SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Paper on the Proposed Revised Prevention of Money Laundering and Terrorist Financing Guidance Note

Hong Kong
April 2005

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FOREWORD

The Securities and Futures Commission (the "Commission") invites market participants and other interested parties to submit written comments on the proposals discussed in, and the exposure draft of a revised Prevention of Money Laundering and Terrorist Financing Guidance Note (the "Proposed Revised Guidance Note") attached as Appendix 2 to, this Consultation Paper **no later than 10 June 2005**. Any persons wishing to comment on the proposals and / or suggest alternative approaches should provide details of the organisation whose views they represent and are encouraged to submit the text of possible amendments to the Proposed Revised Guidance Note that would be necessary to incorporate their suggestions.

Please note that the names of the commentators and the contents of their submissions may be published on the Commission's website and in other documents to be published by the Commission. In this connection, please read the Personal Information Collection Statement at Appendix 1 to this Consultation Paper.

You may not wish your name to be published by the Commission. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.

Written comments may be sent:

By mail to:	Intermediaries Supervision Department The Securities and Futures Commission 8/F Chater House 8 Connaught Road Central Hong Kong Attn: Consultation on proposed revised Prevention of ML & TF Guidance Note
By fax to:	(852) 2523 4598
By on-line submission to:	http://www.sfc.hk (Please enter into the subsection "Consultation Papers and Conclusions" under the section "Speeches & Publications" on the website)
By e-mail to:	gn_ml_tf@sfc.hk

Additional copies of the Consultation Paper may be obtained from the above address of the Commission. This Consultation Paper is also available at the Commission's website at http://www.sfc.hk.

Intermediaries Supervision Department
Securities and Futures Commission
Hong Kong
April 2005

Consultation Paper on the Proposed Revised Prevention of Money Laundering and Terrorist Financing Guidance Note

I OBJECTIVE

1. The purpose of this Consultation Paper is to solicit the views of market participants and other interested parties on the Proposed Revised Guidance Note. The Commission believes that the Proposed Revised Guidance Note is necessary for providing guidance to licensed corporations and their associated entities in implementing comprehensive and effective anti-money laundering and anti-terrorist financing measures up to the latest standards set by relevant international bodies, notably the Financial Action Task Force on Money Laundering (the "FATF") and the International Organization of Securities Commission (the "IOSCO").

II EXECUTIVE SUMMARY

Background

2. The Commission wishes to update the current Guidance Note to bring it in line with the new set of anti-money laundering and anti-terrorist financing recommendations issued by the FATF in June 2003 and October 2004 respectively, and to provide licensed corporations and associated entities with guidance on areas of practical application. In drawing up the Proposed Revised Guidance Note, we have also taken into account the paper "Principles on Client Identification and Beneficial Ownership for the Securities Industry" issued by the IOSCO in May 2004. In addition, we have taken into account the revisions made and to be made by the Hong Kong Monetary Authority and the Office of the Commissioner of Insurance respectively in their anti-money laundering and anti-terrorist guidelines and consulted relevant agencies and authorities associated with combating money laundering and terrorist financing in Hong Kong. The contents of the Proposed Revised Guidance Note have also been discussed informally with a small group of market practitioners drawn from the brokerage and fund management sectors. We wish to acknowledge and thank them for their valuable input.

The Proposed Revised Guidance Note

3. The Proposed Revised Guidance Note consists of two parts.

4. Part I provides an overview of the international and local initiatives concerning money laundering and terrorist financing, the application of the guidance note and the guiding principles in the establishment of policies and

procedures by licensed corporations and their associated entities to prevent money laundering and terrorist financing.

5. Part II sets forth guidelines on the measures that licensed corporations and their associated entities are ordinarily expected to take in implementing the whole range of anti-money laundering and anti-terrorist financing controls as follows:

- customer acceptance
- customer due diligence
- record keeping
- retention of records
- recognition of suspicious transactions
- reporting of suspicious transactions
- staff screening, education and training

Next step

6. We are now seeking comments and feedback from all market practitioners and other interested parties on the Proposed Revised Guidance Note.

7. We anticipate publishing consultation conclusions in the third quarter of this year, with a view to putting the revised guidance note into effect by the end of 2005.

III BACKGROUND

8. The Commission's Prevention of Money Laundering and Terrorist Financing Guidance Note, as revised (the "Guidance Note") is proposed to be made under section 399 of the Securities and Futures Ordinance (Cap. 571) ("SFO"). The Guidance Note is proposed to apply to all licensed persons[1] in carrying on the regulated activities for which they are licensed, and all associated entities[1] that are not authorised financial institutions, in relation to their business of receiving or holding client assets of licensed corporations of which they are associated entities.

[1] As defined in section 1 of Part 1 of Schedule 1 to the SFO.

9. Pursuant to section 399 of the SFO, the Commission may publish guidelines for the purpose of providing guidance for the furtherance of the Commission's regulatory objectives. The Commission considers that the Proposed Revised Guidance Note would be consistent with the Commission's objective in section 4(d) of the SFO "to minimise crime and misconduct in the securities and futures industry". Under the legislations in Hong Kong, illicit proceeds that criminals may try to launder mainly come from criminal activities such as drug trafficking, smuggling, illegal gambling or bookmaking, blackmail, extortion, loan sharking, tax evasion, prostitution, corruption, trafficking in human beings, robbery or theft, kidnapping, selling of pirated goods, financial fraud and deception, insider dealing and market manipulation. Combating money laundering is of paramount importance in suppressing and deterring any of these serious crimes.

10. In response to changing and increasingly sophisticated methods and techniques of laundering money and financing terrorism, the FATF has made recommendations in June 2003 and October 2004 respectively to enhance and strengthen the framework for combating money laundering and terrorist financing.

11. The Commission proposes that changes should be introduced to its current Guidance Note in order to remain compliant with the latest international standards, so as to maintain Hong Kong's reputation and status as an international financial centre. The changes are mainly to reflect the requirements of the revised 40 Recommendations[2] and the Nine Special Recommendations on Terrorist Financing of the FATF, as applicable to the securities, futures and leveraged foreign exchange businesses and to achieve greater harmonisation of the requirements with other financial regulators in Hong Kong.

12. In addition, in preparing the Proposed Revised Guidance Note, we have taken into account the relevant requirements in the paper, Principles on Client Identification and Beneficial Ownership for the Securities Industry[3], issued by IOSCO in May 2004 to complement the revised FATF's 40 Recommendations.

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[2] The FATF 40 and Nine Special Recommendations have been recognised by the International Monetary Fund and the World Bank as the international standards for combating money laundering and the financing of terrorism.

[3] The IOSCO is the primary forum of international cooperation for securities regulatory agencies. In October 2002, a Task Force on Client Identification and Beneficial Ownership ("CIBO") was established by IOSCO to study existing securities regulatory regimes relating to the identification of clients and beneficial owners and to develop principles that address aspects of the customer due diligence process. This Task Force found that while there are different regulatory approaches to client and beneficial owner identification due to differences in legal and regulatory frameworks, there are certain common features. The CIBO paper, published in May 2004, highlights 8 main principles. IOSCO believes that these principles provide a comprehensive framework relating to client and beneficial ownership identification requirements that take into account the priorities and perspectives of securities regulators, while at the same time complementing the standards of other bodies, such as the revised FATF 40 Recommendations. The CIBO paper can be found on IOSCO's website on http://www.iosco.org/pubdocs/pdf/IOSCOPD167.pdf.

13. To better ensure that the Proposed Revised Guidance Note strikes a proper balance between operational efficacy of the proposed regulatory requirements and their effectiveness in combating money laundering and terrorist financing, the Commission has drawn up the provisions in the Proposed Revised Guidance Note after consulting relevant agencies and authorities associated with combating money laundering and terrorist financing in Hong Kong. In addition, sessions have been held with a small group of market practitioners from a cross-section of the brokerage and fund management industry to canvass their views. We wish to acknowledge and thank them for their valuable input.

14. The Proposed Revised Guidance Note is attached in Appendix 2. The revised FATF's 40 Recommendations have been substantially revised from the previous version such that there is a need for the current Guidance Note to be substantially rewritten. Accordingly, it would not be useful if the changes to the current Guidance Note were shown and we believe it is more appropriate to read the Proposed Revised Guidance Note afresh as a whole in conjunction with this Consultation Paper and, where necessary, the revised FATF's 40 Recommendations which are available on FATF's website at http://www.fatf-gafi.org.

IV MAJOR NEW PROVISIONS OF THE PROPOSED REVISED GUIDANCE NOTE

15. We provide in this section a brief description of the main enhanced features of the Proposed Revised Guidance Note and where appropriate, the background and rationale for drawing up the relevant provisions.

Application of the Proposed Revised Guidance Note (section 1)

16. The Proposed Revised Guidance Note mainly reflects the requirements of the revised FATF's 40 Recommendations applicable to the securities, futures and leveraged foreign exchange businesses and outlines relevant measures and procedures to guide licensed corporations and associated entities in preventing money laundering and terrorist financing.

17. The Proposed Revised Guidance Note is intended for use primarily by licensed corporations and associated entities that are not authorised financial institutions. To avoid regulatory overlap, registered institutions and associated entities that are authorised financial institutions are required to observe only the Hong Kong Monetary Authority's guidelines on prevention of money laundering. However, to the extent that there is some securities or futures-specific guidance in the Proposed Revised Guidance Note which may not be shown in the HKMA's guidelines, the registered institutions and associated entities that are authorized financial institutions shall have regard

to such provisions in the Proposed Revised Guidance Note, namely, risk management procedures to be undertaken where the customer due diligence process could not be satisfactorily completed after securities transactions have been conducted on behalf of a customer (subsection 6.1.8), omnibus accounts established in the name of a financial or professional intermediary (subsection 6.6) and examples of suspicious transactions relating to the securities sector (Appendix C (ii)).

Guiding Principles in Establishing Adequate and Appropriate Controls to Prevent Money Laundering and Terrorist Financing (subsection 4.1)

18. As a "one-size-fits-all" approach may not be appropriate to the securities industry in Hong Kong, each licensed corporation or associated entity should consider the specific nature of its business, organizational structure, type of customer and transaction, etc. when implementing the suggested measures and procedures in the Proposed Revised Guidance Note to ensure that they are effectively applied. The overriding principle is that they should be able to satisfy themselves that the measures taken by them are adequate, appropriate and follow the spirit of the suggested measures.

19. Thus, where reference is made in the Proposed Revised Guidance Note to a licensed corporation or associated entity being satisfied as to any matter, e.g. the use of simplified customer due diligence is reasonable in a particular circumstance, the licensed corporation or associated entity must, as mandated by the revised FATF's 40 Recommendations, be able to justify its assessment to the Commission or any other relevant authority.

Customer acceptance (section 5)

20. In line with Recommendation Five of the revised FATF's 40 Recommendations, we propose that licensed corporations and associated entities should develop customer acceptance policies and procedures that aim to identify the types of customers that are likely to pose a higher than average risk of money laundering and terrorist financing. We provide, by way of example, certain factors that licensed corporations and associated entities should take into account when determining the risk profile of the customer or type of customer. By establishing such policies and procedures, they will be in a better position to apply customer due diligence on a risk sensitive basis depending on the type of customer business relationship or transaction (see Risk-based Approach below).

Customer due diligence

<u>Timing of verification (subsections 6.1.7 & 6.1.8)</u>

21. We propose to set out guidance in the Proposed Revised Guidance Note as to the point at which verification on the identity of the customer should be

performed by licensed corporations and associated entities, in line with Recommendation Five of the revised FATF's 40 Recommendations.

22. Generally, licensed corporations and associated entities should verify the identity of the customer and beneficial owner before establishing a business relationship. However, we realise that transactions conducted on behalf of customers may need to be performed very rapidly due to market conditions or in the case of non face-to-face business. In such situation, there may be practical difficulties for licensed corporations and associated entities to complete the verification process before effecting the transactions. We propose to make allowances in the Proposed Revised Guidance Note for licensed corporations and associated entities to complete the verification process after the establishment of the business relationship provided that the completion of verification occurs within a reasonably practicable timeframe and appropriate risk management procedures have been adopted by the licensed corporations and associated entities to monitor the transactions conducted by these clients during the interim period.

23. However, if the verification by the licensed corporation or associated entity cannot be performed within a reasonably practicable timeframe, then it should, if possible, discontinue the business relationship and consider whether a suspicious transaction report should be filed.

Existing customers (subsections 6.1.9 to 6.1.11)

24. While the new customer identification standards are not required to be applied to existing customers, we propose in the Proposed Revised Guidance Note that licensed corporations and associated entities should take reasonable steps to ensure that the records of these existing customers remain up-to-date and relevant, and consider undertaking periodic reviews of existing customer records. Several examples of when licensed corporations and associated entities may appropriately perform such reviews of existing customer records are set out in the Proposed Revised Guidance Note.

Risk-based Approach (subsection 6.2)

25. Whilst Recommendation Five of the revised FATF's 40 Recommendations sets out the general rule that customers should be subject to the full range of customer due diligence measures, it however recognises that certain customers may be of a higher or lower risk category depending on circumstances such as the customer's background, type of business relationship or transaction etc. As such, financial institutions should apply each of the customer due diligence measures on a risk sensitive basis. Practical guidance is given in the Proposed Revised Guidance Note on such risk-based approach to undertaking customer due diligence. The basic principle is that licensed corporations and associated entities should adopt an

enhanced customer due diligence process for higher risk categories of customers. Conversely, a simplified customer due diligence process may be adopted for lower risk categories of customers. Besides establishing clearly in their customer acceptance policies the risk factors for determining what types of customers and activities are considered as low or high risk, we believe licensed corporations or associated entities must satisfy themselves that the use of simplified customer due diligence is reasonable in the circumstances and approved by senior management.

