008 in view of the lack of a dominant professional body / trade association in the sector. Chapter 9 of the guideline is specifically dedicated to internal control where management of the business is advised to appoint a compliance officer who should have the responsibility of checking on an ongoing basis that the business has policies and procedures to ensure compliance with legal requirements and of testing such compliance.

183. Measures have been taken in a number of sectors to encourage DNFBPs to put in place internal AML/CFT control. However, it seems that where they exist, measures about internal AML/CFT programmes or the appointment of a compliance officer are only recommendations, and do not amount to obligations made to market players. This deficiency has not been addressed.

R16 (Deficiency 6): DNFBPs are not required to pay special attention to transactions with countries which do not or do not adequately implement the FATF Recommendations.

184. Since October 2008, SB has been drawing the attention of DNFBP professional and regulatory bodies on the public statements on high-risk and non-cooperative jurisdictions issued by FATF after each plenary. These statements are posted on the concerned bodies’ websites and/or newsletters for information of their members.

185. This deficiency has been addressed.

Recommendation 16, Overall conclusion

186. The overall compliance of Hong Kong, China with R. 16 can be assessed at a level essentially equivalent to PC.

RECOMMENDATION 17 –RATED PC

R17 (Deficiency 1): Sanctions available with respect to the insurance sector are limited in their scope and do not lend themselves readily to address the wide range of deficiencies that may be identified.

R17 (Deficiency 2): Only criminal sanctions are available with respect to remittance and money changing businesses, and no measures are available to address less serious deficiencies.

187. Under section 21 of the AMLO, the Insurance Authority (IA) and the Commissioner for Customs and Excise (CEE) are empowered to impose a range of supervisory sanctions for breaches of the statutory requirements. Such sanctions include public reprimand, order for remedial actions and fines.

188. Under section 5 of the AMLO, financial institutions, their employees and/or management will be criminally liable if they knowingly or with intent to defraud cause or allow the financial institutions to breach the specified provisions on the CDD and record-keeping requirements provided under Schedule 2 of the AMLO.

189. This deficiency has been addressed.

R17 (Deficiency 3): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from the preventive measures and corresponding regulatory regime.

190. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

191. This deficiency has been partially addressed.

R17 (Deficiency 4): For institutions regulated by the HKMA, the range of sanctions available does not include the power to impose financial sanctions.

192. Under Section 21 of the AMLO, the Hong Kong Monetary Authority (HKMA) is empowered to impose a range of supervisory sanctions, including fines for breaches of the statutory requirements by financial institutions regulated by the HKMA.

193. This deficiency has been addressed.

Recommendation 17, Overall conclusion

194. The overall compliance of Hong Kong, China with R. 17 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 24 – RATED NC

R24 (Deficiency 1): Except for estate agents, there are no designated competent authorities or formal structures in place to monitor DNFBPs' compliance with AML/CFT obligations.

195. In moving towards regulation/supervision of DNFBPs, Hong Kong, China has since late 2009 initiated discussions with a number of professional and regulatory bodies of DNFBPs sectors to

examine options for bringing in regulatory control, including, amongst others, their assuming of the role of self-regulatory organisations in accordance with FATF's requirement.

196. LSHK is playing an active role in monitoring the compliance of its members' (viz. lawyers) with the AML/CFT obligations reflected in the "Practice Direction P" which was implemented in July 2008. Failure to comply with the mandatory Practice Direction may result in disciplinary actions by LSHK ranging from a fine to forbidding a solicitor to practice in Hong Kong. Overseas models in relation to AML regulatory regimes for DNFBPs have also been examined. The capacity building work with relevant sectors of DNFBPs has enabled the Government to identify practical and other relevant issues which need to be addressed in establishing the eventual statutory regulatory regime with respect to CDD and record-keeping requirements on DNFBPs. Hong Kong, China will continue to engage the DNFBPs on the extension of statutory CDD and record-keeping requirements and the introduction of a formal AML regulatory regime.

197. As illustrated in item R. 12. 1., there are well-established industry practices among the DNFBP sectors which stipulate the required professionalism of the practitioners in the guard against money laundering and terrorist financing. Where applicable, practitioners who fail to comply with the practices may be subject to disciplinary actions leading to the suspension or revocation of their professional qualifications.

198. It seems that all DNFBP sectors do not yet have in place formal structures to monitor compliance with their AML/CFT obligations. This deficiency has been partially addressed.

R24 (Deficiency 2): With very limited exceptions, the only sanctions applicable to DNFBPs arise under the criminal law for failure to file STRs.

