



# Seven Key Updates to AML/CFT Guideline

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The Securities and Futures Commission (the “SFC”) had issued a Consultation Paper on 18 September 2020 and a Consultation Conclusion on 15 September 2021 to propose amendments to the “Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations)” (the “**AML/CFT Guideline**”), which have become effective since 30 September 2021<sup>1</sup>. This explanatory note intends to list seven key updates to the AML/CFT Guideline and a summary of material amendments thereto.

## 1. The seven key updates to the AML/CFT Guideline

The seven key updates to the AML/CFT Guideline are listed out as follows: -

- (i) Institutional risk assessment;
- (ii) Risk indicators for institutional and customer risk assessments;
- (iii) Due diligence for cross-border correspondent relationships;
- (iv) Simplified and enhanced measures under a risk-based approach;
- (v) Red-flag indicators of suspicious transactions and activities;
- (vi) Third-party deposits and payments; and
- (vii) Person purporting to act on behalf of the customer (“PPTA”).

## 2. Summary of amendments

The amendments made to the key updates under paragraph 1 above are summarized below: -

### (i) **Institutional risk assessment**

Pursuant to paragraph 2.3 of the AML/CFT Guideline, a licensed corporation (“LC”) should take appropriate steps to identify, assess, and understand its money laundering and terrorist financing (“ML/TF”) risks which should include: -

- considering all relevant risk factors;
- keeping the risk assessment up-to-date;
- documenting the risk assessment;
- obtaining the approval of senior management of the risk assessment results; and
- having appropriate mechanisms to provide risk assessment information to relevant authorities upon request.

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<sup>1</sup>The SFC will provide a 6-month transition period from 30 Sep 2021 for LCs to implement the policies, procedures and controls for the new requirements for cross-border correspondent relationships stipulated in paragraphs 4.20 of the AML/CFT Guideline.



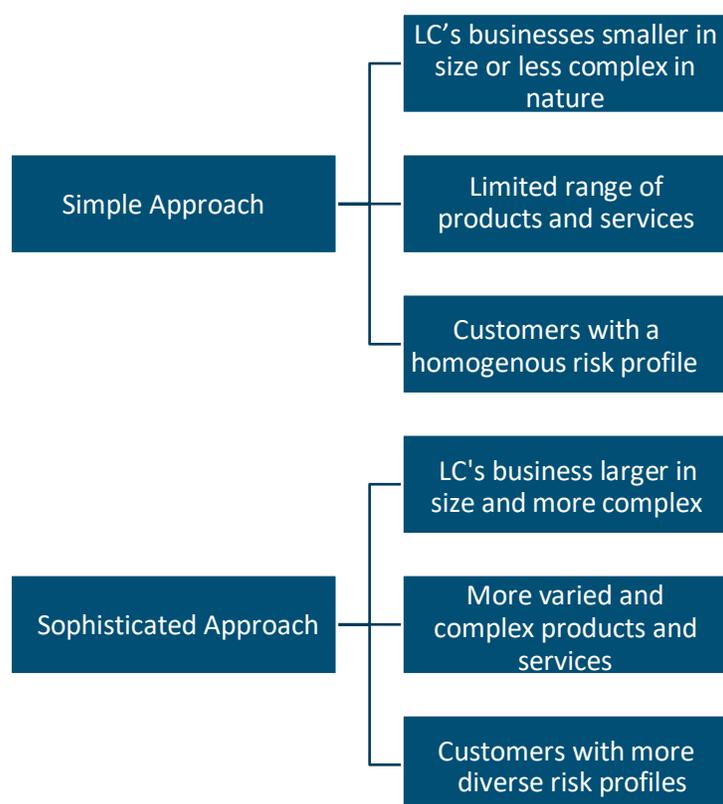
In accordance with paragraph 2.7 of the AML/CFT Guideline, in determining the level of overall risk, an LC should holistically consider a range of factors, including: -

- country risk;
- customer risk;
- product/service/transaction risk;
- delivery/distribution channel risk; and
- other risks e.g. the review results of compliance.

Under paragraph 2.9 of the AML/CFT Guideline, LC's institutional risk assessments should be subject to periodic review at least once every two years or more frequently upon the occurrence of triggering events. The completion of the SFC's business and risk management questionnaire is not a substitute for conducting an institutional risk assessment.

By virtue of paragraph 2.11 of the AML/CFT Guideline, the institutional risk assessment should be communicated to, reviewed and approved by, the senior management of the LC.

