18 December 2020

Securities and Futures Commission
54/F, One Island East
18 Westlands Road, Quarry Bay
Hong Kong

Re: Consultation on Revised AML/CFT Guideline

Dear Sirs and Madams,

The Asia Securities Industry & Financial Markets Association (**ASIFMA**)[1] and its members welcome the opportunity to respond to the Securities and Futures Commission (**SFC**) consultation paper on the proposed amendments to the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) (**AML/CFT Guideline**) and the Prevention of Money Laundering and Terrorist Financing Guideline issued by the SFC for Associated Entities (**Guideline for AEs**).

Our response to the consultation questions is set out in the Annexure to this letter.

In general our members welcome the SFC's suggested amendments to the AML/CFT Guideline. The main submission of our members is that asset management is out of scope of "cross-border correspondent relationships". Our members would welcome the SFC's clarification on certain matters of practicality in relation to due diligence of overseas distributors within the context of cross-border correspondent relationships, third-party deposits and payments and persons purporting to act on behalf of the customer.

We thank you in advance for your consideration of our members concerns.

This response has been prepared with the support of Eversheds Sutherland, based on feedback from ASIFMA and its members.

If you have any questions regarding this response, please do not hesitate to contact Laurence Van Der Loo, Executive Director Technology & Operations (lvanderloo@asifma.org).

Yours sincerely,

Asia Securities Industry & Financial Markets Association
Mark Austen, Chief Executive Officer

[1] ASIFMA is an independent, regional trade association with over 120 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, professional and consulting firms, and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

ASIA SECURITIES INDUSTRY & FINANCIAL MARKETS ASSOCIATION | Unit 3603, Tower 2 Lippo Centre | 89 Queensway Admiralty, Hong Kong | Tel: +852 2531 6500 www.asifma.org

ANNEXURE

Questions for Public Consultation – ASIFMA Response

Question 1: Do you agree that the institutional risk assessment should be subject to periodic review at least once every two years or more frequently upon the occurrence of trigger events? Please explain.

1. Our members support the proposed amendment as it is consistent with their existing practices as well as requirements from other leading regulators such as HKMA and MAS.

Question 2: Do you consider the expanded list of illustrative examples of risk indicators to be sufficiently comprehensive? Please state your views.

2. Our members welcome the expanded list of illustrative examples of risk indicators.

Question 3: Do you agree with the scope of application for the cross-border correspondent relationships provisions for the securities sector? Please explain.

3. We refer to our response to the SFC soft consultation regarding the proposed amendments to the AML/CFT Guideline dated 28 February 2020 (**Response to the Soft Consultation**) and would like to reiterate / make the following points.

Definition of "cross-border correspondent relationships"

4. Paragraph 4.20.1 of the proposed AML/CFT Guideline defines "cross-border correspondent relationships" as follows:

> "*4.20.1 For the purpose of this Guideline, "cross-border correspondent relationships" refers to the provision of services for conducting transactions, which constitutes dealing in securities, dealing in futures contracts, or leveraged foreign exchange trading*[2] *for which an FI is licensed or registered, by the FI (hereafter referred to as "correspondent institution") to another financial institution*[3] *located in a place outside Hong Kong (hereafter referred to as "respondent institution"), whether the transactions are effected by the respondent institution on principal or agency basis.*"

5. The above definition appears to be a catch-all for any relationship between a financial institution in Hong Kong and a financial institution located in a place outside Hong Kong that involves provision of services for transactions that constitute "dealing in securities", "dealing in futures contracts" and "leveraged foreign exchange trading" as defined in Part 2 of Schedule 5 to the Securities and Futures Ordinance Cap. 571 (**SFO**). Our members would appreciate more clarification on the scope of "cross-border correspondent relationships". In particular, our members suggest that the scope be narrowed and consider that the following business is out of scope of "cross-border correspondent relationships" for the reasons explained below.

Asset management is out of scope

6. As per the definition set out above, cross-border correspondent relationships refers to the provision of services by a correspondent institution to a respondent institution for conducting transactions, which constitutes dealing in securities, dealing in futures contracts, or leveraged foreign exchange trading.

---

[2] The terms "dealing in securities", "dealing in futures contracts" and "leveraged foreign exchange trading" are as defined in Part 2 of Schedule 5 to the SFO.

[3] Financial institution in this context refers to businesses falling within the definition of the term "financial institutions" under the FATF Recommendations and which are conducted for or on behalf of customers.

7. "Dealing in securities" (Type 1), "dealing in futures contracts" (Type 2) and "leveraged foreign exchange trading" (Type 3) are regulated activities defined under Schedule 5, Part 2 of the SFO.