199. Apart from the legislation on the reporting of suspicious transactions which are applicable to all DNFBPs, the LSHK, EAA and HKICPA have effective disciplinary powers for sanction of non-compliance of professional standards, including relevant AML requirements, for their members (*i.e.* solicitors, estate agents and CPAs respectively), including, for example, attaching specified conditions to the licence, censure, and suspension of or removal from practice, etc. The relevant governing Ordinances provide necessary powers for sanctions on respective DNFBPs regarding their professional conducts and compliance with prevailing rules and guidelines. The AML guidelines issued by relevant professional bodies in other DNFBP sectors are also well observed and widely recognised as part of their ongoing efforts to safeguard professional standard and reputation.

200. It seems that all DNFBP sectors do not yet have in place specific sanctions applicable for failure to comply with AML/CFT obligations. This deficiency has been partially addressed.

Recommendation 24, Overall conclusion

201. The overall compliance of Hong Kong, China with R. 24 can be assessed at a level essentially equivalent to PC.

RECOMMENDATION 29 –RATED PC

R29 (Deficiency 1): The legal authority of the OCI routinely to monitor for AML/CFT compliance and to apply sanctions is limited.

202. Under Section 9 of the AMLO, the Insurance Authority (IA) is empowered to conduct routine inspection to supervise compliance by insurers and insurance intermediaries. Section 21 of the AMLO also empowers the IA to impose supervisory sanctions for breaches of the statutory requirements. Such sanctions include public reprimand, order for remedial actions and fines.

203. This deficiency has been addressed.

R29 (Deficiency 2): There are no powers to permit routine monitoring of remittance and money changing businesses.

204. The AMLO designates CCE as the regulatory authority for MSOs and empowers CCE to conduct routine inspections on MSOs (Section 9). *See item R 5 Deficiency 2.*

205. This deficiency has been addressed.

R29 (Deficiency 3): Only police powers are available to require production of or access to records, documents or information of the remittance agents.

206. Following the implementation of the AMLO, the Commissioner for Customs and Excise (CCE) is the designated regulatory authority for MSOs and is given a full range of inspection/investigation/enforcement powers to supervise MSOs' compliance under Part 3 of the AMLO. Specifically, CCE can (a) conduct routine inspection by entering the business premises of MSOs, inspect and make copies of records and documents and make inquiries of the MSOs or related persons (section 9); (b) conduct investigation and require production of records and documents, require persons to answer any relevant questions (section 12); (c) enter any premises to search and seize records or documents with a magistrate's warrant (Section 17).

207. Criminal offences are provided under sections 10 and 13 of the AMLO for non-compliance with relevant authorities' requirements imposed on financial institutions under sections 9 and 12 of the AMLO.

208. This deficiency has been addressed.

R29 (Deficiency 4): Only criminal sanctions are available for individuals running remittance services and these criminal sanctions are not proportionate to the offences, nor do they apply to all AML/CFT requirements.

209. Under section 21 of the AMLO, the CCE is empowered to impose a range of supervisory sanctions for breaches of the statutory obligations. Such sanctions include public reprimand, order for remedial actions and fines. Under section 5 of the AMLO, financial institutions, their employees or management will be criminally liable if they knowingly or with intent to defraud cause or allow the financial institutions to breach the specified provisions on the CDD and record-keeping requirements provided under Schedule 2 to the AMLO with knowledge or intent to defraud. *See R.17 Deficiency 2.*

210. This deficiency has been addressed.

R29 (Deficiency 5): Scope limitation: no formal assessment has been undertaken to justify exclusion of money lenders, credit unions, the post office and financial leasing companies from the preventive measures and corresponding regulatory regime.

211. See the outcome of the sectoral risk assessments conducted for money lenders (and financial leasing companies), credit unions, and the post office – R5 Deficiency 5.

212. This deficiency has been partially addressed.

Recommendation 29, Overall conclusion

213. The overall compliance of Hong Kong, China with R. 29 can be assessed at a level essentially equivalent to LC.

RECOMMENDATION 33 –RATED PC

R33 (Deficiency 1): Measures are not adequate to ensure that there is sufficient, accurate and timely information held on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.

214. Hong Kong, China has arrangements in place for competent authorities and the public to access information on company particulars. For example, under the Companies Ordinance, Cap.32 (CO), every company must keep a register of its members recording the names and the addresses of the members, the shares held by the members and the date when a person becomes or ceases to be a member. The company's register must be made available for inspection by any person. Non-compliance will be subject to criminal sanction.