There is no one-size-fits-all methodology for conducting an institutional risk assessment. The illustrative examples of how the nature and extent of institutional risk assessment procedures should be commensurate with the nature, size and complexity of the business of an LC are further elaborated in paragraph 2.5 of the AML/CFT Guideline and summarized below: -





**(ii) Risk indicators for institutional and customer risk assessments**

Pursuant to paragraphs 2.6, 2.7 and 2.17 of the AML/CFT Guideline, when performing customer risk assessments, the core principle is that an LC should holistically take into account all relevant risk factors instead of any single risk factor in isolation.

Further, new indicator examples set out in Appendix A to the AML/CFT Guideline are not exhaustive and are intended to cover only higher or lower risk indicators as may generally be applicable. LCs are reminded to refer to relevant guidance published by the Financial Action Task Force or industry bodies for sector- or product-specific risk indicators which should be taken into account in their holistic assessments of the overall risk of their businesses or customers as appropriate.

**(iii) Due diligence for cross-border correspondent relationships**

Pursuant to paragraph 4.20 of the AML/CFT Guideline, LCs are required to carry on due diligence for cross-border correspondent relationships.

***(a) Cross-border correspondent relationships***

It is specified that cross-border correspondent relationship in the securities sector resembles cross-border correspondent banking relationship. A striking example of a cross-border correspondent relationship in the securities industry is illustrated by the circumstances where a Hong Kong securities firm executes securities transactions on a stock exchange for an overseas intermediary which acts for its underlying local customers.

The SFC has further elaborated that the cross-border correspondent relationships provisions do not apply to a business relationship between a domestic asset management firm (i.e. delegated asset manager) and an overseas delegating management company for the reason that the transactions are initiated by the domestic asset management firm (i.e. delegated asset manager) based on a delegated mandate rather than by the customer (i.e. the overseas delegating management company).

The cross-border correspondent relationships provisions are also applicable: -

- when an LC executes trade orders received from its customer that is an overseas fund manager to invest in listed securities for or on behalf of an investment vehicle; or
  - when an LC deals in fund shares or units for a customer that is an overseas distributor for or on behalf of its underlying customers, irrespective of whether the funds are managed by the LC or not.
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Further, it is elaborated in the Consultation Conclusion that transactions conducted for a respondent institution which is an overseas affiliated company (whether or not on agency or principal basis) do not necessarily pose lower ML/TF risks, thus the cross-border correspondent relationship provisions should be scoped in and apply to affiliated companies.

**(b) Customer due diligence measures**

Pursuant to paragraph 4.20.5 of the AML/CFT Guideline, an LC must carry out customer due diligence (“CDD”) measures in relation to a customer including a respondent institution. The cross-border correspondent relationships provisions do not require LCs to conduct CDD on a respondent institution’s underlying customers. Nevertheless, the LC should apply the following additional CDD measures when it establishes a cross-border correspondent relationship to mitigate the associated risks: -

- collect sufficient information about the respondent institution to understand fully the nature of the respondent institution’s business;
- determine the reputation of the respondent institution;
- assess whether the AML/CFT controls of the respondent institution are adequate and effective;
- obtain approval from its senior management; and
- understand clearly the respective AML/CFT responsibilities of the LC and the respondent institution within the cross-border correspondent relationship.

The LC should adopt a risk-based approach in applying the additional due diligence measures stated above, taking into account relevant factors such as:-

- the purpose of the cross-border correspondent relationship, the nature and expected volume and value of transactions;
- how the respondent institution will provide services to its underlying customers through the account maintained by the LC (the “**correspondent account**”);
- the types of underlying customers of the respondent institution serves through the correspondent account, and the extent to which any of these underlying customers and their transactions are assessed as high risk by the respondent institution; and
- the quality and effectiveness of the AML/CFT regulation and supervision by authorities in the jurisdictions of the respondent institution.

Specifically, for direct access arrangements<sup>2</sup> which pose higher risks, LCs are only required to take further steps and be satisfied that the respondent institution has conducted CDD on its underlying customers following requirements similar to those of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615), and would provide documents, data or information about those customers to LCs upon request.

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<sup>2</sup> For example, an LC may provide its electronic trading system for a respondent institution under a white label arrangement which permits the underlying customers of the respondent institution to submit order directly to the LC for execution, but the identities of those underlying customers are not known to the LC.





In accordance with paragraph 4.20.10 of the AML/CFT Guideline, senior management approval is required for establishing cross-border correspondent relationships<sup>3</sup>.

The SFC considers a six-month transition period for cross-border correspondent relationships provisions to operate to be appropriate. That is to say, the relevant provisions shall become effective in March 2022.