8. Pursuant to the exceptions in paragraph (xiv) of the definition of "dealing in securities" and in paragraph (vi) of the definition of "dealing in futures" (Schedule 5, Part 2, SFO), if a person is licensed or registered for the regulated activity of "asset management" (Type 9) and performs "dealing in securities" or "dealing in futures contracts" solely for the purposes of carrying on asset management, that act would not constitute dealing in securities / futures contracts.

9. "Asset management" is defined as: (a) "real estate investment scheme management", i.e. the provision of a service of operating a collective investment scheme by one person for another where the property being managed primarily consists of immovable property and the scheme is authorized under section 104 SFO; or (b) "securities or futures contracts management", i.e. the provision of a service of managing a portfolio of securities or futures contracts by one person for another (Schedule 5, Part 2, SFO).

10. Accordingly, if an asset manager in Hong Kong provides services to an overseas respondent institution for conducting transactions, which constitutes dealing in securities/futures contracts, but solely for the purposes of carrying on asset management, it appears that the provision of such services would fall outside the scope of "cross-border correspondent relationships". This is because the provision of such services in such circumstances is expressly excluded from the definition of "dealing in securities" and "dealing in futures contracts" and therefore not caught by the definition of "cross-border correspondent relationships". On this basis, we consider that asset management is out of scope of "cross-border correspondent relationships". Moreover, it appears that a simple but express reference in the proposed definition of "cross-border correspondent relationships" to "asset management" would put the matter beyond doubt. As such, the lack of such an express reference to "asset management" in the definition of "cross-border correspondent relationships" further confirms our view above.

Requests for clarification

11. Our members would be grateful for the SFC's clarification in relation to the following matters:

    11.1. Paragraph 33 of the consultation paper states that the cross-border correspondent provisions at paragraph 4.20 of the proposed AML/CFT Guideline "*also apply to cases where an LC provides brokerage services to an overseas portfolio manager and the LC does not have a business relationship with the investment vehicle for which the portfolio manager acts …*". We would be grateful if the SFC could clarify whether the LC in this scenario is contemplated to be an executing broker providing services to an overseas fund manager for a set of funds, and such relationship between the LC and the overseas fund manager would be a "cross-border correspondent relationship";

    11.2. The footnote to paragraph 4.20.6 of the proposed AML/CFT Guideline refers to a "nested correspondent relationship". Our members consider that such a relationship may include a relationship between a correspondent FI and an overseas distributor which has appointed a sub-distributor. Our members would be grateful for further guidance on the standard of additional due diligence expected by the SFC in relation to such a cross-border correspondent relationship; and

    11.3. Paragraph 4.20.13 of the proposed AML/CFT Guideline requires an FI to "[monitor] transactions of the respondent institution …". Our members would be grateful for further guidance on the transaction monitoring controls in relation to respondent institutions which are distributors. Unlike direct retail clients, the transaction value, transaction volume and patterns of transactions from distributors are

highly unpredictable, for instance, there may be no transaction for a period of time followed by a surge of purchases. An asset management firm may receive net subscription/redemption orders from distributors and have no visibility on the actual transactions of the underlying clients. From a risk mitigation perspective, it is therefore not very meaningful for an asset management firm to establish transaction monitoring controls for distributors. It should be appreciated that most, if not all, distributors will conduct their own transaction monitoring for the underlying clients which should capture any suspicious transaction in an effective manner. Therefore, further guidance from the SFC in this specific context would be most welcome.

Direct access to the correspondent account by the underlying customers of a respondent institution

12. Footnote 66 of paragraph 4.20.12 of the proposed AML/CFT Guideline states that where the respondent institution falls within paragraph 4.8.3(b) of the proposed AML/CFT Guideline, the correspondent institution may consider conducting "sample tests" from time to time. Our members are of the view that many cross-border respondent institutions may not readily disclose their underlying customers' information due to confidentiality and data privacy concerns or where the respondent is not acting on an agency basis. We would recommend that in such scenarios, an undertaking or attestation from the respondent institution should be treated to be sufficient (e.g. through an "AML attestation letter") in providing comfort to the correspondent institution regarding the AML measures undertaken by the respondent institution on its underlying customers.