Due diligence for specific types of customers (subsections 6.3 to 6.11)

26. We propose to set out detailed guidance in respect to specific types of customers in the Proposed Revised Guidance Note. We believe this will clarify the application of the customer due diligence requirements with regard to different types of customers as well as providing further guidance to licensed corporations and associated entities on the risk-based approach to undertaking customer due diligence. For the purpose of compliance with these specific requirements, we believe the guiding principle is that licensed corporations and associated entities should be able to justify that they have taken objectively reasonable steps to satisfy themselves as to the true identity of their customers, including beneficial owners.

27. We wish to highlight the provisions concerning certain types of customers as follows.

Corporate customers (subsections 6.4 & 6.5)

28. Customer due diligence includes identifying and verifying the customer as well as the beneficial owner. In the case of corporate customers, this would generally entail identifying and verifying the substantial shareholders, directors and authorised persons, and following through the ownership structure of a chain of companies to the ultimate principal beneficial owners of the customer and to verify the identity of those individuals. The proposed measures set out in the Proposed Revised Guidance Note aim to provide practical guidance to licensed corporations and associated entities on the level of detail as to the type and amount of information and documents required to be obtained with regard to corporate customers.

29. In line with the risk-based approach, the type and amount of identification information and documents that licensed corporations and associated entities should obtain necessarily depend on the risk category of a particular corporate customer. Listed companies and regulated investment vehicles that are subject to regulatory disclosure requirements or anti-money laundering controls consistent with the revised FATF's 40 Recommendations are considered to be of a lower risk category and the corporation itself can be regarded as the person where identity is to be verified without tracing further down to the beneficial owners. Conversely,

where there is any doubt as to the identity of the beneficial owners, shareholders, directors or authorized persons of the corporate customer and company searches are not available or do not provide meaningful information, licensed corporations and associated entities are advised to perform such additional customer due diligence measures as set out in the Proposed Revised Guidance Note. Specifically, we have provided guidance on the customer due diligence measures applicable to companies which have a significant proportion of capital in bearer shares.

Omnibus accounts of financial or professional intermediaries (subsection 6.6)

30. A common type of customer account opened with licensed corporations and associated entities is an account held in the name of a financial or professional intermediary for that financial or professional intermediary to engage in securities, futures or leverage foreign exchange transactions on behalf of its customers (i.e. omnibus accounts). In drawing up provisions with regard to this type of customer, we have looked to IOSCO's paper on Client Identification and Beneficial Ownership for the Securities Industry which has provided specific guidance on the appropriate simplified customer due diligence measures and the conditions under which they should be applied.

31. Where the omnibus account is established by a financial intermediary which is authorised and supervised by the Commission, Hong Kong Monetary Authority or Office of the Commissioner of Insurance or an equivalent authority in a FATF member or equivalent jurisdiction[4], we have proposed in the Proposed Revised Guidance Note that it would generally be sufficient for the licensed corporation or associated entity to conduct identification and verification of that intermediary and not of its underlying clients.

32. On the other hand, enhanced due diligence will generally be required to detect and prevent money laundering in cases where the omnibus account is established by a financial or professional intermediary incorporated in non-cooperative countries and territories or where it has not been established that the financial or professional intermediary has put in place reliable systems to verify customer identity. Licensed corporations and associated entities are encouraged to make reasonable enquiries in order to be able to recognize any suspicious transactions passing through these omnibus accounts.

Trust and nominee accounts (subsection 6.8)

33. We believe that proper customer due diligence in relation to trust and nominee accounts is necessary to help curb increasing attempts to disguise

[4] Equivalent jurisdictions means jurisdictions that apply standards of prevention of money laundering and terrorist financing equivalent to those of the FATF. In the Proposed Revised Guidance Note, such jurisdictions will include all members of the European Union (including Gibraltar), Antilles and Aruba of the Kingdom of the Netherlands, Isle of Man, Guernsey and Jersey.

the true ownership and control of illicit proceeds through the use of trust and nominee accounts. In the Proposed Revised Guidance Note, we propose that licensed corporations and associated entities should take reasonable measures to understand the relationship among the relevant parties in handling a trust or nominee account. There should be satisfactory evidence of the identity of the trustees or nominees and the persons on whose behalf they are acting.

Politically exposed persons (subsection 6.9)

34. Politically exposed persons ("PEPs") are defined as individuals who are or have been entrusted with prominent public functions, for example, heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with PEPs may expose a licensed corporation or associated entity to particularly significant reputation or legal risks. This is not to say that licensed corporations and associated entities should not open an account for a PEP. However, in line with Recommendation Six of the revised FATF's 40 Recommendations, we propose that they should have in place appropriate risk management systems to determine whether the customer is a PEP and perform enhanced customer due diligence procedures on this type of customer on a risk-sensitive basis. The concern is that there is a possibility, especially in countries where corruption is widespread, that such PEPs may abuse their public powers to enrich themselves through the receipt of bribes. To the extent possible, where a customer is suspected to be a PEP, licensed corporations and associated entities should identify that person fully, including ascertaining source of wealth and source of funds of customers and beneficial owners before opening a customer account. Because of the higher risk involved, we believe that the decision to open accounts for this type of customers should be taken at a senior management level.

35. We have included for reference a list of risk factors that licensed corporations and associated entities should consider in handling PEP accounts.

Reliance on introducers for customer due diligence (subsection 6.11)

36. Duplication of effort may be avoided if financial institutions are entitled to rely on the identification and verification steps that have already been undertaken on customers introduced from another member of the same financial services group, or from another financial institution. We believe that such reliance does not undermine the "gatekeeping" role of licensed corporations and associated entities against money laundering provided that certain criteria are met and that they continue to take ultimate responsibility for knowing the customer. Therefore, we propose to include in the Proposed Revised Guidance Note specific criteria which licensed corporations and

associated entities should be satisfied with prior to reliance on introducers for performing customer due diligence process, in line with Recommendation Nine of the revised FATF's 40 Recommendations. Regarding the countries in which the introducer that meets the criteria can be based, we propose that the introducer should be incorporated in, or be operating from, a jurisdiction that is a member of the FATF or an equivalent jurisdiction as defined in footnote 4 and have adequate procedures to prevent money laundering and terrorist financing (e.g. being regulated by the Commission, Hong Kong Monetary Authority or by an authority that performs similar functions).

37. Where reliance can be placed on an introducer, we suggest that the licensed corporation need only obtain the necessary customer information (but not all related documentation) from the introducer, with the exception of obtaining copies of documentation pertaining to the customer's identity at the account opening stage in accordance with the requirement under paragraph 6.2(1)(a) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. Furthermore, we propose that the licensed corporation or associated entity should take adequate steps to satisfy themselves that all other relevant documents relating to the customer due diligence requirements will be provided by the introducer upon request without delay.

Designation of an officer for reporting of suspicious transactions (subsection 10.2)

38. To ensure licensed corporations and associated entities properly discharge their legal obligations to report suspicious transactions to the Joint Financial Intelligence Unit, we propose that an officer responsible for the compliance function within a licensed corporation or an associated entity should be appointed to act as a central reference point in facilitating onward reporting of suspicious transactions and for playing an active role in the identification and assessment of potentially suspicious transactions.

High standards when hiring employees in key positions with respect to anti-money laundering (subsections 11.1 & 11.2)

39. We propose that licensed corporations and associated entities should have adequate screening procedures in place to ensure high standards when hiring employees, in line with Recommendation 15 of the revised FATF's 40 Recommendations. Following on from this, we propose that licensed corporations and associated entities should identify the key positions within their own organization structures having regard to the risk of money laundering and terrorist financing and the size of their business and ensure the employees taking up such key positions are suitable and competent to perform their duties.

V ANCILLARY CHANGES

40. We propose to make clarifications or enhancements to the existing Guidance Note in the following areas.

- A glossary of terms is set out upfront providing readers with an easy reference to look up terms referred to throughout the Proposed Revised Guidance Note;

- Licensed corporations and associated entities should cover in their anti-money laundering policies and procedures a clarification on the role of internal audit (subsection 4.2.3(f));

- A notification requirement is stipulated for licensed corporations and associated entities to notify the Commission in the event of their overseas branch or subsidiary being unable to observe its group standards on customer due diligence requirements (subsection 4.3.2);

- Additional guidance is provided in respect of the identification of individual customers, such as providing examples of the type of information needed to verify these clients. We believe this guidance helps to clarify issues not sufficiently detailed in the existing Guidance Note (subsection 6.3);

- The identification requirements for partnerships and other unincorporated businesses are set out in greater detail (subsection 6.7);

- For situations where a non face-to-face approach is used for account opening, suggested measures are provided to mitigate the risk posed by these non face-to-face customers (subsection 6.10);

- The summary of key provisions of the United Nations (Anti-Terrorism Measures) Ordinance is updated to incorporate relevant amendments of the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2004 (section 3 of Appendix A); and

- More examples are added to the list of investment related suspicious transactions (Appendix C (ii)).

VI EFFECTIVE DATE

41. The Commission wishes to ensure that licensed corporations and associated entities are given sufficient time to make all such preparations that are necessary to comply with the requirements in the revised Guidance Note. Therefore, while we anticipate publishing the conclusions to this

Consultation Paper in the third quarter of this year, the Commission proposes that a grace period of three months after the publication of our consultation conclusions and the final revised Guidance Note be allowed for licensed corporations and associated entities to attain compliance.

Appendix 1

Personal Information Collection Statement

1. This Personal Information Collection Statement (the "PICS") is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data[1] will be used following collection, what you are agreeing to with respect to the Commission's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance, Cap. 486 (the "PDPO").

Purpose of Collection

2. The Personal Data provided in your submission to the Commission in response to this Consultation Paper may be used by the Commission for one or more of the following purposes:

   - to administer the relevant provisions[2] and codes and guidelines published pursuant to the powers vested in the Commission;
   - in performing the Commission's statutory functions under the relevant provisions;
   - for research and statistical purposes; and
   - for other purposes permitted by law.

Transfer of Personal Data

3. Personal Data may be disclosed by the Commission to members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the Commission's web site and in documents to be published by the Commission during the consultation period or at its conclusion.

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1 Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

2 Defined in Schedule 1 to the Securities and Futures Ordinance (Cap. 571) ("SFO") to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Paper. The Commission has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the Commission in response to the Consultation Paper will be retained for such period as may be necessary for the proper discharge of the Commission's functions.

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong

Appendix 2

Proposed revised Prevention of

Money Laundering and Terrorist Financing

Guidance Note

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GLOSSARY

In this Guidance Note, the following abbreviations and references are used:

DTROP	"DTROP" means the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap.405).
Equivalent jurisdictions	Jurisdictions that apply standards of prevention of money laundering and terrorist financing equivalent to those of the FATF. Presently, this includes all members of the European Union (including Gibraltar), Antilles and Aruba of the Kingdom of the Netherlands, Isle of Man, Guernsey and Jersey.
FATF	"FATF" means the Financial Action Task Force on Money Laundering.
FATF members	Current FATF members are Argentina; Australia; Austria; Belgium; Brazil; Canada; Denmark; Finland; France; Germany; Greece; Hong Kong China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; United Kingdom and the United States. Two international organizations are also members of the FATF: the European Commission and the Gulf Co-operation Council.
Financial intermediary	A financial institution conducting financial transactions for or on behalf of a pool of customers.
JFIU	"JFIU" means the Joint Financial Intelligence Unit. The unit is jointly run by staff of the Hong Kong Police Force and the Hong Kong Customs & Excise Department.
NCCTs	"NCCTs" means non-cooperative countries and territories identified by the FATF to have critical deficiencies in their anti-money laundering systems or a demonstrated unwillingness to co-operate in anti-money laundering efforts. The current list of NCCTs can be found on the FATF website www.fatf-gafi.org, and may be updated by the FATF from time to time.
OSCO	"OSCO" means the Organized and Serious Crimes Ordinance (Cap.455).
PEPs	"PEPs" means politically exposed persons and are defined as individuals who are or have been entrusted with prominent public functions, for example heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. The

	definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.
Professional intermediary	A lawyer or an accountant conducting financial transactions for or on behalf of a pool of customers.
SFO	"SFO" means the Securities and Futures Ordinance (Cap.571).
Substantial shareholders	As defined under section 6 of Part 1 of Schedule 1 to the SFO.
UNATMO	"UNATMO" means the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575).

PART I OVERVIEW

1. Introduction

1.1 This Guidance Note, which is published under section 399 of the SFO, provides a general background on the subjects of money laundering and terrorist financing, summarizes the main provisions of the applicable anti-money laundering and anti-terrorist financing legislation in Hong Kong, and provides guidance on the practical implications of that legislation. The Guidance Note also sets out the steps that a licensed corporation or associated entity that is not an authorized financial institution, and any of its representatives, should implement to discourage and identify any money laundering or terrorist financing activities. The relevance and usefulness of this Guidance Note will be kept under review and it may be necessary to issue amendments from time to time.

1.2 This Guidance Note is intended for use primarily by corporations licensed under the SFO and associated entities that are not authorized financial institutions. Where relevant, this Guidance Note applies to licensed representatives. Registered institutions and associated entities that are authorized financial institutions are subject to the Hong Kong Monetary Authority's guidelines on prevention of money laundering (the "HKMA's guidelines"). However, to the extent that there are some securities or futures-sector specific guidance in this Guidance Note which may not be shown in the HKMA's guidelines, viz. risk management procedures to be undertaken where the customer due diligence process could not be satisfactorily completed after securities transactions have been conducted on behalf of a customer, omnibus account established in the name of a financial or professional intermediary and examples of suspicious transactions relating to the securities sector, the registered institutions and associated entities that are authorized financial institutions shall have regard to the relevant parts under subsection 6.1.8, 6.6 and Appendix C(ii) respectively in this Guidance Note.

