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Intermediaries Supervision Department
Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

18 November 2011

Dear Sirs

Consultation Paper on (1) the Proposed Guideline on Anti-Money Laundering and Counter-Terrorist Financing and (2) the Proposed Prevention of Money Laundering and Terrorist Financing Guideline Issued by the Securities and Futures Commission for Associated Entities (Consultation Paper)

We welcome the opportunity to provide comments on the Consultation Paper. We have gathered views from a number of industry participants, including those set out in the Appendix, and include those views along with our own.

The key point, in our view, is that the requirements in relation to the proposed Guideline on Anti-Money Laundering and Counter-Terrorist Financing ("**Guideline**") should retain appropriate flexibility and not be unduly prescriptive. This is particularly important because of the potential criminal sanctions for breach under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("**AMLO**"). There are a number of points which we would like to provide comments, reflecting also feedback from a working group of large financial institutions.

Identification and verification of a person purporting to act on behalf of the customer

Under section 2(1)(d) of Schedule 2 to the AMLO, financial institutions ("**FIs**") are required to identify all persons purporting to act on behalf of customers, and take reasonable measures to verify their identity and verify their authority to act on behalf of the customers. Whilst the Guideline has provided some flexibility as to what measures would be considered reasonable, and has helpfully limited the circle of persons whose identity must be ascertained and verified, in practice this requirement is still extremely burdensome.

The adoption of a signatory list suggested by the SFC as a reasonable measure for dealing with low risk institutions, would be less of an issue if "moving funds and assets" does not include trading. But still in practice it will be difficult to obtain identification for the authorized signatories and not practical for low risk institutions.

The adoption of an authorized traders list, i.e. those traders who can trade an account on behalf of the customer, is practically not feasible for customers that are large FIs and have literally thousands of traders who initiate securities transactions (which would involve the movement of funds or assets). Without an exemption from the identification and verification of a person purporting to act on behalf of the customer, a more practical solution is to allow an FI to accept a confirmation from the other FI to the effect that the relevant person has authority to act on behalf of the FI and that the FI has verified the identity of such person. At least where the nature of the customer permits simplified due diligence ("**SDD**"), this would appear to be a sensible approach which is consistent with a risk-based approach to customer due diligence.

An industry participant has also suggested that for a customer based in Hong Kong or which is another FI or intermediary in an equivalent jurisdiction, it would be more reasonable to limit the designation of "person purporting to act on behalf of the customer" to persons who is not an employee or director of the customer.

Customer due diligence ("CDD") for natural persons and corporation

Under paragraph 4.8.1, FIs are required to obtain the identification documents of natural persons and connected persons, which includes directors and shareholders. Feedback we received from the working group suggests that it would not be feasible to obtain such identification for all such persons.

Under paragraph 4.9.11, in relation to corporate customers, an FI should, amongst other things, identify and record the identity of all directors and verify the identity of at least one director, and identify and record the identity of all beneficial owners. This is not a

requirement of the AMLO and would appear an excessive requirement in cases where SDD may be applied to that customer.

Ongoing monitoring

We note that in paragraph 5.1(a) FIs are required to continuously monitor their business relationship with the customers by reviewing from time to time documents, data and information relating to the customer.

We understand from paragraph 5.8 that an FI can satisfy compliance with its ongoing monitoring obligations by applying a risk-based approach, i.e. more frequent and intensive monitoring will be required for high-risk relationships and vice versa.

In relation to natural persons, the Guideline states in paragraph 4.7.12 that once the identity of a customer has been satisfactorily verified, there is no obligation generally to re-verify the identity; yet it requires FIs to ensure that the customer information that has been obtained is up-to-date and relevant, which would seem to include requesting updated identity and travel documents – this would seem excessive in the absence of any suspicion that the client's name or nationality has changed.

Wire transfers

According to paragraphs 10.2 and 10.3 of the Guideline, if a wire transfer is between two FIs on their own behalf then Chapter 10 does not apply to the transfer. The Guideline also mentions that Chapter 10 applies primarily to authorized institutions and money service operators.

However, where a broker initiates a wire transfer to settle a customer transaction, e.g. wiring the purchase price of a securities purchase, would the SFC consider that this would fall under Chapter 10? If so, this would be a very difficult requirement to comply with. It would be helpful to get clarification from the SFC that Chapter 10 would not apply in this case.

Definition of customer

We understand from paragraph 4.1.4 that the term "customer" is not defined in the AMLO and the Guideline simply notes that the meaning of customer should be inferred from its everyday meaning and in the context of the industry practice.

The SFC has provided a sector specific guidance in paragraph 4.1.4a where a "customer" for the securities sector is a person who is a client of a licensed corporation. The Guideline goes on to define a "client" in relation to an intermediary to be a person for whom the intermediary

provides a service constituting a regulated activity under the Securities and Futures Ordinance ("**SFO**").

FIs generally view a client to be any relationship that they provide a regulated product or service to. Conversely, intermediaries who deposit securities, money or collateral (which are part of the definition of client under the SFO) would not normally be considered customers and it is not clear why they should be considered as such for the purposes of the AMLO.