Group-wide considerations for cross-border correspondent relationships

13. In relation to cross-border correspondent banking relationships, paragraph 11.20 of the HKMA Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Authorised Institutions) (October 2018)[4] allows an authorised institution (**AI**) to rely on its parent bank, head office or foreign branch in establishing a correspondent banking relationship including the due diligence and review of that relationship:

> "*Group-wide considerations*
> *11.20 If an AI relies on its parent bank, head office or foreign branch in establishing a correspondent banking relationship, and the parent bank, head office or foreign branch perform the due diligence and assume responsibilities to conduct assessments and reviews on the correspondent banking relationship, the AI should ensure that the assessments and reviews adopted take into account its own specific circumstances and business arrangements, and the particular correspondent banking relationship in Hong Kong. The AI should still ensure that it complies with the requirements set out in this Guideline and the ultimate responsibility for implementing AML/CFT measures remains with it.*"

14. We note that the proposed AML/CFT Guideline do not permit this practical group-wide approach in relation to cross-border correspondent relationships in the securities sector. We would propose that the SFC give consideration to adopting this approach also for the securities sector.

Question 4: Do you have any views on the additional due diligence and other risk mitigating measures applied to cross-border correspondent relationships in the securities sector? Please state your views.

General comment on additional due diligence measures for cross-border correspondent relationships

[4] https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/guideline/g33.pdf

15. Given the broad scope of "cross-border correspondent relationships" (paragraph 4.20.1 of the proposed AML/CFT Guideline), our members suggest that, on a risk-based approach, the additional due diligence requirements (paragraph 4.20.5 of the proposed AML/CFT Guideline) should be applied only to those respondent institutions that are assessed to pose high risk[5] by the correspondent FI in accordance with its own policies and procedures, rather than to all respondent institutions that fall within the scope of a cross-border correspondent relationship.

Requirement for senior management approval

16. Without prejudice to our primary position (above), our members suggest that the requirement for senior management approval (paragraph 4.20.5(d) of the proposed AML/CFT Guideline) should be limited to those respondent institutions which are assessed to pose high risk. This approach would, for example, be consistent with the requirement for senior management approval in relation to foreign PEPs who also pose high risk (paragraph 4.11.12 of the proposed AML/CFT Guideline).

17. In relation to senior management approval, paragraphs 4.20.5(d) and 4.20.10 of the proposed AML/CFT Guideline require an FI to obtain approval "when it establishes"/"before establishing" a cross-border correspondent relationship. Our understanding of this requirement is that senior management approval is required only at the time of onboarding of the respondent institution (i.e. when the relationship is established) rather than each time an account is opened for that respondent institution. We should be grateful if the SFC could: (i) confirm that our understanding is correct; and (ii) clarify whether senior management approval is also required for pre-existing cross-border correspondent relationships.

Application of the additional due diligence measures on a risk-based approach

18. Paragraph 4.20.6(a) of the proposed AML/CFT Guideline states that an FI should adopt a risk-based approach in applying the additional due diligence measures taking into account "… the nature and expected volume and value of the transactions". Our members would be grateful for further guidance on: (i) how FIs should assess the "expected volume and value of the transactions" particularly in volatile market situations; (ii) whether the assessment for existing cross-border correspondent relationships should be done by reference to transaction monitoring tools as opposed to KYC "static data"; and (iii) how the assessment should be carried out for new cross-border correspondent relationships?

Question 5: Do you have any views on the expanded list of illustrative examples of possible simplified and enhanced measures under a risk-based approach? Please state your views.

19. Our members welcome the expanded list of illustrative examples of possible simplified and enhanced measures under a risk-based approach.

Question 6: Do you have any views on the list of illustrative red-flag indicators of suspicious transactions and activities set out in Appendix B to the Proposed Revised Guideline? Please state your views.

20. Our members note that a new illustrative indicator of suspicious transaction and activity has been added in paragraph 1(g) of Appendix B, which provides that it is a red-flag indicator where a "customer's legal or mailing address is associated with other apparently unrelated accounts; or does not seem connected to the customer". Our members are concerned that if they identify two seemingly unrelated customers, it will be difficult from a practical point of view for them to obtain clarification from the customers without breaching relevant confidentiality and data privacy law and regulations. For example, two seemingly unrelated customers sharing the same legal/mailing address may well be a married couple living together. However, there may be

[5] We note that paragraph 4.9.1 of the existing AML/CFT Guideline requires an FI to comply with the special requirements set out in section 15 of Schedule 2, AMLO in two situations: (a) a situation that by its nature may present a high risk of ML/TF; or (b) a situation specified by the "relevant authority" in a notice in writing given to the FI.

confidentiality and data privacy concerns for FIs to verify the reason and relationship as it may involve disclosing to a customer the personal information of another and obtaining the relationship between two separate customers. Our members would be grateful for clarification from the SFC as to how to approach similar scenarios. Our members would also like to invite the SFC to arrange a session with ASIFMA to discuss others concerns in relation to the new paragraph 1(g) of Appendix B.