215. Electronic incorporation of companies and electronic filing of commonly filed company documents have also been introduced by phases since March 2011 and have now been completed. With the introduction of electronic incorporation and electronic filing of documents, transparency of legal and natural persons involved in the establishment and management of corporate entities is further enhanced through the user registration system of the e-Registry. To use the electronic services of the e-Registry, a person must register as a user of the e-Registry. Individual user has to attach an electronic certificate, or a certified true copy of his/her identification document (Hong Kong Identity Card or overseas passport), or present the original identification document in person at the Registry's offices when applying for user registration. The identities of the registered users will be verified by the Companies Registry (CR) before documents can be signed and submitted via the e-Registry. Submission of documents would require the use of digital signature and password as appropriate.

216. Information on the particulars of new companies would be available for inspection round-the-clock shortly after the incorporation of companies.

217. Companies registers and the new incorporation form and the introduction of electronic incorporation of companies will improve access to information. However, it looks like available

information pertains only to legal ownership/control, and not so much to beneficial ownership. This deficiency has consequently been partially addressed.

R33 (Deficiency 2): Information on the companies register pertains only to legal ownership/control (as opposed to beneficial ownership), is not verified and is not necessarily reliable.

218. The Company Registry would investigate and verify information on companies register whenever necessary, *e.g.* when there is inconsistency in records or on receipt of complaints relating thereto. This information seems to focus on legal ownership/control, and does not provide details on beneficial ownership

219. The electronic system will facilitate the identification of the source of information on the register, which in turn would enhance the reliability of the information. However, there is no indication that the information will be verified in all cases. Besides, and as already noted, it does not seem that it will include information on beneficial ownership.

220. Consequently, this deficiency has been partially addressed.

R33 (Deficiency 3): Corporate and nominee directors are permitted, which further obscures beneficial ownership and control information

221. Under the CO, all listed/public companies and their associated companies are prohibited from appointing a body corporate as their director.

222. As for private companies, the new CO, which was passed by LegCo on 12 July 2012, require that each private company must have at least one natural person as director. It is expected that the requirement of at least one natural person as a director to be held accountable for the company's action will enhance the effectiveness of enforcement. The new CO will be brought into operation in 2014.

223. This deficiency has been partially addressed.

R33 (Deficiency 4): There are only limited measures in place to ensure that share warrants to bearer, which may be issued by companies incorporated in Hong Kong, are not misused for money laundering.

224. Issue of share warrants to bearer by a private company is not possible in view of the restriction as to the transfer of shares under Section 29 of the CO. As at end March 2012, there are only 521 public companies limited by shares which are not prohibited from issuing share warrants. None of them have issued any share warrants. The new CO were passed by LegCo on 12 July 2012, and one of the provisions is to ban share warrants to bearer for public companies limited by shares, which will be implemented in 2014.

225. This deficiency has been addressed.

Recommendation 33, Overall conclusion

226. The overall compliance of Hong Kong, China with R. 33 can be assessed at a level essentially equivalent to PC.

RECOMMENDATION 34 –RATED PC

R34 (Deficiency 1): While the investigative powers are generally sound, there are not adequate measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal arrangements that can be obtained or accessed in a timely fashion by competent authorities.

227. Law enforcement agencies and relevant regulatory authorities are provided with a broad range of investigatory powers under various Ordinances, *e.g.* the Police Force Ordinance (Cap.232), OSCO, and DTROP to obtain information from all persons, including trustees and beneficial owners of legal arrangements. Investigatory and inspection powers are also provided for in the CO; and such powers would be invoked by the Company Registry as and when necessary. These powers are effectively used to ensure timely access to information on beneficial ownership and control of legal arrangement.

228. Given the lack of details provided as to the practical measures in place to enable competent authorities to get effective access to information on the beneficial ownership and control of legal arrangements, it is not possible to assess if this deficiency was addressed.

R34 (Deficiency 2): Providers of trust services, other than those which are financial institutions, are not subject to or monitored for AML/CFT obligations.

229. Some trust service providers are already subject to the regulation of their respective professional bodies. They include accountants who are members of the Hong Kong Institute of Certified Public Accountants (HKICPA), and solicitors who are members of the Lawyer Society of Hong Kong (LSHK). LSHK has issued the mandatory Practice Direction P, which requires all law firms and lawyers to observe the CDD and record-keeping requirements therein.

230. HKICPA has issued a Legal Bulletin on AML/CFT advising its members on the prevailing legislative requirements. HKICPA, in collaboration with the Joint Financial Intelligence Unit (JFIU) and Security Bureau (SB), has issued a supplement to the Legal Bulletin on making STRs for its members in May 2012 to reinforce members' awareness of suspicious transaction.