1.3 This Guidance Note does not have the force of law and should not be interpreted in any manner which would override the provisions of any law, codes or other regulatory requirements applicable to licensed corporations and associated entities. In the case of any inconsistency, the provision requiring a higher standard of conduct will apply. However, a failure to comply with any of the requirements of this Guidance Note by licensed corporations, licensed representatives (where applicable), or associated entities will, in the absence of extenuating circumstances, reflect adversely on their fitness and properness. Similarly, a failure to comply with any of the requirements of the HKMA's guidelines or to have regard to the relevant parts under subsections 6.1.8, 6.6 and Appendix C(ii) of this Guidance Note by

registered institutions or associated entities that are authorized financial institutions will, in the absence of extenuating circumstances, reflect adversely on their fitness and properness.

1.4 Unless otherwise specified or the context otherwise requires, words and phrases in the Guidance Note shall be interpreted by reference to any definition of such word or phrase in Part 1 of Schedule 1 to the SFO.

2. Background

2.1 The nature of money laundering and terrorist financing

2.1.1 The term "money laundering" covers a wide range of activities and processes intended to alter the identity of the source of criminal proceeds in a manner which disguises their illegal origin.

2.1.2 The term “terrorist financing” includes the financing of terrorist acts, and of terrorists and terrorist organizations. It extends to any funds, whether from a legitimate or illegitimate source.

2.1.3 Terrorists or terrorist organizations require financial support in order to achieve their aims. There is often a need for them to obscure or disguise links between them and their funding sources. It follows then that terrorist groups must similarly find ways to launder funds, regardless of whether the funds are from a legitimate or illegitimate source, in order to be able to use them without attracting the attention of the authorities.

2.2 Stages of money laundering

2.2.1 There are three common stages in the laundering of money, and they frequently involve numerous transactions. A licensed corporation or an associated entity should be alert to any such sign for potential criminal activities. These stages are:

(a) Placement - the physical disposal of cash proceeds derived from illegal activities;

(b) Layering - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of the money, subvert the audit trail and provide anonymity; and

(c) Integration - creating the impression of apparent legitimacy to criminally derived wealth. In situations where the layering process succeeds, integration schemes effectively return the laundered proceeds back into the

general financial system and the proceeds appear to be the result of, or connected to, legitimate business activities.

2.2.2 The chart set out at Appendix B illustrates the laundering stages in greater detail.

2.3 Potential uses of the securities, futures and leveraged foreign exchange businesses in the money laundering process

2.3.1 Since the securities, futures and leveraged foreign exchange businesses are no longer predominantly cash based, they are less conducive to the initial placement of criminally derived funds than other financial industries, such as banking. Where, however, the payment underlying these transactions is in cash, the risk of these businesses being used as the placement facility cannot be ignored, and thus due diligence must be exercised.

2.3.2 The securities, futures and leveraged foreign exchange businesses are more likely to be used at the second stage of money laundering, i.e. the layering process. Unlike laundering via banking networks, these businesses provide a potential avenue which enables the launderer to dramatically alter the form of funds. Such alteration may not only allow conversion from cash in hand to cash on deposit, but also from money in whatever form to an entirely different asset or range of assets such as securities or futures contracts, and, given the liquidity of the markets in which these instruments are traded, with potentially great frequency.

2.3.3 Investments that are cash equivalents e.g. bearer bonds and similar investments in which ownership can be evidenced without reference to registration of identity, may be particularly attractive to the money launderer.

2.3.4 As mentioned, securities, futures and leveraged foreign exchange transactions may prove attractive to money launderers due to the liquidity of the reference markets. The combination of the ability to readily liquidate investment portfolios procured with both licit and illicit proceeds, the ability to conceal the source of the illicit proceeds, the availability of a vast array of possible investment mediums, and the ease with which transfers can be effected between them, offers money launderers attractive ways to effectively integrate criminal proceeds into the general economy.

2.4 International initiatives

2.4.1 The FATF is a pre-eminent inter-governmental organization established in 1989 to examine and recommend measures to

counter money laundering. The FATF's 40 Recommendations set out the framework for anti-money laundering efforts and are designed for universal application. Hong Kong has been a FATF member since 1990 and is obliged to implement its recommendations. In October 2001, the FATF expanded its scope of work to cover matters relating to terrorist financing.

2.4.2 In 1992, the International Organization of Securities Commissions ("IOSCO"), of which the Commission is a member, adopted a resolution inviting IOSCO members to consider issues relating to minimising money laundering, such as adequate customer identification, record keeping, monitoring and compliance procedures and the identification and reporting of suspicious transactions.

2.4.3 In June 1996, FATF issued a revised set of 40 recommendations for dealing with money laundering. The 40 Recommendations were further revised in June 2003[1] in response to the increasingly sophisticated combinations of techniques in laundering criminal funds. The revised 40 Recommendations apply not only to money laundering but also to terrorist financing, and when combined with the Nine Special Recommendations revised by FATF in October 2004, provide an enhanced, comprehensive and consistent framework of measures for combating money laundering and terrorist financing.

2.4.4 In light of the recent work of FATF and other international organizations, IOSCO established a task force, in October 2002, to study existing securities regulatory regimes and to develop principles relating to the identification of customers and beneficial owners. IOSCO subsequently issued, in May 2004, the paper "Principles on Client Identification and Beneficial Ownership for the Securities Industry"[2] to guide securities regulators and regulated firms of the securities industry in implementing requirements relating to customer due diligence.

3. Legislation Concerned with Money Laundering and Terrorist Financing

3.1 As one of the major financial centres in the world, it is very important for Hong Kong to maintain an effective anti-money laundering regime which helps to further reinforce the integrity and stability of our financial system. Money laundering can have devastating consequences

[1] FATF's 40 Recommendations can be found on the FATF website www.fatf-gafi.org

[2] IOSCO's Principles on Client Identification and Beneficial Ownership for the Securities Industry can be found on the IOSCO's website www.iosco.org/library/index.cfm

to the whole community. Not only does it allow the criminals to perpetrate their illicit activities, it can also undermine the financial system, causing adverse consequences to the government as well as the community at large.

3.2 The three main pieces of legislation in Hong Kong that are concerned with money laundering and terrorist financing are the DTROP, the OSCO and the UNATMO. The principal anti-money laundering and anti-terrorist financing provisions are summarized in Appendix A. The summary is not a legal interpretation of the applicable legislation and, where appropriate, legal advice should be sought.

4. Policies and Procedures to Combat Money Laundering and Terrorist Financing

4.1 Guiding principles

4.1.1 This Guidance Note has taken into account the requirements of the latest FATF's 40 Recommendations applicable to the securities, futures and leveraged foreign exchange businesses. The detailed guidelines in Part II has outlined relevant measures and procedures to guide licensed corporations and associated entities in preventing money laundering and terrorist financing. Some of these suggested measures and procedures may not be applicable in every circumstance. Each licensed corporation or associated entity should consider carefully the specific nature of its business, organizational structure, type of customer and transaction, etc. to satisfy itself that the measures taken by them are adequate and appropriate to follow the spirit of the suggested measures in Part II.

4.1.2 Where reference is made in this Guidance Note to a licensed corporation or associated entity being satisfied as to a matter, the licensed corporation or associated entity must be able to justify its assessment to the Commission or any other relevant authority.

4.2 Obligation to establish policies and procedures

4.2.1 International initiatives taken to combat drug trafficking, terrorism and other organised and serious crimes have concluded that financial institutions[3] must establish procedures of internal control aimed at preventing and impeding money laundering and terrorist financing. There is a common obligation in all the statutory requirements not to facilitate money laundering or

[3] "Financial institutions", as defined in the FATF's 40 Recommendations, encompasses persons or entities engaging in a wide range of financial activities. For details, please refer to the Glossary of the FATF's 40 Recommendations which can be found on the FATF Website www.fatf-gafi.org

terrorist financing. There is also a need for financial institutions to have a system in place for reporting suspected money laundering or terrorist financing transactions to the law enforcement authorities.

4.2.2 In light of the above, senior management of a licensed corporation or an associated entity should be fully committed to establishing appropriate policies and procedures for the prevention of money laundering and terrorist financing and ensuring their effectiveness and compliance with all relevant legal and regulatory requirements. Licensed corporations and associated entities should:

(a) issue a statement of policies and procedures, on a group basis where applicable, for dealing with money laundering and terrorist financing reflecting the current statutory and regulatory requirements;

(b) ensure that the content of this Guidance Note is understood by all staff members;

(c) regularly review the policies and procedures on prevention of money laundering and terrorist financing to ensure their effectiveness;

(d) adopt customer acceptance policies and procedures which are sensitive to the risk of money laundering and terrorist financing;

(e) undertake customer due diligence ("CDD") measures[4] to an extent that is sensitive to the risk of money laundering and terrorist financing depending on the type of customer, business relationship or transaction; and

(f) develop staff members' awareness and vigilance to guard against money laundering and terrorist financing.

[4] The customer due diligence ("CDD") measures comprise the following: (a) identify the customer, i.e. know who the individual or legal entity is; (b) verify the customer's identity using reliable, independent source documents, data or information; (c) identify beneficial ownership and control, i.e. determine which individual(s) ultimately own(s) or control(s) the customer and/or the person on whose behalf a transaction is being conducted; (d) verify the identity of the beneficial owner of the customer and/or the person on whose behalf a transaction is being conducted, corroborating the information provided in relation to (c); and (e) conduct ongoing due diligence and scrutiny, i.e. perform ongoing scrutiny of the transactions and account throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the licensed corporation's or associated entity's knowledge of the customer, its business and risk profile, taking into account, where necessary, the customer's source of funds.

4.2.3 Policies and procedures should cover:

(a) communication of group policies relating to prevention of money laundering and terrorist financing to all management and relevant staff whether in branches, departments or subsidiaries;

(b) customer acceptance policy and customer due diligence measures, including requirements for proper identification;

(c) maintenance of records;

(d) compliance with relevant statutory and regulatory requirements;

(e) co-operation with the relevant law enforcement authorities, including the timely disclosure of information; and

(f) role of internal audit or compliance function to ensure compliance with policies, procedures, and controls relating to prevention of money laundering and terrorist financing, including the testing of the system for detecting suspected money laundering transactions, evaluating and checking the adequacy of exception reports generated on large and/or irregular transactions, the quality of reporting of suspicious transactions and the level of awareness of front line staff of their responsibilities in this regard.

4.3 Application of policies and procedures to overseas branches and subsidiaries

4.3.1 Whilst appreciating the sensitive nature of extra-territorial regulations, licensed corporations and associated entities should ensure that their overseas branches and where practicable, subsidiaries are aware of group policies concerning money laundering and terrorist financing and apply the group standards to the extent that local applicable laws and regulations permit. If appropriate, overseas branches and where practicable, subsidiaries should be instructed as to the local reporting point to whom disclosure should be made of any suspicion about a person, transaction or property.

4.3.2 Licensed corporations and associated entities should pay particular attention to branches and where practicable, subsidiaries which are located in jurisdictions that do not or insufficiently implement the FATF's Recommendations

including jurisdictions designated as the NCCTs[5] by the FATF. Where an overseas branch or subsidiary is known to be unable to observe group standards, the licensed corporation or associated entity should inform the Commission as soon as practicable.

PART II DETAILED GUIDELINES

5. Customer Acceptance

5.1 Licensed corporations and associated entities should develop customer acceptance policies and procedures that aim to identify the types of customers that are likely to pose a higher than average risk of money laundering and terrorist financing. A more extensive customer due diligence process should be adopted for higher risk customers. There should also be clear internal policies on which level of management is able to approve a business relationship with such customers.

5.2 In determining the risk profile of a particular customer or type of customers, licensed corporations and associated entities should take into account factors such as the following:

(a) background or profile of the customer, such as being, or linked to, a PEP;

(b) nature of the customer's business, which may be particularly susceptible to money laundering risk, such as money changers or casinos that handle large amounts of cash;

(c) origin of the customer (e.g. place of birth, residence), the place of establishment of the customer's business and location of the counterparties with which the customer does business, such as NCCTs designated by the FATF or those known to the licensed corporations and associated entities to lack proper standards in the prevention of money laundering or customer due diligence process;

(d) for a corporate customer, unduly complex structure of ownership for no good reason;

(e) means of payment as well as type of payment (cash or third party cheque the drawer of which has no apparent connection with the prospective customer may be a cause for increased scrutiny); and

[5] For NCCT with serious deficiencies and where inadequate progress has been made to improve their position, the FATF may recommend the application of further counter-measures. The specific counter-measures, as recommended by FATF, will be advised by the Commission as and when appropriate. The measures will generally focus on more stringent customer due diligence and enhanced surveillance and reporting of transactions. Licensed corporations and associated entities should apply the counter-measures as advised by the Commission to such NCCTs.

(f) any other information that may suggest that the customer is of higher risk (e.g. knowledge that the customer has been refused a business relationship by another financial institution).

5.3 Licensed corporations and associated entities should adopt a balanced and common sense approach with regard to customers of higher than average risk of money laundering and terrorist financing; e.g. those from or closely linked with NCCTs or from other jurisdictions which do not meet FATF standards. While extra care should be exercised in such cases, it is not a requirement that licensed corporations and associated entities should refuse to do any business with such customers or automatically classify them as high risk and subject them to an enhanced customer due diligence process under the risk-based approach discussed in subsection 6.2 of this Guidance Note. Rather, licensed corporations and associated entities should weigh all the circumstances of the particular situation and assess whether there is a higher than normal risk of money laundering.