21. In addition, our members would like to clarify whether the SFC expects financial institutions to expressly incorporate the illustrative indicators under Appendix B in their internal policies and procedures.

Question 7: Do you have any views on the facilitative guidance permitting delayed third-party deposit due diligence? Please state your views.

22. We refer to our feedback on the SFC Circular dated 31 May 2019 in relation to third-party deposits and payments dated 24 September 2019 (**Response to the SFC Circular**) which our members still consider to be valid. Our members would therefore be grateful if the SFC could provide clarification in relation to the matters set out in our Response to the SFC Circular. Solely for the purposes of this submission, our members have highlighted below some further concerns in relation to the existing guidance on third-party deposits and payments and set out their feedback on the new facilitative guidance permitting delayed third-party deposit due diligence.

Scope of a third party

23. Our members suggest that a formal definition of a "third party" should be inserted under the proposed AML/CFT Guideline, particularly from an asset management point of view. For example, a third party is a natural or legal person who is not a party to the business relationship between the FI and the customer, except where such legal person has a contractual relationship with the customer, such as a custodian bank, a trustee or an investment manager of an investment vehicle or a legal entity customer. The suggested exemption is based on the common market practice that legal entity customers contract with nominees or custodian banks, which are authorized to operate the account or hold funds in their bank account for the legal entity customer.

24. Further, during the SFC soft consultation regarding the proposed amendments to the AML/CFT Guideline, the SFC explained that any joint-owner of a jointly-owned bank account other than the client of the firm is a third party for the purposes of third-party deposits and payments. Our members consider that it would be helpful if this clarification is also provided by the SFC in the proposed AML/CFT Guideline in the form of a footnote in Chapter 11.

25. In relation to the asset management industry, the SFC has advised that so long as the client account name with the asset management firm does not match with the bank account name used for the purposes of subscription and redemption, such an arrangement would be considered as a third-party deposit and payment arrangement. Our members acknowledge that it is important to mitigate the risk associated with third-party deposits and payments, however, they are of the view that only matching the client's account name against the bank account name used for subscription or redemption is too simplistic an approach which fails to take into account the fact that many clients, which are investment vehicles, investment managers/ fund administrator or trustee of mutual funds, may use a bank account which is not under the client's name for transactions. The simplistic approach suggested by the SFC would inflict a disproportionate compliance burden on asset management firms under Chapter 11 of the proposed AML/CFT Guideline.

26. We understand that to mitigate the abovementioned compliance burden, the SFC has suggested that asset management firms may consider granting standing exception approval to such clients provided that the

arrangement is assessed to be of low risk. However, this would: (a) create additional administrative burden for asset management firms in relation to deposit/payment arrangements which are common in the industry (as explained above); and (b) still require e.g., enhanced monitoring of client accounts and periodic review of standing approvals in relation to the relevant third parties (see paragraphs 11.3(e) and 11.6 of the proposed AML/CFT Guideline).

27. We would therefore suggest that the parties contracted with the legal entity customers which are investment vehicles or any service providers (such as investment managers, custodian bank, trustee, etc.) acting on behalf of an investment vehicle, should be exempted from the definition of a third party / scope of Chapter 11 of the proposed AML/CFT Guideline.

Role of the MIC of AML/CFT

28. The last sentence of paragraph 11.3 of the proposed AML/CFT Guideline states that an MIC of AML/CFT should be designated to oversee the proper design and implementation of the policies and procedure relating to third-party deposits or payments including delayed due diligence in exceptional scenarios on the source of a deposit or evaluation of a third-party deposit.

29. According to Annex 1 of the SFC Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management dated 16 December 2016[6] (**MIC Circular**): (i) the MIC of Compliance is responsible for, among other things, "*setting the policies and procedures for adherence to legal and regulatory requirements in the jurisdiction(s) where the corporation operates*" and monitoring and reporting on compliance matters; and (ii) the MIC of AML/CFT is "*responsible for establishing and maintaining internal control procedures to safeguard the corporation against involvement in money laundering activities or terrorist financing*".

30. Given that it is the MIC of Compliance who is expected to be responsible for setting the policies and procedures for compliance with regulatory requirements, which would arguably also include the proper design of the policies and procedures for third-party deposit and payments in the proposed AML/CFT Guideline, our members are concerned that the proposed language regarding the responsibility of the MIC of AML/CFT for both "design and implementation" would lead to confusion over the role expectations of the MIC of Compliance and the MIC of AML/CFT. Given the foregoing, we would recommend that the last sentence of paragraph 11.3 of the proposed AML/CFT Guideline be deleted.

