

A CLEANER SET OF RULES

The Hong Kong government has issued two consultation papers over its intention to strengthen local anti-money laundering and counter-terrorist financing regimes. [George W. Russell](#) looks at the proposed new provisions and the reaction from the accounting profession and financial sector

Illustrations by Ester Zirilli

When the Financial Action Task Force, the international policy-making body established in 1989 to counter threats to the global financial system, first asked Hong Kong to join the crackdown on potential sources of money laundering and the financing of terrorism, policies were concentrated on financial institutions.

But as things develop, the focus is now on so-called “designated non-financial businesses and professions,” which can be almost any middleman caught wittingly or unwittingly in illegal transactions.

As a result, the Hong Kong government has issued two consultation papers. One is a proposal to amend the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance to strengthen due diligence by non-financial businesses. The second would amend the Companies Ordinance

to improve transparency of beneficial ownership of entities.

A “designated non-financial business and profession,” according to FATF, is any kind of corporate entity that poses a money laundering risk but cannot be classified as a financial institution. Examples include casinos, vehicle and boat dealerships or horseracing bookmakers.

However, the major targets in Hong Kong are accountants, lawyers and property agents as well as trust or company service providers. “They are regarded as important intermediaries and gatekeepers who, together with financial institutions, can help protect the financial system from exploitation by criminals and terrorists,” says Raphael Ding, Chief Executive of the Hong Kong Institute of CPAs.

The two consultation proposals have been largely welcomed, given the importance of global harmonization of laws. Hong Kong

enacted the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance nearly five years ago and FATF guidelines have evolved since then.

“The proposals are in the right direction to ensure our local laws are in line with the FATF standards in order to safeguard the integrity and reputation of Hong Kong as an international financial centre,” says Cliff Lam, Associate Managing Director at Kroll and an Institute member.

He points out that the specified transactions that are the target of the proposed new rules include real estate purchases, management of client assets such as savings or securities accounts, company formation and management, and buying and selling of business entities.

“These transactions are usually of high value and may involve a certain extent of financial crime risks,” says Lam. “It is





important for practitioners to really know their clients, the source of funds for the transactions, and the source of wealth of their clients.”

Not much to report

However, concerns have emerged over how effective CPAs are at identifying high-risk customers and making what FATF calls “suspicious transaction reports” if they suspect, or have reasonable grounds to suspect, that a particular transaction represents the proceeds of criminal activity or is related to terrorism.

“You must have experience to be able to be alert to such high-risk transactions involving money launder-

ing and terrorist financing,” says Edwin Yeung, Managing Partner of Edwin Yeung & Company CPA and an Institute member. “We have to know the proper way to get the attention of the authorities.”

In 2015, Institute members made just six suspicious transaction reports, accounting for 0.014 percent of the 42,555 reports received by the Joint Financial Intelligence Unit, the body – staffed by the Hong Kong Police and the Customs and Excise Department – that manages the suspicious transaction reporting regime in Hong Kong.

In comparison, the 4,600 suspicious transaction reports made by accountants in the United Kingdom



during 2015 accounted for 1.21 percent of the total. “CPAs need to get more regular training on financial crime risks and a clear communication of their roles and responsibilities,” says Lam at Kroll.

Some CPAs also have reservations about the application of the proposals. “We acknowledge the responsibility and expectations of a professional accountant to take part in the anti-money laundering and counter-terrorist financing processes,” says Patrick Sze, Managing Partner of Zhonghui Anda CPA and an Institute member.

“The effectiveness of CPAs in identifying a high-risk customer is directly linked to their awareness of financial crime risks and their reporting obligations.”

Despite that, he adds, obstacles can emerge. “There are certain practical difficulties, such as if the potential client is not willing to cooperate, it is very difficult for a CPA to apply enhanced customer due diligence measures,” Sze points out.

Lam, however, says CPAs could well be in a better position to identify money laundering risks than financial institutions. “Since these professionals are involved in the specified transactions, they would have better understanding of the transactions’ nature,” he says.