5.4 A licensed corporation or an associated entity should consider reclassifying a customer as higher risk if, following initial acceptance of the customer, the pattern of account activity of the customer does not fit in with the licensed corporation's or associated entity's knowledge of the customer. A suspicious transaction report should also be considered.

6. Customer Due Diligence

6.1 General

6.1.1 Specific CDD requirements applicable to different types of customers are outlined in subsections 6.3 to 6.11. For the purpose of compliance with these requirements, the guiding principle is that licensed corporations and associated entities should be able to justify that they have taken objectively reasonable steps to satisfy themselves as to the true identity of their customers including beneficial owners.

6.1.2 In the context of this Guidance Note, a customer refers to the individual or legal entity who maintains an account with a licensed corporation or an associated entity. A beneficial owner refers to the individual who ultimately owns or controls the customer and/or the person on whose behalf a transaction is being conducted. The CDD measures set out in this Guidance Note should, except provided otherwise, be applied to both the customer itself and its beneficial owner.

6.1.3 Licensed corporations and associated entities should verify their customers' identity using documents issued by reliable sources. Wherever possible, the documents should be obtained from a source independent from the customer.

6.1.4 Depending on the type of customer, business relationship or transaction, licensed corporations and associated entities would need to obtain appropriate information on the purpose and intended nature of the business relationship on a risk sensitive basis such that ongoing due diligence on the customer may be conducted at a level commensurate with the customer's risk profile.

6.1.5 Licensed corporations and associated entities should not keep anonymous accounts or accounts using fictitious names.

6.1.6 When establishing a business relationship, licensed corporations and associated entities should ask whether the customers are acting for their own accounts or for the account of another party or parties for the purpose of identifying the beneficial owner of the account opened by the customer.

6.1.7 In general, a licensed corporation or an associated entity should verify the identity of the customer and beneficial owner before establishing a business relationship. When the licensed corporation or associated entity is unable to perform the CDD process satisfactorily at the account opening stage, it should not commence the business relationship or perform the transaction and should consider whether a suspicious transaction report should be made.

6.1.8 However, where transactions conducted on behalf of customers need to be performed very rapidly due to market conditions or in the case of non face-to-face business, it would be permissible for verification to be completed after the establishment of the business relationship provided that the verification occurs as soon as reasonably practicable. A licensed corporation or an associated entity would need to adopt appropriate risk management procedures concerning the conditions and timeframe under which a customer is permitted to establish the business relationship prior to verification. These procedures should include a set of measures such as limitation of the number, types and/or amount of transactions that can be performed and the monitoring of large or complex transactions being carried out that fall outside the expected norms for that type of relationship. For example, consideration may be given to not allowing funds to be paid out of the account to a third party before the identity of the customer is satisfactorily verified. If the licensed corporation

or associated entity is unable to perform the CDD process satisfactorily within a reasonably practicable timeframe after commencing the business relationship, it should, if possible, discontinue the business relationship and consider whether a suspicious transaction report should be made.

6.1.9 Licensed corporations and associated entities should take reasonable steps to ensure that the records of existing customers remain up-to-date and relevant.

6.1.10 To achieve this, a licensed corporation or an associated entity should consider undertaking periodic reviews of existing customer records. An appropriate time to do so may be when there is a transaction that is unusual or not in line with the customer's normal trading pattern based on the licensed corporation's or associated entity's knowledge of the customer; when there is a material change in the way that the account is operated; when the licensed corporation or associated entity is not satisfied that it has sufficient information about the customer; or when there are doubts about the veracity or adequacy of previously obtained identification data.

6.1.11 Even in the absence of any of the circumstances mentioned in subsection 6.1.10 above, licensed corporations and associated entities are encouraged to consider whether to require additional information in line with their current standards from those existing customers.

6.2 Risk-based approach

6.2.1 The general rule is that customers are subject to the full range of CDD measures. Licensed corporations and associated entities should however determine the extent to which they apply each of the CDD measures on a risk sensitive basis. The basic principle of a risk-based approach is that licensed corporations and associated entities adopt an enhanced CDD process for higher risk categories of customers, business relationships or transactions. Similarly, simplified CDD process is adopted for lower risk categories of customers, business relationships or transactions. The relevant enhanced or simplified CDD process may vary from case to case depending on customers' background, transaction types and specific circumstances, etc. Licensed corporations and associated entities should exercise their own judgment and adopt a flexible approach when applying the specific enhanced or simplified CDD measures to customers of particular high or low risk categories.

6.2.2 Licensed corporations and associated entities should establish clearly in their customer acceptance policies the risk factors for determining what types of customers and activities are to be considered as low or high risk. In addition, they must satisfy themselves that the use of simplified customer due diligence is reasonable in the circumstances and approved by senior management. The opening of a high risk account whereby enhanced CDD would be required should be subject to approval by senior management.

6.2.3 Simplified CDD procedures may be used for identifying and verifying the identity of the customer and the beneficial owner where there is no suspicion of money laundering or terrorist financing, and:

- the inherent risk of money laundering or terrorist financing relating to a type of customer is assessed to be low; or

- there is adequate public disclosure or other checks and controls elsewhere in national systems in relation to the customers.

Some examples of lower risk categories of customers are:

(a) financial institutions that are authorised and supervised by the Commission, Hong Kong Monetary Authority or Office of the Commissioner of Insurance or by an equivalent authority in a jurisdiction that is a FATF member or in an equivalent jurisdiction;

(b) public companies that are subject to regulatory disclosure requirements. This refers to companies that are listed on a specified stock exchange as defined under the SFO[6];

(c) government administrations or enterprises in a non-NCCT jurisdiction where the risk of money laundering is assessed to be low and where the licensed corporation or associated entity has no doubt as regards the ownership of the enterprise;

(d) pension, superannuation or similar schemes that provide retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme

[6] Licensed corporations and associated entities should pay special attention to Recommendation 21 of the FATF's 40 Recommendations and exercise extra care in respect of customers and business relationships from NCCTs, including corporate customers listed on stock exchanges of NCCTs.

rules do not permit the assignment of a member's interest under the scheme.

6.2.4 It should be noted that there might be instances where the circumstances may lead to suspicions even though the inherent risk of the customer is considered to be low. Should there be any doubt, the full range of CDD measures should be adopted.

6.2.5 Licensed corporations and associated entities should note that jurisdictions which are not designated as NCCTs do not necessarily mean that they could be taken as equivalent jurisdictions that apply standards of prevention of money laundering and terrorist financing equivalent to those of the FATF.

6.2.6 Apart from the risk factors set out in subsection 5.2 for determining a customer's risk profile, the following are some examples of high risk categories of customers:

(a) complex legal arrangements such as unregistered or unregulated investment vehicles;

(b) companies that have nominee shareholders or a significant portion of capital in the form of bearer shares;

(c) persons (including corporations and other financial institutions) from or in countries which do not or insufficiently apply the FATF's Recommendations (such as jurisdictions designated as the NCCTs by the FATF or those known to the licensed corporations and associated entities to lack proper standards in the prevention of money laundering and terrorist financing); and

(d) non face-to-face customers, (i.e. customers whose accounts are opened using a non face-to-face approach).

6.2.7 Licensed corporations and associated entities should pay special attention to all complex, unusual large transactions and all unusual patterns of transactions which have no apparent economic or visible lawful purpose, in particular with customers from countries which do not or insufficiently apply the FATF's Recommendations. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities.

6.3 Individual customers

6.3.1 Information such as the following would normally be needed for verification of the identity of individual customers:

(a) name,

(b) number of Hong Kong Identity Card for a local customer (i.e. resident with a right of abode in Hong Kong) and passport or an unexpired government-issued identification evidencing nationality or residence for non-local customers,

(c) date of birth,

(d) residential address (and permanent address if different), and

(e) occupation/business.

6.3.2 Hong Kong Identity Cards or unexpired government-issued identification such as passports are the types of documents that should be produced as identity proof. File copies of the identity documents should be retained.

6.3.3 Licensed corporations and associated entities should check the address of the customer by the best available means, e.g. sighting of recent utility bill or bank statement.

6.3.4 It must be appreciated that no form of identification can be fully guaranteed as genuine or representing correct identity. If there is doubt or difficulty with distinguishing whether an identification document is genuine, licensed corporations and associated entities may contact the Immigration Department for guidance on recognizing the special features borne with a genuine identity card.

6.3.5 Whenever possible, it is recommended that the prospective customer be interviewed personally. Where the risk of money laundering or terrorist financing relating to the customer is assessed to be high, it is advisable that licensed corporations and associated entities ask the customer to make himself available for a face-to-face interview.

6.4 Corporate customers

6.4.1 For a corporate customer which is not listed on a stock market of a country which is a FATF member or on a specified stock

exchange as defined under the SFO[6], or is not a subsidiary of such a listed company, or is not a state-owned corporation in a non-NCCT jurisdiction, or is not a financial institution trading for its own account (see subsection 6.6.8), documents and information such as those mentioned below would be relevant for the purpose of conducting CDD:

(a) Certificate of Incorporation and, where applicable, Business Registration Certificate or any other documents proving the incorporation or similar evidence of the legal status of the corporation;

(b) Board resolution evidencing the approval of the opening of the account and conferring authority on those who will operate it;

(c) information about the nature of the business of the corporate customer and its ownership and control structure for identifying which individual(s) ultimately own(s) or control(s) the customer;

(d) specimen signatures;

(e) copies of identification documents of at least 2 authorized persons to act on behalf of the corporate customer;

(f) copies of identification documents of at least 2 directors (including the managing director); and

(g) copies of identification documents of the substantial shareholders and beneficial owners.

6.4.2 If the customer, which is a non-listed company, has a number of layers of companies in its ownership structure, the licensed corporation or associated entity would normally need to follow the chain of ownership to identify the individuals who are the ultimate principal beneficial owners of the customer and to verify the identity of those individuals. However, it is not required to check the details of each of the intermediate companies (including their directors) in the ownership chain. Where a customer in the ownership chain is a company listed on a stock market of a country which is a FATF member or on a specified stock exchange as defined under the SFO[6] or is a subsidiary of such a listed company, it should generally be sufficient to stop at that point and to verify the identity of that customer in line with the suggested CDD measures mentioned in subsection 6.5.2 below.

6.4.3 For higher risk categories of customers or where there is any doubt as to the identity of the beneficial owners, shareholders, directors or account signatories of the corporate customer, it is advisable that the licensed corporations and associated entities perform additional CDD measures on a risk sensitive basis. Examples of relevant additional measures include:

(a) making a company search or credit reference agency search;

(b) obtaining the memorandum and articles of association;

(c) verifying the identity of all persons who are authorized to operate the account; and

(d) verifying the residential address of individuals who are connected with the corporate customers (e.g. substantial shareholders, directors, account signatories and partners).

6.4.4 In the case of an offshore investment vehicle owned by individuals (i.e. the ultimate beneficial owners) who use such vehicle as the contractual party to establish a business relationship with a licensed corporation or an associated entity and the investment vehicle is incorporated in a jurisdiction where company searches or certificates of incumbency (or equivalent) are not available or cannot provide meaningful information about its directors and substantial shareholders, it is advisable that licensed corporations and associated entities adopt an enhanced CDD process in relation to the customer. Besides satisfying itself that:

- they know the identity of the ultimate beneficial owners; and

- there is no suspicion of money laundering,

it is advisable that the licensed corporation or associated entity perform additional CDD measures on a risk sensitive basis. Examples of relevant additional measures include:

(a) obtaining self-declarations in writing about the identity of, and the relationship with, the directors and substantial shareholders from the ultimate beneficial owners;

(b) obtaining comprehensive client profile information; e.g. purpose and reasons for opening the account, business or employment background, source of funds and anticipated account activity;

(c) conducting face-to-face meeting with the customer before acceptance of such customer;

(d) obtaining approval of senior management for acceptance of such customer;

(e) assigning a designated staff to serve the customer and that staff should bear the responsibility for CDD and ongoing monitoring to identify any unusual or suspicious transactions on a timely basis; and

(f) conducting face-to-face meetings with the customer as far as possible on a regular basis throughout the business relationship.

6.4.5 Licensed corporations and associated entities need to exercise special care in dealing with companies which have a significant proportion of capital in the form of bearer shares. It is advisable for licensed corporations and associated entities to have procedures to monitor the identity of all substantial shareholders. This may require licensed corporations and associated entities to consider whether to immobilize the shares, such as by holding the bearer shares in custody. Where it is not practical to immobilize the bearer shares, the licensed corporation or associated entity may adopt measures such as obtaining a declaration from each substantial shareholder of the corporate customer on the percentage of his shareholding, requiring such substantial shareholders to provide a declaration on an annual basis and notify the licensed corporation or associated entity if the shares are sold, assigned or transferred.

6.4.6 Licensed corporations and associated entities also need to exercise special care in initiating business transactions with companies that have nominee shareholders. Satisfactory evidence of the identity of beneficial owners of such companies should be obtained.

6.5 Listed companies and regulated investment vehicles

6.5.1 Where a corporation is a company which is listed on a stock market of a country which is a FATF member or on a specified stock exchange as defined under the SFO[6], or is a subsidiary of such a listed company, or is a state-owned corporation in a non-NCCT jurisdiction[7], the corporation itself can be regarded as the person whose identity is to be verified.

[7] Licensed corporations and associated entities should be satisfied that the risk of money laundering in the non-NCCT jurisdiction is low and there is no doubt as regards the ownership of the enterprise.

6.5.2 For customers mentioned in subsection 6.5.1 above, it will therefore be generally sufficient for a licensed corporation or an associated entity to obtain copies of relevant identification documents such as certificate of incorporation, business registration certificate and board resolution to open an account, without the need to make further enquiries about the identity of the substantial shareholders, individual directors or authorized signatories of the account. However, evidence that any individual operating the account has the necessary authority to do so should be sought and retained.