#### **(iv) Simplified and enhanced measures under a risk-based approach**

Illustrative examples of possible simplified and enhanced measures under a risk-based approach are expanded under Appendix C of the AML/CFT Guideline.

It should be noted that the example in paragraph 2(d) of Appendix C to the AML/CFT Guideline in relation to the customer's source of wealth or source of funds was meant to be guidance concerning higher-risk customers who are not: -

- political exposed persons (“PEPs”); or
- subject to the special requirements in high-risk situations.

In the above cases, the respective special requirements in paragraphs 4.9 and 4.11 of the AML/CFT Guideline apply as mandatory enhanced measures for PEPs.

#### **(v) Red-flag indicators of suspicious transactions and activities**

A list of illustrative red-flag indicators of suspicious transactions and activities is set out in Appendix B to the AML/CFT Guideline.

Under paragraph 7.12 of the AML/CFT Guideline, LCs should have reasonable policies and procedures to identify and analyse relevant red flags of suspicious activities for their customer accounts. Such policies and procedures should include red flags relevant to LCs' business nature and operations to enable them to identify suspected ML/TF activities.

LCs should determine the appropriate indicators set out in the AML/CFT Guideline to be included, taking into account the nature of their businesses and customer transactions, customers' risk profiles and types of business relationships, instead of incorporating all illustrative indicators.

#### **(vi) Third-party deposits and payment**

Facilitative guidance permitting delayed third-party deposit due diligence is intended to address the industry's concerns upon practical difficulties in completing the due diligence process before settling transactions with deposited funds.

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<sup>3</sup> The level of seniority of the member of an LC's senior management in making such approval should be commensurate with the assessed ML/TF risk.





For these provisions, “third party” means any person other than the customer. Further, under paragraph 4.1.6 of the AML/CFT Guideline, “customer” refers to a person who is a client of an LC, where “client” is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

Under paragraph 11.9 of the AML/CFT Guideline, LCs are only permitted to do so under exceptional situations provided that: -

- any ML/TF risk arising from the delay can be effectively managed;
- it is necessary to avoid interruption of the normal conduct of business with the customer; and
- the third-party deposit due diligence is completed as soon as possible after settling transactions with the deposited funds.

Under paragraph 11.10 of the AML/CFT Guideline, if an LC allows third-party deposit due diligence to be delayed in exceptional situations, it should adopt appropriate risk management policies and procedures, including: -

- establishing a reasonable timeframe for the completion of the third-party deposit due diligence;
- placing appropriate limits on the number, types, and/or amount of transactions that can be performed;
- performing enhanced monitoring of transactions carried out by or for the customer; and
- ensuring senior management is periodically informed of all cases involving delay.

Paragraph 11.3 of the AML/CFT Guideline has been updated to provide that LCs may designate the Manager-In-Charge of Compliance or other appropriate senior management personnel to oversee the implementation of the related policies and procedures.

The SFC will issue an FAQ to explain how these provisions are operated.

#### **(vii) PPTAs**

A factor known as “ML/TF risks associated with the business relationship” is added as one of the factors for determining who should be considered as PPTA under paragraph 4.4.1 of the AML/CFT Guideline. It should be noted that “ML/TF risks associated with the business relationship” complements, but does not replace, the existing factor of “ML/TF risks associated with the roles and activities that a person is authorised to conduct on behalf of the customer”.





Illustrative examples of PPTA have already been set out in the footnote to paragraph 4.4.1 of the AML/CFT Guideline (e.g. any person authorised to act on behalf of a customer to establish a business relationship with an LC) and the SFC will issue an FAQ to guide on whether persons carrying out transactions on behalf of the customer may be considered as PPTAs.

It should be noted that the illustrative example in the footnote to paragraph 4.4.3 of the AML/CFT Guideline regarding customers with a long list of PPTAs is not exhaustive. LCs have the flexibility to implement other streamlined approaches to verify the identity of a PPTA if the business relationship with a customer poses a low ML/TF risk<sup>4</sup>.

Should you have any questions, please contact our Mr Lawrence Yeung on (852) 2854 3070 or by email at [lawrence.yeung@ycylawyers.com.hk](mailto:lawrence.yeung@ycylawyers.com.hk).

*This explanatory note is not, and should not be regarded as, legal advice. Should you have any enquiries, please seek specific advice from legal advisers.*

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<sup>4</sup> For example, LC could verify the identities of the PPTAs with reference to a list of PPTAs whose identities and authority to act have been confirmed by an independent department or person within that customer whose identities are being verified (e.g. a list verified by compliance, audit or human resources).