The government acknowledges that due diligence can be difficult, expensive and time-consuming but says technology could help. “There are already exciting advances,” says James Lau, Under Secretary for Financial Services and the Treasury, citing technological developments that facilitate customer verification and other safeguards.

Blockchain, a secure transaction database, could power “solid ‘know your customer’ and anti-money laundering systems,” he says, by including not only traditional identity information but also biometric data and records verified by third parties such as universities, governments, employers and banks.

Sharing responsibility

Hong Kong’s proposals are being considered just as the U.S. banking industry is seeking an overhaul of rules combating money laundering and terrorism financing. The global financial community is currently examining the ramifications of a report describing U.S. regulations aimed at preventing money laundering and terrorism financing as anachronistic and inefficient.

The report, *A New Paradigm: Redesigning the U.S. AML/CFT Framework to Protect National Security and Aid Law Enforcement*, issued on 16 February by The Clearing House, an influential U.S. banking advocacy group, proposes a system under which banks report only on transactions that reflect law enforcement priorities, rather than every suspicious transaction. Such a change would “lessen the burden” on banks, the report argues, tapping into the anti-regulation fervour of President Donald Trump’s administration.

Regulation

AML/CTF



There is some sympathy for that general view in Hong Kong. “The responsibility of combating financial crime should not be solely on the shoulder of financial institutions,” says Lam at Kroll. “The effectiveness of CPAs in identifying a high-risk customer is directly linked to their awareness of financial crime risks and their reporting obligations.”

Lawyers are bound by the Hong Kong Law Society’s Practice Direction P, which addresses suspicious transaction reporting. “If legal professionals understand and follow the practice direction, there should not be much difficulty in recognizing the risk of money laundering or terrorist financing,” says Dominic Wai, Partner of ONC Lawyers.

Under the proposals, the Institute, the Law Society and – in the case of the property industry – the Estate Agents Authority would be responsible for investigating breaches and applying appropriate sanctions under their respective disciplinary regimes.

Criminal prosecutions for accountants, lawyers and estate agents would not be an option under the proposals, although employees of financial institutions who knowingly contravene certain provisions of the anti-money laundering ordinance can face prison

terms of up to seven years and fines of up to HK\$1 million.

A matter of trust

Under the proposed amendments, Hong Kong-based trust companies and company formation and service providers would be regulated for the first time. Such entities would be required to pass a “fit and proper” test and obtain a licence from the Registrar of Companies. It would be a criminal offence for a trust or company service provider to offer services without a licence.

Many trust companies and company formation and service providers are owned or operated by CPAs. Although the Institute’s existing system of oversight doesn’t have any specific requirements for trust companies, Yeung, of Edwin Yeung & Company CPA, believes the Institute’s oversight and disciplinary system is sufficient regulation. “CPAs rely on the control of the Institute,” he says.

Wai at ONC believes consistent oversight under the anti-money laundering ordinance would help. “If the relevant rules, licence-granting process and monitoring of compliance of conditions of licence are clear and robust, there is no reason that [a regime]

would not work for trust companies and company formation and service providers,” he says.

While trust companies have no objection to regulatory oversight in principle, the proposal to make beneficial ownership more transparent is causing ripples in the sector. “In my view, there is no legitimate need for the public to access each and every company’s beneficial ownership information,” says Hans Peter Stadelmann, Managing Director of Alpadis Trust.

He cites client safety considerations as a reason not to make beneficial ownership data accessible to all-comers, especially when customers are from politically sensitive countries. “A publicly transparent beneficial ownership register is no protection for the clients, but good and enforceable regulations are.”

With so much at stake, many Institute members will be keenly monitoring the consultation process. (Submissions will be received by the Financial Services and the Treasury Bureau until 5 March). “It looks promising on paper,” says Lam at Kroll, “but we will have to observe its operational effectiveness when this licensing regime goes live.”