6.5.3 Where a listed corporation is effectively controlled by an individual or a small group of individuals, it is suggested that a licensed corporation or an associated entity consider whether it is necessary to verify the identity of such individual(s).

6.5.4 Where the customer is a regulated or registered investment vehicle, such as a collective investment scheme or mutual fund that is subject to adequate regulatory disclosure requirements, it is not necessary to seek to identify and verify the identity of any unit holder of that entity.

6.6 Financial or professional intermediaries

6.6.1 Where the account established in the name of a financial or professional intermediary is an omnibus account in order for that financial or professional intermediary to engage in securities, futures or leveraged foreign exchange transactions on behalf of its customers, a licensed corporation or an associated entity should conduct identification and verification of the omnibus account holder, i.e. the financial or professional intermediary that is the licensed corporation's or associated entity's client, and is not required to "drill down" through the financial or professional intermediary to identify and verify the pool of customers for whom the financial or professional intermediary performs financial transactions.

6.6.2 When the omnibus account is established by a financial intermediary which is authorized and supervised by the Commission, Hong Kong Monetary Authority and Office of the Commissioner of Insurance or an equivalent authority in a jurisdiction that is a FATF member or an equivalent jurisdiction, the risk of money laundering and terrorist financing activity is considered lower. The application of simplified identification and verification procedures in relation to such accounts is appropriate. It will generally be sufficient for a licensed corporation or an associated entity to verify that the financial

intermediary is on the list of authorized (and supervised) financial institutions in the jurisdiction concerned. Evidence that any individual operating the account has the necessary authority to do so should be sought and retained.

6.6.3 However, when the omnibus account is established by a financial or professional intermediary other than those mentioned in subsection 6.6.2 above, enhanced procedures would be necessary. Besides conducting identification and verification of the financial or professional intermediary through procedures consistent with those set out in subsection 6.4.1, the enhanced procedures to be undertaken may include measures such as gathering sufficient information about the financial or professional intermediary to understand the nature of its business and to assess the regulatory and oversight regime of the country in relation to CDD standards in which the financial or professional intermediary is located.

6.6.4 To facilitate the assessment of the CDD standards of the financial or professional intermediary, licensed corporations and associated entities may collect information such as its location of business, major business activities, management, authorization status, reputation (whether it has been subject to a money laundering or terrorist financing investigation or regulatory action), quality of supervision (system of regulation and supervision in its country in relation to CDD standards) and its anti-money laundering or terrorist financing controls. Licensed corporations and associated entities may also draw reference from publicly available information to assess the professional reputation of the financial or professional intermediary.

6.6.5 Licensed corporations and associated entities should pay particular attention when maintaining an omnibus account with a financial or professional intermediary

(a) incorporated in NCCTs;

(b) in a jurisdiction in which it neither has a physical presence nor is affiliated with a regulated financial group that has such presence; or

(c) where it has not been established that the financial or professional intermediary has put in place reliable systems to verify customer identity,

and enhanced due diligence will generally be required in such cases to detect and prevent money laundering and terrorist financing. Licensed corporations and associated entities are

encouraged to make reasonable enquiries about transactions passing through omnibus accounts that pose cause for concern or to report these transactions if any suspicion is aroused. If necessary, licensed corporations and associated entities should not permit the financial or professional intermediary to open or continue to maintain an omnibus account.

6.6.6 In particular, licensed corporations and associated entities should not establish or maintain an omnibus account for a financial intermediary incorporated in a jurisdiction in which it neither has a physical presence nor is affiliated with a regulated financial group that has such presence unless after having undertaken the above enhanced procedures, they are satisfied that the financial or professional intermediary is subject to adequate regulatory supervision in relation to CDD standards under the regulation of the jurisdiction in which it is located.

6.6.7 Approval of senior management should be obtained before establishing a new omnibus account relationship. Licensed corporations and associated entities should preferably document[8] the respective responsibilities of each party.

6.6.8 For a customer that is a financial institution and is trading for its own account, a licensed corporation or an associated entity should similarly conduct such simplified or enhanced procedures depending on whether the institution is subject to adequate supervision in a jurisdiction that is a FATF member or an equivalent jurisdiction as described above for a financial intermediary that is an omnibus account holder.

6.7 Unincorporated businesses

6.7.1 In the case of partnerships and other unincorporated businesses whose partners are not known to the licensed corporation or associated entity, licensed corporations and associated entities would need to obtain satisfactory evidence for the purpose of conducting CDD such as the identity of at least 2 partners, the identity of at least 2 authorized signatories and a mandate from the partnership authorizing the opening of an account and conferring authority on those who will operate it in the case of a formal partnership arrangement.

6.7.2 Where the risk of money laundering or terrorist financing relating to the customer is assessed to be high, enhanced CDD should be

[8] It is not necessary that the licensed corporation or associated entity and the financial or professional intermediary always have to set out their respective responsibilities in written form, provided there is a clear understanding as to which party will perform the required measures.

performed; e.g. by verifying the identity of all partners and authorized signatories.

6.8 Trust and nominee accounts

6.8.1 Licensed corporations and associated entities should understand the relationship among the relevant parties in handling a trust or nominee account. There should be satisfactory evidence of the identity of the trustees or nominees and the persons on whose behalf they are acting.

6.8.2 For a trust account customer, licensed corporations and associated entities should take reasonable measures to understand the nature of the trust. Documents and information such as the following would be relevant for the purpose of conducting CDD:

(a) identity of trustees or person exercising effective control over the trust, protectors[9], settlors / grantors[10];

(b) identity of beneficiaries (as far as possible), though a broad description of the beneficiaries such as family members of an individual or employees of a pension scheme, where the scheme rules do not permit the assignment of a member 's interest under the scheme, may be accepted;

(c) copy of the trust deed or legal documents that evidence the existence and good standing of the legal arrangement.

6.8.3 Where the identity of beneficiaries has not previously been verified, licensed corporations and associated entities should consider assessing the need to undertake verification of the identity of beneficiaries when they become aware that any payment out of the trust account is made to the beneficiaries or on their behalf. In making this assessment, licensed corporations and associated entities may adopt a risk-based approach by taking into account the amounts involved and any suspicion of money laundering or terrorist financing. Approval of senior management should preferably be obtained for a decision not to undertake such verification.

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[9] Licensed corporations and associated entities may adopt a risk-based approach to determine whether it is necessary to verify the identity of protectors. The identity of the protectors is relevant information which has to be verified because these persons can, under certain circumstances, exercise their powers to replace the existing trustees.

[10] To the extent that the CDD process on the settlors / asset contributors has been adequately performed, licensed corporations and associated entities may accept a declaration from the trustee or other contractual party to confirm the link or relationship with the settlors / asset contributors.

6.9 Politically exposed persons

6.9.1 Business relationships with individuals holding important public positions as well as persons or companies clearly related to them (i.e. families, close associates etc) expose a licensed corporation or an associated entity to particularly significant reputation or legal risks. There should be enhanced due diligence in respect of such politically exposed persons or PEPs.

6.9.2 The concern is that there is a possibility, especially in countries where corruption is widespread, that such PEPs may abuse their public powers for their own illicit enrichment through the receipt of bribes, etc.

6.9.3 The definition of PEP is not intended to cover middle ranking or more junior individuals in the foregoing categories. Licensed corporations and associated entities must however satisfy themselves that the criteria they use for classifying foreign politicians, government judicial or military officials, etc as PEPs are sensitive to the risk of money laundering and terrorist financing.

6.9.4 Licensed corporations and associated entities should have appropriate risk management systems to determine whether the customer is a PEP (including making reference to publicly available information or commercially available databases). A risk-based approach may be adopted for identifying PEPs and especially on persons from countries that are generally considered to be of higher risk from a corruption point of view.

6.9.5 In the case when the licensed corporation or associated entity is considering establishing a relationship with a person that is suspected to be a PEP, it should identify that person fully, as well as people and companies that are clearly related to him. Licensed corporations and associated entities should ascertain the source of wealth and source of funds of customers and beneficial owners identified as PEPs before opening a customer account.

6.9.6 The decision to open an account for a PEP should be taken at a senior management level. Where a customer has been accepted and the customer or beneficial owner is subsequently found to be or become a PEP, a licensed corporation or an associated entity should obtain senior management approval to continue the business relationship.

6.9.7 Risk factors that licensed corporations and associated entities should consider in handling a business relationship (or potential relationship) with a PEP include:

(a) any particular concern over the country where the PEP is from, taking into account his position;

(b) any unexplained sources of wealth or income (i.e. value of assets owned not in line with the PEP's income level);

(c) unexpected receipts of large sums from governmental bodies or state-owned enterprises;

(d) source of wealth described as commission earned on government contracts;

(e) request by the PEP to associate any form of secrecy with a transaction; and

(f) use of accounts at a government-owned bank or government accounts as the source of funds in a transaction.

6.10 Non face-to-face customers

6.10.1 Account opening using a non face-to-face approach refers to a situation where the customer is not interviewed and the signing of account opening documentation and sighting of identity documents of the customer is not conducted in the presence of an employee of a licensed corporation; e.g. where the account is opened via internet. If the account is opened using a non face-to-face approach, the account opening procedures should be one that satisfactorily ensures the identity of the customer.

6.10.2 Reference should be made to the relevant provisions in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "Code") concerning account opening procedures using a non face-to-face approach. The signing of the client agreement and the sighting of the identity documents of the customer should be certified in such manner as provided in the Code (presently paragraph 5.1(a)). Alternatively, the identity of the client (other than corporate entities), may be verified in accordance with such procedural steps as provided in the Code (presently, paragraph 5.1(b)).

6.10.3 A financial intermediary that is regulated and incorporated in, or operating from, a jurisdiction that is a FATF member or an equivalent jurisdiction may also be used, besides those persons deemed to be suitable certifiers in paragraph 5.1(a) of the Code, to certify the signing of the client agreement and sighting of related identity documents.

6.10.4 Particular care should be taken when the signing of the customer agreement and sighting of related identity documents is witnessed by certifiers who are in a jurisdiction that is not a FATF member or an equivalent jurisdiction. In such circumstances, licensed corporations and associated entities are encouraged to assess the reliability of the documents, data or information by these professional persons and consider taking additional measures to mitigate the risk posed by such non face-to-face customers, including:

(a) independent contact with the customer by the licensed corporation or associated entity;

(b) request additional documents to complement those required for face-to-face customers;

(c) more frequent information updates on non face-to-face customers;

(d) completion of on-line questionnaires for account opening applications that require a range of information capable of independent verification; or

(e) in extreme cases, refusal of business relationship without face-to-face contact for high risk customers.

6.11 Reliance on introducers for customer due diligence

6.11.1 This subsection refers to a third party which introduces customers to a licensed corporation or an associated entity. In practice, this often occurs through introduction made by another member of the same financial services group, or sometimes from another financial institution. This subsection does not apply to relationships, accounts or transactions between a licensed corporation or an associated entity and a financial or professional intermediary for its customers, i.e. omnibus accounts. Those relationships are addressed in subsection 6.6 of this Guidance Note.

6.11.2 The licensed corporation or associated entity may rely on the third party to perform elements (a) to (d) of the CDD measures in footnote 4 provided that criteria set out below are met. However, the ultimate responsibility for knowing the customer always remains with the licensed corporations and associated entities.

6.11.3 Prior to reliance, licensed corporations and associated entities must satisfy themselves that it is reasonable to rely on an

introducer to apply a CDD process. For these purposes, it is advisable for licensed corporations and associated entities to establish clear policies in order to determine whether the introducer in question possesses an acceptable level of reliability.

6.11.4 Licensed corporations and associated entities relying upon an introducer should:

(a) immediately obtain the necessary information concerning elements (a) to (d) of the CDD measures in footnote 4 and the purpose and intended nature of the business relationship

(b) immediately obtain copies of documentation pertaining to the customer's identity, as required under paragraph 6.2(a) of the Code (licensed corporations and associated entities may choose not to obtain copies of other relevant documentation provided that (a) has been satisfied and copies of the documentation will be provided by the introducer upon request without delay);

(c) take adequate steps to satisfy themselves that copies of other relevant documentation relating to the CDD requirements will be made available from the introducer upon request without delay, e.g. by establishing their respective responsibilities in writing, including reaching an agreement with the introducer that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the introducer upon request without delay and that the licensed corporation or associated entity will be permitted to verify the due diligence undertaken by the third party at any stage; and

(d) ensure the introducer is regulated and supervised for, and has measures in place to comply with CDD and record keeping requirements in line with those set out in sections 5 to 8, Part II of this Guidance Note.

6.11.5 To provide additional assurance that these criteria can be met, it is advisable for a licensed corporation or an associated entity to rely, to the extent possible, on third parties which are incorporated in, or operating from, a jurisdiction that is a member of the FATF or an equivalent jurisdiction and:

(a) regulated by the Commission, Hong Kong Monetary Authority or Office of the Commissioner of Insurance or by an authority that performs similar functions; or

(b) if not so regulated, are able to demonstrate that they have adequate procedures to prevent money laundering and terrorist financing.

6.11.6 Licensed corporations and associated entities should consider conducting periodic reviews to ensure that an introducer upon which it relies continues to conform to the criteria set out above. This may involve review of the relevant policies and procedures of the introducer and sample checks of the due diligence conducted.

6.11.7 Licensed corporations and associated entities should not rely on introducers based in jurisdictions considered as high risk, e.g. NCCTs or jurisdictions that are inadequately-regulated with respect to CDD.

7. Record Keeping

7.1 Licensed corporations and associated entities should ensure compliance with the record keeping requirements contained in the relevant legislation, rules or regulations of the Commission and of the relevant exchanges.