Simplified customer due diligence

Paragraph 4.10.1 of the Guideline explains that FIs applying SDD do not need to identify and verify the beneficial owner, while other aspects of customer due diligence must be undertaken, including ongoing monitoring of the business relationship. Paragraph 4.10.5 also stresses that the identification and verification process must be carried out at the customer level. This is inconsistent with, and less flexible than, the FATF 40 Recommendations[1] (paragraph 9 of the Interpretative Notes) where SDD can be applied to both the customer and beneficial owner.

We also question why SDD can only be applied to the identification and verification of the beneficial owner but not to other due diligence requirements; the prescribed application of SDD in the Guideline leaves little room for a risk-based approach.

The Guideline has set out in paragraph 4.10.3 certain circumstances under which an FI is allowed to apply SDD on an institutional client. One of the mandatory requirements is for an institution to have "measures in place to ensure compliance with requirements similar to those imposed under Schedule 2". Given that the relevant institution will either need to be a FATF member or be located in a jurisdiction which "imposes requirements similar to those imposed under Schedule 2" (cf. definition of "equivalent jurisdiction"), it is difficult to understand what exactly the obligations of an FI are in this respect.

Company registry search

Paragraph 4.9.12 of the Guideline requires FIs to perform a company registry search and obtain a full company search report in respect of all locally incorporated private companies and companies incorporated in jurisdictions which have a public company registry. As a reasonable measure, FIs should be allowed to use company search as proxy to certificate of incorporation and memorandum and articles of association.

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[1] http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF

Paragraph 4.9.13 of the Guideline states that alternative documents can be substituted in respect of a company incorporated in a jurisdiction that does not have a public company registry or has only a partially public registry. Whilst the SFC recognizes that company searches of companies in certain jurisdictions may not be current or complete, it is not clear in respect of which jurisdictions FIs could safely rely their company registry and we suggest the SFC provide an eligible jurisdictions list. In any event, a risk-based approach should mean that FIs are allowed to judge and justify the reliability and legitimacy of a source and FIs should not be penalized for making a reasonable judgment with documentations in place.

Even if a public search is available in a particular jurisdiction, it is possible that no comparable documents are available or only very basic information is available, in which case the value of the requirement, while potentially costly, will be limited.

We are also of the view that that this requirement is not consistent with the spirit of a risk-based approach when an FI is allowed little flexibility in deciding when a company registry search is appropriate in serving its customer due diligence purpose. For example, company registry search should not be required for regulated entities, i.e. where SDD may apply.

Reliance on CDD performed by intermediaries

Under paragraph 4.17.3 of the Guideline, if an FI relies upon an intermediary to perform any part of its CDD measures, then the FI should obtain satisfactory evidence to confirm the status and eligibility of the intermediary. Under a risk-based approach, FIs should be allowed to exercise discretion in determining the extent of due diligence on the intermediary, which could be based on seeking evidence comprising corroboration for the intermediary's regulatory authority, or evidence from the intermediary of its status, regulation, policies and procedures.

The intermediary should also be qualified if it has legislation that are equivalent to FATF recognized jurisdictions, but it is not clear from the Guideline whether this will satisfy the eligibility evidence.

It is not clear from paragraph 4.17.1 why the SFC considers that reliance is not applicable to "business relationships, accounts or transactions between FIs for their clients" – the rationale for this should be clarified.

Compliance officer (CO) and money laundering reporting officer (MLRO)

In ensuring proper implementation of AML policies and procedures, FIs must appoint a CO and an MLRO. It is not clear from the Guideline whether the CO and MLRO can be based outside of Hong Kong. We assume they can but suggest the SFC provide clarification on this.

High-risk situations

The Guideline in paragraph 4.11.1 has specified examples of higher risk customers which include non-resident customers and private banking customers. We assume that these cases are provided as examples, not as a prescriptive list. Many non-resident customers and private banking customers do not warrant additional measures or enhanced due diligence. FIs should be allowed the flexibility in exercising discretion as to the extent of CDD that apply to such customers.

Suspicious transaction reports

Under paragraph 7.17, FIs are expected to make the submission of a disclosure to the Joint Financial Intelligence Unit ("**JFIU**") of a priority, particular when a customer is instructing a "significant" movement of funds. The FIs are expected to contact the JFIU before funds or the other property is moved or cash is collected. Whilst FIs are well aware of the importance of prompt notification to the JFIU, this creates major challenges for the FIs, particularly for the retail sector considering the volume of funds movements. It is also a concern that the timing and manner of reports as specified under the Guideline potentially increase the risk of tipping off customers which is prohibited under paragraph 7.14.

Should the SFC wish to discuss any of our comments please do not hesitate to contact Mark Shipman, Matt Feldmann or Donna Wacker in the first instance.

Yours faithfully

Clifford Chance

Appendix

Bank of America Merrill Lynch [Merrill Lynch (Asia Pacific) Limited]

BNP Paribas Hong Kong Branch

Credit Suisse (HK) Limited

Deutsche Bank AG

Morgan Stanley Asia Limited

Morgan Stanley Hong Kong Securities Limited