231. As for the other trust service providers, the Hong Kong Trustees' Association (HKTA) targets to promulgate within 2012 the Best Practice Guide, with specific emphasis on the need to comply with CDD and AML requirements, to educate and raise the professional standard of its members. HKTA will prepare and issue a Practice Guideline specifically on AML (to elaborate in greater details on how to achieve the best practices) after the promulgation of the Best Practice Guides.

232. This deficiency has been partially addressed.

Recommendation 34, Overall conclusion

233. The overall compliance of Hong Kong, China with R. 34 can be assessed at a level essentially equivalent to PC.

SPECIAL RECOMMENDATION VI –RATED PC

SRVI (Deficiency 1): There is no system for monitoring remittance services and ensuring they comply with the FATF Recommendations: the only oversight is by use of law enforcement powers.

234. The AMLO covers the AML regulation and licensing of MSOs, which include entities providing remittance services.

See also R5 Deficiency 2., R10 Deficiency 3, 4 and 5, R11 Deficiency 2, R17 Deficiency 2., R29 Deficiency 2., 3 and 4.

235. This deficiency has been addressed.

SRVI (Deficiency 2): Only criminal sanctions are available and these are not effective, proportionate and dissuasive.

236. Section 21 of the AMLO empowers the Commissioner for Customs and Excise, the designated regulatory authority for MSOs, to impose a range of supervisory sanctions on MSOs. These sanctions include imposition of fines not exceeding the amount that is the greater of HKD10 million or 3 times the amount of the profit gained, or costs avoided by the financial institution as a result of the contravention of the statutory CDD and record-keeping requirements.

237. This deficiency has been addressed.

SRVI (Deficiency 3): A broad range of deficiencies identified under other Recommendations are also relevant to the remittance sector.

238. The implementation of the AMLO has provided a comprehensive legal framework for AML/CFT regulation of the remittance sector, thus addressing the deficiency identified. The AMLO prescribes the CDD and record-keeping requirements for financial institutions with attendant provisions for sanctions and provides for a licensing regime to regulate the remittance sector. MSOs are financial institutions covered under the AMLO and are thus subject to the same set of statutory CDD and record-keeping requirements as other financial institutions specified under the AMLO. CCE, as the regulatory authority for MSOs, is given a full range of inspection/investigation/enforcement powers to supervise MSOs' compliance with CDD and record-keeping requirements and has the power to impose supervisory sanctions for breaches of the statutory requirements.

See also R5 Deficiency 2, R10 Deficiency 3, 4 and 5, R11 Deficiency 2, R17 Deficiency 2., R29 Deficiency 2., 3 and 4.

239. This deficiency has been addressed.

Special Recommendation VI, Overall conclusion

240. The overall compliance of Hong Kong, China with SR. VI can be assessed at a level essentially equivalent to C.

SPECIAL RECOMMENDATION VII –RATED PC

SRVII (Deficiency 1): For remittances ordered by non-accountholders, institutions are only required to conduct verification of the customer’s identity for amounts of HKD 8 000 or more when the remitter appears in person.

241. The requirement for conducting verification on customers’ identity has been strengthened. Under section 3(1)(c) of Schedule 2 of the AMLO, financial institutions are required to conduct CDD measures as provided under Section 2 of Schedule 2 (including identifying the customer and verifying the identity) when carrying out occasional transactions that are wire transfers involving amount equal to or above HKD8,000 (equivalent to US\$1,000).

242. This requirement is applied to all customers, regardless of whether they appear in person or not. In addition to the standard CDD measures, non-face-to-face transactions are subject to special CDD requirements under section 9 of Schedule 2. *See also R10 Deficiency 3.*

243. This deficiency has been addressed.

SRVII (Deficiency 2): There is no requirement for remittance agents or the post office to transmit full originator information in the message or form accompanying the wire transfer.

244. Financial institutions, including MSOs and the Postmaster General (for the post office’s remittances services) are required to obtain, maintain and transmit full originator information in the message or form accompanying the wire transfer under Section 12 to the AMLO.

245. This deficiency has been addressed.

SRVII (Deficiency 3): There is no mechanism for monitoring compliance by remittance agents.

246. Under the AMLO, the Commissioner for Customs and Excise is the designated regulatory authority for MSOs under the AMLO and is given a full range of inspection/investigation/enforcement powers.

See also R5 Deficiency 2., R10 Deficiency 3, 4 and 5, R11 Deficiency 2, R17 Deficiency 2., R29 Deficiency 2., 3 and 4.