7.2 Licensed corporations and associated entities should maintain such records which are sufficient to permit reconstruction of individual transactions (including the amounts and types of currencies involved, if any) so as to provide, if necessary, evidence for prosecution of criminal behavior.

7.3 Should there be any suspected drug related or other laundered money or terrorist property, the competent investigating authorities would need to trace through the audit trail for reconstructing a financial profile of the suspect account. To enable this reconstruction, licensed corporations and associated entities should retain the following information for the accounts of their customers in order to maintain a satisfactory audit trail:

(a) the beneficial owner of the account;

(b) the volume of the funds flowing through the account; and

(c) for selected transactions:

- the origin of the funds;
- the form in which the funds were offered or withdrawn, e.g. cash, cheques, etc.;
- the identity of the person undertaking the transaction;

- the destination of the funds;
- the form of instruction and authority.

7.4 Licensed corporations and associated entities should ensure that all customer and transaction records and information are available on a timely basis to the competent investigating authorities. Where appropriate, they should consider retaining in Hong Kong certain records, e.g. customer identification, account files, and business correspondence, for periods which may exceed that required under other relevant legislation, rules and regulations of the Commission or of the relevant exchanges.

8. Retention of Records

8.1 The following document retention terms should be observed:

(a) All necessary records on transactions, both domestic and international, should be maintained for at least seven years.

(b) Records on customer identification (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence should be kept for at least five years after the account is closed.

8.2 In situations where the records relate to on-going investigations or transactions which have been the subject of a suspicious transaction reporting, they should be retained until it is confirmed that the case has been closed.

9. Recognition of Suspicious Transactions

9.1 For the purpose of compliance with this Guidance Note, a licensed corporation or an associated entity should conduct the necessary ongoing monitoring for identification of suspicious transactions in order to satisfy its legal obligations of reporting funds or property known or suspected by it to be proceeds of crime or terrorist property to the JFIU.

9.2 Depending on the size of the business of the licensed corporation or associated entity, it may sometimes be inadequate to rely simply on the initiative of front-line staff to identify and report suspicious transactions. In such circumstances, there may need to be systems or procedures in place, such as development of transaction reports, which can provide management and compliance officers with timely information on a regular basis to enable them to detect patterns of unusual or suspicious

activity, particularly in relation to higher risk accounts, such as PEPs, omnibus accounts with financial institutions incorporated in NCCTs, etc.

9.3 The types of transactions which may be used by a money launderer and terrorist are virtually unlimited, thus it is difficult to specifically list out all types of transactions that might constitute a suspicious transaction. Suspicion may arise where a transaction is carried out for a purpose inconsistent with a customer's known business or personal activities or with the normal business for that type of account. Therefore, the first step to recognition is to know enough about a customer's business and financial circumstances to recognize that a transaction, or series of transactions, is unusual.

9.4 To facilitate the identification of suspicious activity, an effective systemic approach to help identify suspicious financial activity recommended by the JFIU is provided in Appendix C(i). These methods of recognizing suspicious activities and approaches in the questioning of customers, are given by way of example only. The timing and the extent of the questioning should depend on all circumstances in totality.

9.5 A list of potentially suspicious or unusual activities which shows the types of transactions that could be a cause of scrutiny is also provided in Appendix C(ii). The list is neither exhaustive nor does it take the place of any legal obligations related to the reporting of suspicious or unusual transactions imposed under the legislation. The list of characteristics should be taken into account by licensed corporations and associated entities along with other information (including any list of designated terrorists published in the Gazette, which can be found in the Government website http://www.gld.gov.hk/cgi-bin/gld/egazette/index.cgi?lang=e&agree=0), the nature of the transaction itself and the parties involved in the transaction. The existence of one or more of the factors described in the list may warrant some form of increased scrutiny of the transaction. However, the existence of one of these factors by itself does not necessarily mean that a transaction is suspicious or unusual.

9.6 In relation to terrorist financing, the FATF issued a paper in April 2002 on guidance for financial institutions in detecting terrorist financing. The document describes the general characteristics of terrorist financing with case studies illustrating the manner in which law enforcement agencies were able to establish a terrorist financing link based on information reported by financial institutions. Annex 1 of the document contains a series of characteristics of financial transactions that have been linked to terrorist activities in the past. A licensed corporation or an associated entity is advised to acquaint itself with the FATF paper[11].

[11] The FATF paper is available on the FATF website www.fatf-gafi.org/dataoecd/39/21/34033955.pdf.

9.7 Licensed corporations and associated entities should have in place an effective procedure to promptly identify terrorist suspects specified in Gazette notices or other lists that have been made known to them (e.g. lists designated under the US President's Executive Order 13224 on blocking of terrorist property which can be found on the United States Department of the Treasury website [12] and lists referred to in the circulars issued by the Commission [13]). To this end, licensed corporations and associated entities should consider consolidating the various lists into a single database for facilitating access by staff for the purpose of identifying suspicious transactions. They should check the names of both existing customers and applications for business relationship against the terrorist suspects specified as above. They should be particularly alert for suspicious remittances and should bear in mind the role which non-profit organizations are known to have played in terrorist financing. Enhanced checks should be completed before processing a transaction, where possible, if there are circumstances giving rise to suspicion.

10. Reporting of Suspicious Transactions

10.1 The obligation to report under the DTROP, the OSCO or the UNATMO rests with the individual who becomes suspicious of a person, transaction or property. Disclosures of suspicious transactions under the DTROP, the OSCO or the UNATMO should be made to the JFIU. In addition to acting as the point for receipt of disclosures made by any organization or individual, the JFIU functions as the local and international advisor on money laundering matters generally and can offer practical assistance to the financial sector on the subject of money laundering and terrorist financing.

10.2 An officer responsible for compliance function (hereinafter referred to as "compliance officer") within a licensed corporation or an associated entity should be appointed to act as a central reference point within the organization to facilitate onward reporting to the JFIU. The role of the compliance officer is not simply that of a passive recipient of ad hoc reports of suspicious transactions, but rather, he or she plays an active role in the identification and reporting of suspicious transactions, which may involve regular review of exception reports of large or irregular transactions generated by licensed corporations' or associated entities' internal system as well as ad hoc reports made by front-line staff. Depending on the organization structure of the licensed corporation or associated entity, the specific task of reviewing reports may be

[12] Lists designated under the US President's Executive Order can be found on the United States Department of the Treasury website at www.ustreas.gov/offices/enforcement/ofac/sanctions/terrorism.html.

[13] These circulars can be found on the Securities and Futures Commission's website at www.sfc.hk/sfc/html/EN/intermediaries/supervision/supervision.html.

delegated to other staff but the compliance officer or the supervisory management should maintain oversight of the review process.

10.3 In circumstances where a staff member of a licensed corporation or an associated entity brings a transaction to the attention of the compliance officer, the circumstances of each case can then be reviewed at that level to determine whether the suspicion is justified. If a decision is made not to report an apparently suspicious transaction to the JFIU, the reasons for this should be fully documented by the compliance officer. Suspicious transactions should be reported regardless of whether they are also thought to involve tax matters. The fact that a report may have already been filed with the JFIU in relation to previous transactions of the customer in question should not necessarily preclude the making of a fresh report if new suspicions are aroused. If the suspicion remains, the transaction should be reported to the JFIU without delay.

10.4 The use of a standard format for reporting is encouraged (see Appendix D). In the event that urgent disclosure is required, an initial notification should be made by telephone. The contact details of the JFIU are set out at Appendix F.

10.5 A register of all reports made to the JFIU and all reports made by employees to management should be kept. Licensed corporations and associated entities, their directors, officers and employees should not warn their customers when information relating to them is being reported to an authorized officer (e.g. the JFIU), as such action may constitute an offence.

10.6 The JFIU will acknowledge receipt of any disclosure made. If there is no immediate need for action e.g. the issue of a restraint order in relation to an account, consent will usually be given for the licensed corporation or associated entity to operate the account under the provisions of section 25A(2) of the DTROP, or section 25A(2) of the OSCO, or section 12(2) of the UNATMO, as the case may be. An example of such a letter is shown at Appendix E.

10.7 Following the receipt and consideration of a disclosure by the JFIU, the information disclosed will be allocated to trained financial investigation officers in the Police and the Customs and Excise Department for further investigation.

10.8 Access to the disclosed information is restricted to the relevant financial investigating officers within the Police and the Customs and Excise Department. In the event of a prosecution, production orders will be obtained to produce the material at court. Section 26 of the DTROP and the OSCO place strict restrictions on revealing the identity of the person making a disclosure under section 25A.

10.9 The Police and Customs and Excise Department and the JFIU are not obliged to, but may, on request, provide a status report on the disclosure to a disclosing licensed corporation or an associated entity.

10.10 Enhancing and maintaining the integrity of the relationship which has been established between law enforcement agencies and licensed corporations/associated entities is considered to be of paramount importance.

11. Staff Screening, Education and Training

11.1 For the purpose of compliance with this Guidance Note, licensed corporations and associated entities should take such measures for screening and training employees that are appropriate having regard to the risk of money laundering and terrorist financing and the size of their business.

11.2 Licensed corporations and associated entities should identify the key positions under their own organizational structures with respect to anti-money laundering and anti-terrorist financing and should ensure that all employees taking up such key positions are suitable and competent to perform their duties.

11.3 Licensed corporations and associated entities must provide proper anti-money laundering and anti-terrorist financing training to their local and overseas staff members.

11.4 Members of staff should be aware of their own personal obligations under the DTROP, the OSCO and the UNATMO and that they can be personally liable should they fail to report information as required. They are advised to read the relevant sections of the DTROP, the OSCO and the UNATMO. Members of staff must be encouraged to co-operate fully with the JFIU and to disclose suspicious transactions promptly. If in doubt, they should contact the JFIU.

11.5 Licensed corporations and associated entities should have educational programmes in place for training all new employees.

11.6 It is also necessary to make arrangements for refresher training at regular intervals to ensure that members of staff, in particular those who deal with the public directly and help customers open new accounts, and those who supervise or manage such staff members, do not forget their responsibilities.

Appendix A: Summary Of Legislation Concerned With Money Laundering And Terrorist Financing

1 The Drug Trafficking (Recovery of Proceeds) Ordinance ("DTROP")

1.1 The DTROP contains provisions for the investigation of assets that are suspected to be derived from drug trafficking activities, the freezing of assets on arrest and the confiscation of the proceeds from drug trafficking activities upon conviction.

1.2 Under section 25(1) of the DTROP, a person commits an offence if he deals with any property knowing or having reasonable grounds to believe it to represent any person's proceeds of drug trafficking. "Dealing" in relation to property referred to in the definition of "drug trafficking", the award of a restraint order under section 10, or the offence under section 25, includes:-

(a) receiving or acquiring the property;

(b) concealing or disguising the property (whether by concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to it or otherwise);

(c) disposing of or converting the property;

(d) bringing the property into or removing it from Hong Kong;

(e) using the property to borrow money, or as security (whether by way of charge, mortgage or pledge or otherwise).

The highest penalty for the offence upon conviction is imprisonment for 14 years and a fine of $5 million. A person has a defence to an offence under section 25(1) if he intended to make a disclosure under section 25A and there is a reasonable excuse for his failure to do so.

1.3 Under section 25A of the DTROP where a person knows or suspects that any property,

(a) directly or indirectly, represents a person's proceeds of,

(b) was used in connection with, or

(c) is intended to be used in connection with,

drug trafficking, he shall disclose that knowledge or suspicion to an authorized officer as soon as it is reasonable for him to do so. "Authorized officer" includes any police officer, any member of the Customs and Excise Department, and the JFIU. The JFIU, established in 1989 is operated by the Police and Customs and Excise Department. Section 25A(4) of the DTROP provides that a person who is in employment can make disclosure to the appropriate person in accordance with the procedures established by his employer for making such disclosures (see also section 10 of this Guidance Note). To the employee, such disclosure has the effect of disclosing the knowledge or suspicion to an authorized person as required under section 25A(1). Failure to make a disclosure under section 25A is an offence, the maximum penalty upon conviction of which is a fine of HK$50,000 and imprisonment for 3 months.

1.4 Section 25A(2) of the DTROP provides that if a person who has made a disclosure under section 25A(1) does any act in contravention of section 25(1) before or after the disclosure, and the disclosure relates to that act, the person does not commit an offence under section 25(1) if:-

(a) the disclosure is made before he does that act and he does that act with the consent of an authorized officer; or

(b) the disclosure is made after he does that act, is made on his own initiative and is made as soon as it is reasonable for him to make it.

1.5 Under section 25A(5) of the DTROP, it is an offence if a person who knows or suspects that a disclosure has been made under section 25A(1) or (4) discloses to any other person any matter which is likely to prejudice any investigation which might be conducted following the disclosure under section 25A(1) or (4). The maximum penalty upon conviction of this offence is a fine of $500,000 and imprisonment for 3 years.

1.6 Section 25A(3)(a) provides that a disclosure made under the DTROP shall not be treated as a breach of any restriction upon

the disclosure of information imposed by contract or by enactment, rules of conduct or other provision. Section 25A(3)(b) provides that the person making the disclosure shall not be liable for damages for any loss arising out of the disclosure or any act done or omitted to be done in relation to the property concerned in consequence of the disclosure.

1.7 Licensed corporations and associated entities may receive restraint orders and charging orders on the property of a defendant of a drug trafficking offence. These orders are issued under sections 10 and 11 of the DTROP. On service of these orders, an authorized officer may require a person to deliver documents or information that may assist in determining the value of the property. Failure to provide the documents or information as soon as practicable is an offence under section 10 or 11 of DTROP. Moreover, any person who deals in the property in contravention of a restraint order or a charging order commits an offence under DTROP.