Approval from MIC of AML/CFT or MLRO

31. We would like to reiterate that it is practically challenging to obtain MIC of AML/CFT or MLRO's approval for all third-party deposits and payments. In this regard, we propose that the approval of third-party deposits and payments can be provided by the delegates of the MIC of AML/CFT or MLRO, for example a relevant employee in Operational Control and Review core function under a defined set of criteria or from the AML Compliance function of the relevant institution.

32. In particular, we would propose the following amendments to paragraphs 11.5 and 11.7 of the proposed AML/CFT Guideline (see underlined below):

> "***Due diligence process for assessing third-party deposits and payments***
>
> *11.5 …*

[6] https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=16EC68

(c) obtaining the approval of the MIC of AML/CFT or MLRO (or their delegate) for the acceptance for a third-party deposit or payment; …

11.7 Given that not all third-party payors and payees pose the same level of ML/TF risk [footnote omitted], an FI should apply enhanced scrutiny to those third parties which might pose higher risks, and require the dual approval of deposits or payments from or to such third parties by the MIC of AML/CFT (or MLRO) or their delegate, and another member of senior management."

Policies and procedures for delayed due diligence of third-party deposit

33. Pursuant to paragraphs 11.3(d) and 11.10 of the proposed AML/CFT Guideline, we understand that the SFC expects FIs to have documented policies and procedures concerning delayed due diligence in exceptional scenarios on the source of a deposit or evaluation of a third-party deposit, setting out the conditions under which the customer may utilise the deposited funds prior to the completion of the third-party deposit due diligence.

34. We would like to seek clarification on whether the SFC has any specific expectations in relation to the drafting of such a policy having regard to the parameters specified in sub-paragraphs (a)-(d) of paragraph 11.10 of the proposed AML/CFT Guideline, particularly in relation to the "reasonable timeframe" and "appropriate limits on the number, types and/or amount of transactions" referred to in paragraphs 11.10 (a) and (b) respectively of the proposed AML/CFT Guideline.

35. Lastly, in relation to the requirement that the policies and procedures should ensure that senior management is periodically informed of all cases involving delay in completing third-party deposit due diligence (paragraph 11.10(d) of the proposed AML/CFT Guideline), our members consider this to be an additional burden given that approval of MIC of AML/CFT or MLRO is required in any event for all third-party deposits and payments under paragraph 11.5(c) of the proposed AML/CFT Guideline and suggest that this requirement be removed. Our members consider that it would be more reasonable if this requirement is applied only to deposits and payments for which "standing approval" has been provided by the MIC of AML/CFT or MLRO under paragraph 11.6 of the proposed AML/CFT Guideline.

Other response

Person purporting to act on behalf of the customer (PPTA)

36. We note that following our Response to the Soft Consultation, the SFC has reinstated the example of a streamlined approach in the footnote to paragraph 4.4.3 of the proposed AML/CFT Guideline. We are grateful for the SFC's cooperation and have the following further comments:

    36.1. Our members note that they are required to take reasonable measures to verify the identity of the PPTA pursuant to paragraph 4.4.3 of the existing AML/CFT Guideline. In this regard, the SFC has reinstated the streamlined approach in footnote number 37 to that paragraph and given an example namely "legal person customer with many PPTAs …". Our members appreciate the above, but would like to seek further clarification from the SFC on when the streamlined approach may be adopted. Our members are of the view that the streamlined approach should also be available even if there is only one or a single PPTA, if the customer is an FI or listed company. In this regard, our members would like to point out that, in practice, PPTAs of an FI or a listed company may be reluctant to provide personal details due to confidentiality or privacy concerns when at the same time the associated ML/TF risk is very low;

36.2. Despite the application of the streamlined approach to "verify" the identity of PPTAs, our members note that an FI is still required to "identify" the PPTA in line with the identification requirements for a customer that is a natural / legal person (paragraph 4.4.3 of the proposed AML/CFT Guideline). Our members are of the view that some legal persons may not readily disclose all personal information of their PPTAs for identification purposes (such as date of birth, nationality, ID type and number) due to confidentiality and data privacy concerns. Accordingly, in situations where a business relationship with a legal person customer with PPTAs is assessed to present low ML/TF risk, our members suggest that the streamlined approach should also apply in relation to fulfilling the identification requirements for the PPTAs ; and

36.3. In relation to identification and verification of PPTA's generally, our members consider that it would be helpful if the SFC could provide further guidance in the form of FAQs. For example, please see the FAQs provided by the HKMA on this topic (https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/aml-cft/FAQ_amlcft_jul_2019.pdf).