247. This deficiency has been addressed.

Special Recommendation VII, Overall conclusion

248. The overall compliance of Hong Kong, China with SR. VII can be assessed at a level essentially equivalent to C.

SPECIAL RECOMMENDATION IX –RATED NC

SRIX (Deficiency 1): There is neither a disclosure nor a declaration system for detection, seizure or confiscation of cross-border movement of currency or BNI.

SRIX (Deficiency 2): Authorities are not empowered to ask for further information where a false/misleading disclosure/declaration has been made.

SRIX (Deficiency 3): There is no offence for making a false/misleading declaration or disclosure and authorities are not empowered to seize or confiscate property resulting from a false/misleading disclosure or declaration.

SRIX (Deficiency 4): The only specific authority to seize currency or BNI at the border is in relation to property that is related to drug trafficking.

SRIX (Deficiency 5): The Immigration Department is not involved in domestic co-ordination mechanisms in this area.

SRIX (Deficiency 6): There appears to be no co-ordination or action taken jointly with Mainland China border authorities in relation to the cross-border movement of currency or BNI.

SRIX (Deficiency 7): There are no sanctions in cross-border movement of currency or BNI related to ML or TF other than the TF offence itself.

SRIX (Deficiency 8): Limited statistics are maintained on cross-border movement of currency or BNI.

249. Hong Kong, China has already formulated the framework and essential parameters for establishing an SR IX system to detect and prevent illicit physical cross-boundary transportation of cash or bearer negotiable instruments (CBNI). Specifically, Hong Kong, China plans to implement a mixed system with declaration on cross-boundary cargo and inbound passenger movements and with disclosure on outbound passengers, and to set the value threshold at HKD120,000 (equivalent to around US\$15,000).

250. Narcotics Division (ND) of SB is taking charge of the planning and the Customs and Excise Department (C&ED) is leading the implementation of the proposed SR IX system. Key actions include a review of the legislative framework required to enable the implementation of such a system, workflow review and redesign, computer system upgrade, and engagement with stakeholders to facilitate the preparation of the necessary implementation plan.

251. C&ED is conducting a survey at the boundary control points in order to assess the volume and pattern of cross-boundary transportation of CBNI over the threshold, and is examining the workflow with a view to identifying the need for additional resources, including extra manpower, equipment and office space. ND has started to draw up the detailed plan for implementation, taking into account the inputs from C&ED. ND has also started to work with relevant government departments on the key actions mentioned above.

252. Following intensive preparatory work and detailed deliberation, Hong Kong, China decided, in April 2012, to adopt a mixed system for passengers and a declaration system for both incoming and outgoing cargoes, and to set the threshold at HKD120,000 (around US\$ 15,000). Hong Kong, China has since then started to examine more specific requirements of a number of key issues which need to be addressed in order to implement the system and draw up a detailed implementation firm timetable, including examining the legislative approach and proposal, conducting surveys at boundary control points (BCPs) to gauge the volume of traffic, and review and redesign of the workflow and operational procedures, engagement of internal and external stakeholders, and formulation of the hardware and software requirements for implementation.

253. Apart from the development of a new computer system to handle and process information to be received from the proposed SR IX system and renovation of BCPs, another critical task leading to

the full compliance of FATF's SR IX requirements is the introduction of new legislation to impose relevant obligations on cross-boundary passengers and cargoes and to empower enforcement agents with appropriate powers. Subject to feedback from stakeholders and views of the Legislative Council, Hong Kong, China plans to take a fast-track approach with a view to taking forward the relevant legislative exercise and, subject to the passage of the legislation, preparing to roll out the SR IX system with relevant measures within 2014.

254. Good note is taken of Hong Kong's China's plan to ensure full compliance with SR IX. At this stage, the deficiencies have not been addressed.

Special Recommendation IX, Overall conclusion

255. The overall compliance of Hong Kong, China with SR. IX can be assessed at a level essentially equivalent to NC.

ANNEXES

Available upon request from the FATF Secretariat at contact@fatf-gafi.org

- ANNEX 1** Detailed progress report prepared by Hong Kong, China
- ANNEX 2** Anti- money Laundering and Counter- terrorist Financing (Financial Institutions) Ordinance (AMLO 15/2011)
- ANNEX 3** Amendments to the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO 20/2012)
- ANNEX 4** United Nations Sanctions (Afghanistan) Regulation 2012 (UN SAR)
- ANNEX 5** Methodology for sectoral assessments (previously submitted under Hong Kong's first progress report)
- ANNEX 6** Results of sectoral risk assessments (previously submitted under Hong Kong's first progress report)
- ANNEX 7** Terrorist offences described in international instruments and corresponding provisions in Hong Kong, China's penal system