1.8 Section 26 of the DTROP provides that no witness in any civil or criminal proceedings shall be obliged to reveal the making of a disclosure nor to reveal the identity of the person making the disclosure except in proceedings for an offence under section 25, 25A or 26 of the DTROP, or where the court is of the opinion that justice cannot fully be done between the parties without revealing the disclosure or the identity of the person making the disclosure.

2 The Organized and Serious Crimes Ordinance ("OSCO")

2.1 The OSCO, among other things:

(a) gives officers of the Police and the Customs and Excise Department powers to investigate organized crime and triad activities;

(b) gives the Courts jurisdiction to confiscate the proceeds of organized and serious crimes, to issue restraint orders and charging orders in relation to the property of a defendant of an offence specified in the OSCO;

(c) creates an offence of money laundering in relation to the proceeds of indictable offences; and

(d) enables the Courts, under appropriate circumstances, to receive information about an offender and an offence in order to determine whether the imposition of a greater sentence is appropriate where the offence amounts to an organized crime/triad related offence or other serious offences.

The term "organized crime" is defined widely in OSCO. To put it simply, it means an offence listed in Schedule 1 to the OSCO that is either connected with the activities of a particular triad society, or is committed by two or more persons that involves substantial planning and organization. The offences that are listed in Schedule 1 include murder, kidnapping, drug trafficking, assault, rape, theft, robbery, obtaining property by deception, false accounting, firearms offences, manslaughter, bribery and smuggling.

2.2 Sections 3 to 5 of the OSCO provide that an authorized officer (including the Police), for the purpose of investigating an organized crime, may apply to the Court of First Instance for an order to require a person to provide information or produce material that reasonably appears to be relevant to the investigation. The Court may make an order that the person make available the material to an authorized officer. An authorized officer may also apply for a search warrant under the OSCO. A person cannot refuse to furnish information or produce material under sections 3 and 4 of the OSCO on the ground of self-incrimination or breach of an obligation to secrecy or other restriction on the disclosure of information imposed by statute or other rules or regulations.

2.3 Sections 25, 25A and 26 of the OSCO are modelled upon sections 25, 25A and 26 of the DTROP. In summary, under section 25(1) of the OSCO a person commits an offence if he deals with any property knowing or having reasonable grounds to believe it to represent the proceeds of an indictable offence. "Dealing" in relation to property referred to in this section includes:-

(a) receiving or acquiring the property;

(b) concealing or disguising the property (whether by concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to it or otherwise);

(c) disposing of or converting the property;

(d) bringing the property into or removing it from Hong Kong;

(e) using the property to borrow money, or as a security (whether by way of charge, mortgage or pledge or otherwise).

The maximum penalty upon conviction of an offence under section 25 is a fine of $5 million and imprisonment for 14 years. A person has a defence to an offence under 25(1) if he intended to make a disclosure under section 25A and there is a reasonable excuse for his failure to disclose.

2.4 Under section 25A of the OSCO where a person knows or suspects that any property,

(a) directly or indirectly, represents a person's proceeds of,

(b) was used in connection with, or

(c) is intended to be used in connection with,

an indictable offence, he shall disclose that knowledge or suspicion to an authorized officer as soon as it is reasonable for him to do so. Failure to make a disclosure under this section constitutes an offence. Where a person is employed at the relevant time, disclosure may be made to the appropriate person in accordance with the procedure established by his employer for the making of such disclosures. The maximum penalty upon conviction of this offence is a fine of HK$50,000 and imprisonment for 3 months.

2.5 Section 25A(2) of the OSCO provides that if a person who has made a disclosure under section 25A(1) does any act in contravention of section 25(1) before or after the disclosure, and the disclosure relates to that act, the person does not commit an offence under section 25(1) if:-

(a) the disclosure is made before he does that act and he does that act with the consent of an authorized officer; or

(b) the disclosure is made after he does that act, is made on his own initiative and is made as soon as it is reasonable for him to make it.

2.6 Under section 25A(5) of the OSCO, it is an offence if a person who knows or suspects that a disclosure has been made under section 25A(1) or (4) discloses to another person any matter which is likely to prejudice any investigation which might be conducted following the disclosure under section 25A(1) or (4). The maximum penalty upon conviction of this offence is a fine of $500,000 and imprisonment for 3 years.

2.7 Section 25A(3)(a) of the OSCO provides that a disclosure made under the OSCO shall not be treated as a breach of any restriction upon the disclosure of information imposed by contract or by any enactment, rules of conduct or other provision. Section 25A(3)(b) provides that the person making the disclosure shall not be liable for damages for any loss arising out of the disclosure or any act done or omitted to be done in relation to the property concerned in consequence of the disclosure.

2.8 Licensed corporations and associated entities may receive restraint orders and charging orders on the property of a defendant of an offence specified in OSCO. These orders are issued under sections 15 and 16 of the OSCO. On service of these orders, an authorized officer may require a person to deliver documents or information that may assist in determining the value of the property. Failure to provide the information as soon as practicable is an offence under section 15 or 16 of the OSCO. Moreover, any person who deals in a piece of property in contravention of a restraint order or a charging order commits an offence under the OSCO.

2.9 Section 26 of the OSCO provides that no witness in any civil or criminal proceedings shall be obliged to reveal the making of a disclosure or to reveal the identity of the person making the disclosure except in proceedings for an offence under section 25, 25A or 26 of the OSCO, or where the court is of the opinion that justice cannot fully be done between the parties without revealing the disclosure or the identity of the person making the disclosure.

3 The United Nations (Anti-Terrorism Measures) Ordinance ("UNATMO")

3.1 The UNATMO was enacted in July 2002 and a substantial part of the law came into operation on 23 August 2002. The UNATMO is principally directed towards implementing decisions contained in Resolution 1373 dated 28 September 2001 of the United Nations Security Council ("UNSC") aimed at preventing the financing of terrorist acts. Previously, the UNSC had passed various other resolutions imposing sanctions against certain designated terrorists and terrorist organizations. Regulations issued under the United Nations Sanctions Ordinance (Cap.537) give effect to these UNSC resolutions. In particular, the United Nations Sanctions (Afghanistan) Regulation and the United Nations Sanctions (Afghanistan) (Amendment) Regulation provide, among others, for a prohibition on making funds available to designated terrorists. The UNATMO is directed towards all terrorists.

3.2 In June 2004, the United Nations (Anti-Terrorism Measures) (Amendment) Bill was passed and a substantial part of the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2004 has come into operation in January 2005.

3.3 Besides the mandatory elements of the UNSC Resolution 1373, the UNATMO as amended by the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2004 ("amended UNATMO") also implements the more pressing elements of the FATF's 8 special recommendations on terrorist financing. The amended UNATMO, among other things, criminalizes the provision or collection of funds and making funds or financial (or related) services available to terrorists or terrorist associates. It permits terrorist property to be frozen and subsequently forfeited. Section 12(1) of the amended UNATMO also requires a person to report his knowledge or suspicion of terrorist property to an authorized officer, which includes a police officer, a member of the Customs and Excise Service/ Immigration Service and an officer of the Independent Commission Against Corruption as specified in the amended UNATMO. Failure to make a disclosure under this section constitutes an offence. The maximum penalty upon conviction of this offence is a fine of HK$50,000 and imprisonment for 3 months.

3.4 The term "funds" includes funds mentioned in the Schedule 1 of the amended UNATMO. It covers cash, cheques, deposits

with financial institutions or other entities, balances on accounts, securities and debt instruments (including stocks and shares, certificates representing securities, bonds, notes, warrants, debentures, debenture stock and derivatives contracts), interest, dividends or other income on or value accruing from or generated by property, documents evidencing an interest in funds or financial resources, etc.

3.5 "Terrorist" means a person who commits, or attempts to commit, a terrorist act or who participates in or facilitates the commission of a terrorist act. "Terrorist associate" means an entity owned or controlled, directly or indirectly, by a terrorist. The term "terrorist act" is defined as the use or threat of action where the action is carried out with the intention of, or the threat is made with the intention of using action that would have the effect of:

(a) causing serious violence against a person;

(b) causing serious damage to property;

(c) endangering a person's life, other than that of the person committing the action;

(d) creating a serious risk to the health or safety of the public or a section of the public;

(e) seriously interfering with or seriously disrupting an electronic system; or

(f) seriously interfering with or seriously disrupting an essential service, facility or system, whether public or private; and

the use or threat is:

(i) intended to compel the Government or to intimidate the public or a section of the public; and
(ii) made for the purpose of advancing a political, religious or ideological cause.

In the case of paragraphs (d), (e) and (f) above, a "terrorist act" does not include the use or threat of action in the course of any advocacy, protest, dissent or industrial action.

3.6 A list of designated terrorists, terrorist associates and terrorist properties is published in the Gazette from time to time pursuant to section 10 of the United Nations Sanctions (Afghanistan) Regulation and section 4 of the amended UNATMO. The published lists reflect designations made by the UN Committee that was established pursuant to UNSC Resolution 1267. The amended UNATMO provides that it shall be presumed, in the absence of evidence to the contrary, that a person specified in such a list is a terrorist or a terrorist associate (as the case may be).

3.7 As regards the obligations under section 12(1) of the amended UNATMO to disclose knowledge or suspicion that property is terrorist property, it should be noted that if a person who has made such a disclosure does any act in contravention of section 7 or 8 of the amended UNATMO (on the provision or collection of funds or making funds or financial (or related) services available to terrorists and their associates) before or after such disclosure and the disclosure relates to that act, the person does not commit an offence if :-

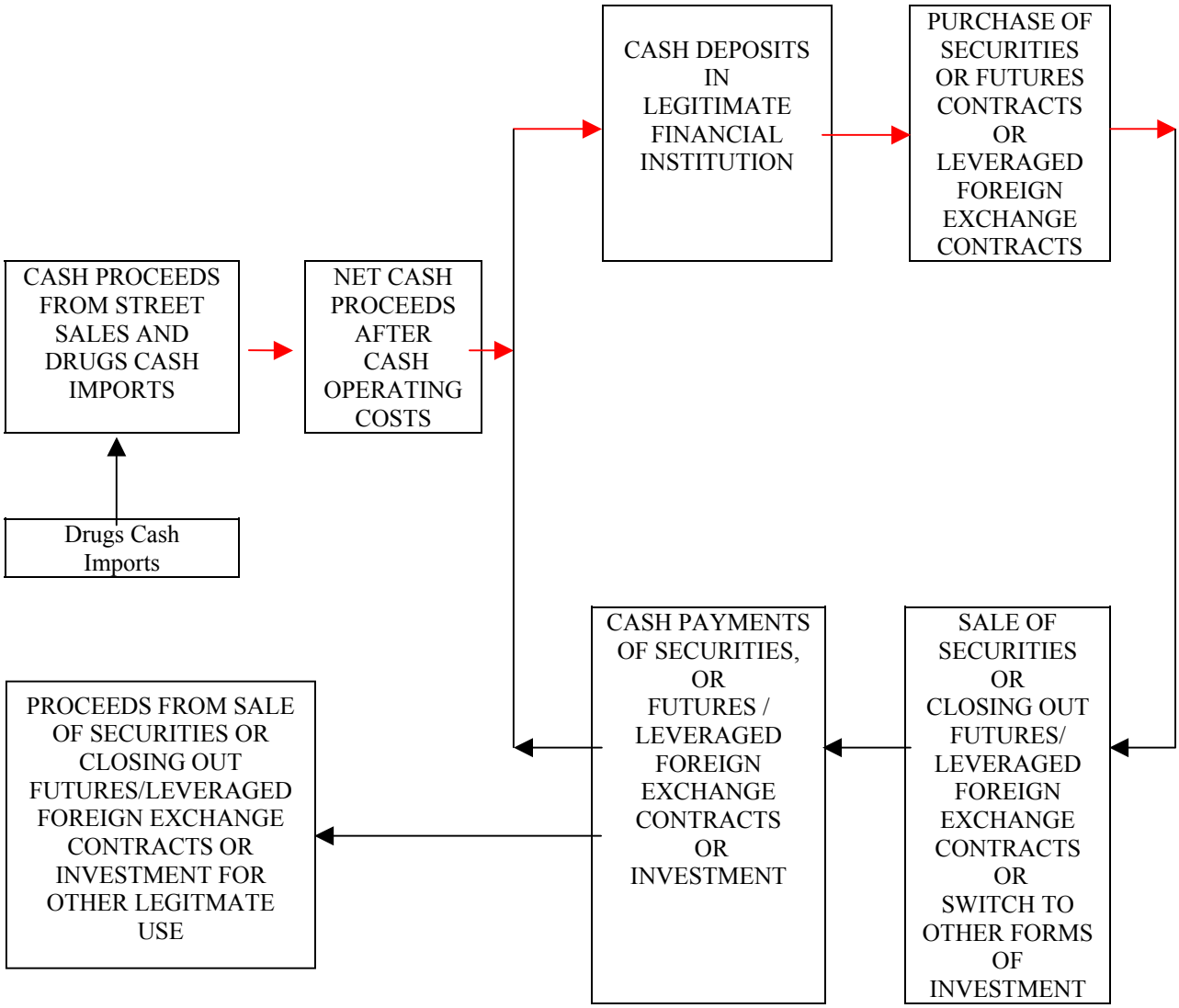
(a) the disclosure is made before he does that act and he does that act with the consent of an authorized officer; or

(b) the disclosure is made after he does that act, is made on his own initiative and is made as soon as it is practicable for him to make it.

3.8 Section 12(3) provides that a disclosure made under the amended UNATMO shall not be treated as a breach of any restriction upon the disclosure of information imposed by contract or by any enactment, rules of conduct or other provision. The person making the disclosure shall not be liable in damages for any loss arising out of the disclosure or any act done or omitted to be done in relation to the property concerned in consequence of the disclosure.

3.9 Section 12(6) of the amended UNATMO permits information obtained from section 12(1) by an authorized officer to be disclosed to certain authorities (i.e. the Department of Justice, the Police, etc.) and overseas authorities, responsible for investigating or preventing and suppressing the financing of terrorist acts.

Appendix B: Laundering Of Proceeds



Other examples of money laundering methods and characteristics of financial transactions that have been linked with terrorist financing can be found on the websites of the JFIU (www.jfiu.gov.hk) and FATF (www.fatf-gafi.org).

Appendix C(i): A Systemic Approach To Identifying Suspicious Transactions Recommended By The JFIU

An effective systemic approach to the identification of suspicious financial activity involves the following four steps.

(a) **Step one**: Recognition of a suspicious financial activity indicator or indicators.

(b) **Step two**: Appropriate questioning of the customer.

(c) **Step three**: Review of information already known about the customer in deciding if the apparently suspicious activity is to be expected from the customer.

(d) **Step four**: Consideration of (a), (b) and (c) above to make a subjective decision on whether the customer's financial activity is genuinely suspicious or not.

Examination of the Suspicious Transactions Reporting ("STR") received by the JFIU reveals that many reporting institutions do not use the system outlined above. Commonly, institutions make a STR merely because a suspicious activity indicator has been recognized, i.e. only step (a) of the systemic approach is followed, steps (b), (c) and (d) are not followed. This failure to use the systemic approach leads to a lower quality of STRs.

Each of the four steps of the systemic approach to suspicious activity identification is discussed in more detail in the following paragraphs.

Step One: Recognition of a Suspicious Financial Activity Indicator or Indicators

The recognition of an indicator, or better still indicators, of suspicious financial activity is the first step in the suspicious activity identification system. A list of suspicious activity indicators commonly seen within Hong Kong's securities sector is attached at Appendix C(ii).

Additional methods of monitoring customer activity for indicators of suspicious activity are also necessary.

The measures summarized below are recognized as contributing towards an effective overall approach to suspicious activity identification.

(a) Train and maintain awareness levels of all members of staff in suspicious activity identification.

This approach is most effective in situations in which members of staff have face-to-face contact with a customer who carries out a particular transaction which displays suspicious activity indicators. However, this approach is much less effective in situations in which either, there was no face-to-face contact between customer and member of staff, or the customer dealt with different members of staff to carry out a series of transactions which are not suspicious if considered individually.

(b) Identification of areas in which staff member/customer face-to-face contact is lacking (e.g. internet trading) and use of additional methods for suspicious activity identification in these areas.

(c) Use of a computer program to identify accounts showing activity which fulfills predetermined criteria based on commonly seen money laundering methods.

(d) Trend Monitoring. A computer program which monitors the turnover of money within an account and notes the rolling average turnover per month for the preceding recent months. The current month's turnover is then compared with the average turnover. The current month's activity is regarded as suspicious if it is significantly larger than the average.

(e) Firms' internal inspection system to include inspection of suspicious activity reporting.

(f) Identification of "High Risk" accounts, i.e. accounts of the type which are commonly used for money laundering, e.g. remittance agencies, money changers, casinos, accounts with members of staff of secretarial companies as authorized signatories, accounts of "shelf" companies, and law company customer accounts. Greater attention is paid to monitoring of the activity of these accounts for suspicious transactions.

(g) Flagging of accounts of special interest on the firm computer. Members of staff carrying out future transactions will notice the "flag" on their computer screen and pay extra attention to the transactions conducted on the account. Accounts to be flagged are those in respect of which a suspicious transaction report has been made and/or accounts of high risk businesses (see (f) above).

A problem with flagging is that members of staff who come across a large transaction involving a flagged account may tend to make a report to the compliance officer whether or not the

transaction is suspicious. This has the effect of overburdening compliance officers with low quality reports. Flagging may also lead to members of staff believing that if an account is not flagged it is not suspicious. Members of staff must be educated on the proper usage of flagging if it is to work properly.

(h) Use of "Exception Report", "Unusual Report", or "High Activity Report", to identify accounts with high levels of activity, followed by consideration of whether the activity is suspicious. Although these reports can be useful in identifying suspicious activity, they are not designed for this function and may not therefore be very effective, e.g. in order to keep the number of reports to be viewed daily at a manageable level, a daily threshold may be set which is higher than sums commonly laundered, and therefore ineffective for suspicious activity identification.

(i) Adopt more stringent policies in respect of customers who are expected to deal in large sums, e.g. request corporate customers for the expected nature of transactions and source of funds when opening such accounts.

Step Two: Appropriate Questioning of the Customer

If members of staff of a licensed corporation or an associated entity receive instructions to carry out a transaction or transactions, bearing one or more suspicious activity indicators, then they should question the customer on the reason for conducting the transaction and the identity of the source and ultimate beneficiary of the money being transacted. Members of staff should consider whether the customer's story amounts to a reasonable and legitimate explanation of the financial activity observed. If not, then the customer's activity should be regarded as suspicious and a suspicious transaction report should be made to the JFIU.

On occasions staff members of financial institutions have expressed reluctance to ask questions of the type mentioned above. Grounds for this reluctance are that the customer may realize that he, or she, is suspected of illegal activity, or regards such questions as none of the questioner's business. In either scenario the customer may be offended or become defensive and uncooperative, or even take his, or her, business elsewhere. This is a genuine concern but can be overcome by members of staff asking questions which are apparently in furtherance of promoting the services of the licensed corporation or associated entity or satisfying customer needs, but which will solicit replies to the questions above without putting the customer on his, or her, guard.

Appropriate questions to ask in order to obtain an explanation of the reason for conducting a transaction bearing suspicious activity indicators will depend upon the circumstances of the financial activity observed. For example, if a customer wishes to make a large cash transaction then staff member can ask the customer the reason for using cash on the grounds that the staff member may be able to offer advice on a more secure method to perform the transaction.

Persons engaged in legitimate business generally have no objection to, or hesitation in answering such questions. Persons involved in illegal activity are more likely to refuse to answer, give only a partial explanation or give an explanation which is unlikely to be true.

If a customer is unwilling, or refuses, to answer questions or gives replies which members of staff suspect are incorrect or untrue, this may be taken as a further indication of the suspicious nature of the financial activity.

Step Three: Review of Information Already Known to the Licensed Corporation or Associated Entity when Deciding if the Apparently Suspicious Activity is to be Expected

The third stage in the systemic approach to suspicious activity identification is to review the information already known to the licensed corporation or associated entity about the customer and his, or her, previous financial activity and consider this information to decide if the apparently suspicious activity is to be expected from the customer. This stage is commonly known as the "know your customer principle".

Licensed corporations and, where applicable, associated entities hold various pieces of information on their customers which can be useful when considering if the customers' financial activity is to be expected or is unusual. Examples of some of these information items and the conclusions which may be drawn from them are listed below.

(a) The customers' occupation. Certain occupations imply the customer is a low wage earner e.g. driver, hawker, waiter, student. High value of transactions on the accounts of such customers would not therefore be expected.

(b) The customers' residential address. A residential address in low cost housing, e.g. public housing, may be indicative of a low wage earner.

(c) The customers' age. As neither very young nor very old persons tend to be involved in frequent high value transactions, such activity by a very young or old customer would not be expected.

(d) The average balance and the number and type of transactions seen on an account over a period of time give an indication of the financial activity which is normal for the customer. Markedly increased activity or activity of a different type to these norms would therefore be considered to be unusual.

Step Four: Is the Financial Activity Suspicious?

The final step in the suspicious activity identification system is the decision whether or not to make a STR. Due to the fact that suspicion is difficult to quantify, it is not possible to give exact guidelines on the circumstances in which a STR should, or should not, be made. However, such a decision will be of the highest quality when all the relevant circumstances are known to, and considered by, the decision maker, i.e. when all three of the preceding steps in the suspicious transaction identification system have been completed and are considered. If, having considered all the circumstances, members of staff find the activity genuinely suspicious then an STR should be made.

Appendix C(ii): Examples of Suspicious Transactions

Money laundering using investment related transactions

(a) Large or unusual settlements of transactions in cash or bearer form.

(b) Buying and selling of securities/futures with no discernible purpose or in circumstances which appear unusual.

(c) A number of transactions by the same counterparty in small amounts relating to the same security, each purchased for cash and then sold in one transaction, the proceeds being credited to an account different from the original account.

(d) Any transaction in which the counterparty to the transaction is unknown or where the nature, size or frequency appears unusual.

(e) Investor introduced by an overseas bank, affiliate or other investor both of which are based in countries where production of drugs or drug trafficking may be prevalent.

(f) The use by a customer of a licensed corporation or an associated entity to hold funds that are not being used to trade in securities, futures contracts or leveraged foreign exchange contracts.

(g) A customer who deals with a licensed corporation or an associated entity only in cash or cash equivalents rather than through banking channels.

(h) The entry of matching buys and sells in particular securities or futures or leveraged foreign exchange contracts ("wash trading"), creating the illusion of trading. Such wash trading does not result in a bona fide market position, and might provide "cover" for a money launderer.

(i) Wash trading through multiple accounts might be used to transfer funds between accounts by generating offsetting losses and profits in different accounts. Transfers of positions between accounts that do not appear to be commonly controlled also could be a warning sign. (It should be noted that wash trading is also an indication of market manipulation and licensed corporations or registered persons are expected to take appropriate steps to ensure that proper safeguards exist to prevent the firm from acting in a way which would result in the firm perpetrating any conduct which constitutes market misconduct under section 279 of the SFO).

(j) Frequent funds transfers or cheque payments to or from unverified or difficult to verify third parties.

(k) The involvement of offshore companies on whose accounts multiple transfers are made, especially when they are destined for a tax haven, and to accounts in the name of companies incorporated under foreign law of which the customer may be a shareholder.

(l) Non-resident account with very large movement with subsequent fund transfers to offshore financial centres.

Money laundering involving employees of licensed corporations and associated entities

(a) Changes in employee characteristics, e.g. lavish life styles or avoiding taking holidays.

(b) Changes in employee or agent performance, e.g. the salesman selling products for cash has remarkable or unexpected increase in performance.

(c) Any dealing with an agent where the identity of the ultimate beneficiary or counterparty is undisclosed, contrary to normal procedures for the type of business concerned.

(d) The use of an address which is not the customer's permanent address, e.g. utilisation of the representative's office or home address for the dispatch of customer documentation.

(e) Requests by customers for investment management services (either foreign currency, securities or futures) where the source of the funds is unclear or not consistent with the customers' apparent standing.

Appendix D: Report Made to the JFIU

REPORT MADE UNDER SECTION 25A OF THE DRUG TRAFFICKING (RECOVERY OF PROCEEDS) ORDINANCE OR ORGANIZED AND SERIOUS CRIMES ORDINANCE, OR SECTION 12 OF THE UNITED NATIONS (ANTI-TERRORISM MEASURES) ORDINANCE TO THE JOINT FINANCIAL INTELLIGENCE UNIT ("JFIU)		
NAME AND ADDRESS OF LICENSED CORPORATION OR ASSOCIATED ENTITY		
SUSPICIOUS ACCOUNT NAME(S) (IN FULL)		
DATE OF ACCOUNT OPENING		DATE OF BIRTH / DATE OF INCORPORATION (IN THE CASE OF A CORPORATE CUSTOMER)
OCCUPATION & EMPLOYER / NATURE OF BUSINESS (IN THE CASE OF A CORPORATE CUSTOMER)		
NATIONALITY / PLACE OF INCORPORATION (IN THE CASE OF A CORPORATE CUSTOMER)		HKID NUMBER / PASSPORT NUMBER/ BUSINESS REG. NO. (IN THE CASE OF A CORPORATE CUSTOMER)
ADDRESS OF ACCOUNT HOLDER		
DETAILS OF TRANSACTION/ PROPERTY AROUSING SUSPICION AND ANY OTHER RELEVANT INFORMATION. PLEASE ALSO ENCLOSE A COPY OF THE TRANSACTION AND ACCOUNT STATEMENT FOR REFERENCE. PARTICULARS OF ACCOUNT HOLDER OR PERSON CONDUCTING THE TRANSACTION ARE TO BE GIVEN IN A SEPARATE SHEET		
REPORTING OFFICER/TEL.NO.	SIGNATURE / DATE	ENTERED RECORDS

Appendix E: Sample Acknowledgement Letter from the JFIU

Date:

Your ref:

Mr.
ABC Brokerage Ltd
XXXX
Hong Kong

Dear Sir,

Drug Trafficking (Recovery of Proceeds) Ordinance
Organized and Serious Crimes Ordinance
United Nations (Anti-Terrorism Measures) Ordinance

I refer to your disclosure made to the JFIU on DD/MM/YY under the above references.

I acknowledge receipt of the information supplied by you under the provisions of Section 25A of the Drug Trafficking (Recovery of Proceeds) Ordinance Cap.405 and the Organized and Serious Crimes Ordinance Cap.455 / Section 12 of the United Nations (Anti-Terrorism Measures) Ordinance Cap.575.

Based upon the information currently available, consent is given for you to continue to operate the account(s) in accordance with normal securities/futures/leveraged foreign exchange practice under the provisions of the Ordinance(s).

Thank you for your co-operation.

Yours faithfully,

Joint Financial Intelligence Unit

Appendix F: JFIU Contact Details

Written reports should be sent to the JFIU at either the address, fax number, e-mail or PO Box listed below:

Joint Financial Intelligence Unit,
16/F, Arsenal House West Wing,
Hong Kong Police Headquarters,
Arsenal Street,
Hong Kong.

or GPO Box 6555
Hong Kong Post Office,
Hong Kong.

Fax : 2529-4013

E-mail : jfiu@police.gov.hk

Urgent reports should be made either by fax, e-mail or by telephone to 2860-3413 or 2866-3366.