

**Public Consultation on  
Legislative Proposals to Enhance Anti-Money Laundering and  
Counter-Terrorist Financing Regulation in Hong Kong**

**FOREWORD**

1. This consultation document is issued by the Financial Services and the Treasury Bureau (“FSTB”) for seeking views on legislative proposals to enhance anti-money laundering and counter-terrorist financing (“AML/CTF”) regulation in Hong Kong through the introduction of (a) a licensing regime for virtual asset services providers (“VASPs”); (b) a two-tier registration regime for dealers in precious metals and stones (“DPMS”); and (c) miscellaneous technical amendments under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”).
2. FSTB welcomes written comments on or before 31 January 2021 through any of the following channels –  
  
By mail: Division 5, Financial Services Branch  
Financial Services and the Treasury Bureau  
24/F, Central Government Offices  
Tim Mei Avenue, Tamar Central, Hong Kong  
  
By fax: (852) – 2527 0790  
By email: [aml-consult@fstb.gov.hk](mailto:aml-consult@fstb.gov.hk)
3. FSTB may, as appropriate, reproduce, quote, summarise and publish the written comments received, in whole or in part, in any form and use without seeking permission of the contributing parties.
4. Names of the contributing parties and their affiliations may be referred to in other documents we publish and disseminate through different means after the consultation. If any contributing parties do not wish to have their names or affiliations disclosed, please expressly state so in their written comments. Any personal data provided will only be used by FSTB, other government

departments/agencies for purposes which are related to this consultation.

# CHAPTER 1

## INTRODUCTION

### **Purpose**

- 1.1 This document sets out for public consultation the conceptual framework and key parameters of legislative proposals to enhance the AML/CTF regulation of VASPs and DPMS in Hong Kong having regard to the Recommendations of the Financial Action Task Force (“FATF”). Views and comments from stakeholders concerned are invited to facilitate our formulation of the details of the legislative proposals.

### **Background**

- 1.2 The FATF is an inter-governmental body established in 1989 that sets international standards for combating money laundering and terrorist financing (“ML/TF”). Comprising 39 major economies of the world, the FATF oversees the implementation of the FATF Standards, promulgated in the form of 40 Recommendations and 11 Immediate Outcomes, through mutual evaluations (i.e. a peer-review process) conducted by member jurisdictions. Failure to comply with the FATF Standards, whether in technical terms or effectively, is subject to scrutiny by the international community and runs the risk of being placed on the FATF’s blacklist for possible countermeasures by member jurisdictions.
- 1.3 The FATF Standards impose a wide range of AML/CTF obligations on both the public and the private sectors. In respect of the private sector, financial institutions and designated non-financial businesses and professions (“DNFBPs”) <sup>1</sup> are required to implement precautionary measures designed to prevent them from

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<sup>1</sup> In the FATF parlance, DNFBPs cover casinos, legal professionals, accounting professionals, estate agents, trust or company service providers, and dealers in precious metals and stones.

being abused by criminals for ML/TF purposes. Among other things, they have to conduct customer due diligence (“CDD”) to identify and verify customers and their beneficial owners, keep records on customer identification and transactions for at least five years, identify and report suspicious transactions, and implement targeted financial sanctions<sup>2</sup> (“TFS”) imposed by the United Nations Security Council.

- 1.4 Hong Kong has been a member of the FATF since 1991. Over the years we have built a robust AML/CTF system having regard to the FATF Standards. We enacted the AMLO in April 2012 to implement the relevant FATF recommendations in respect of financial institutions. Under the AMLO, specified financial institutions, including banks, securities firms, insurance institutions, money service operators and stored value facilities<sup>3</sup>, are subject to statutory CDD and record-keeping obligations. Non-compliance may render them liable to administrative or criminal sanctions.
- 1.5 In respect of DNFBPs, the AMLO was amended in 2018 for the statutory AML/CTF obligations thereunder to be extended to legal professionals, accounting professionals, estate agents and trust or company service providers (“TCSP”). Whilst the DPMS sector is one of the DNFBP sectors covered under the FATF Standards, the 2018 exercise did not feature the DPMS sector as it was considered less ready than the other DNFBP sectors for AML/CTF regulation when the legislative exercise was taken forward.
- 1.6 The FATF also updates its Standards from time to time to combat emerging ML/TF risks. A latest addition to the FATF Standards was introduced in February 2019, requiring jurisdictions to subject

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<sup>2</sup> Targeted financial sanctions generally restrict persons and entities sanctioned by the United Nations Security Council from having access to funds and property under their control and from receiving financial services in relation to such funds and property. Domestically, these requirements are implemented under the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575) (in respect of terrorist financing) and the United Nations (Sanctions) Ordinance (Cap. 537) and its regulations (in respect of financing of proliferation of weapons of mass destruction).

<sup>3</sup> The Clearing and Settlement Systems (Amendment) Ordinance 2015 established a licensing regime for the stored value facilities sector and consequentially amended the AMLO to extend statutory AML/CTF obligation to the sector.

VASPs to the same range of AML/CTF obligations that are currently applicable to financial institutions and DNFBPs. Hong Kong, along with other jurisdictions, is expected to introduce AML/CTF regulation for VASPs as a matter of priority in view of the sector's rising threat to the international financial system.

## **The Need for Enhancement**

- 1.7 Hong Kong underwent a mutual evaluation of our AML/CTF regime conducted by the FATF from 2018 to 2019. The Mutual Evaluation assessed the extent of our compliance with the FATF Standards and the effectiveness of our AML/CTF regime. The Government devoted significant efforts to enhance our AML/CTF regime in the run up to the Mutual Evaluation, including the 2018 exercise to bring DNFBPs under AMLO regulation, and as a result we achieved a satisfactory result in the Mutual Evaluation.
- 1.8 The Mutual Evaluation Report on Hong Kong, published by the FATF in September 2019, concludes that we have a strong legal foundation and effective system for combatting ML/TF. Hong Kong's AML/CTF system is assessed to be compliant and effective overall, and with that we have become the first jurisdiction in the Asia-Pacific region to have achieved an overall compliant result in the latest round of FATF mutual evaluations, and have been placed in the "regular follow-up" process of the FATF (as opposed to "enhanced follow-up" for those who failed). The Mutual Evaluation Report also sets out the FATF's recommendations on areas, one being regulation of DPMS, for Hong Kong to improve in the follow-up process.
- 1.9 As part of the regular follow-up process, the FATF will conduct assessment at regular intervals to review if jurisdictions have addressed the deficiencies identified in their Mutual Evaluation Report and implemented changes to the FATF Standards introduced subsequent to the mutual evaluation. In the case of Hong Kong, we are scheduled to undergo a technical compliance assessment in February 2023, followed by an effectiveness assessment in June

2024, when we will be expected to have introduced AML/CTF regulation for the VASP and DPMS sectors among other enhancements to our AML/CTF system.

- 1.10 Hong Kong is an open, trusted and competitive place to invest and do business. Underpinning our status as an international financial centre is a robust AML/CTF regime that meets with international standards. It helps prevent illicit activities and inspire confidence in investors that Hong Kong is a clean and safe place for doing business. This in turn enhances the competitiveness of Hong Kong as recognised globally by renowned international institutions. To fulfill our obligations under the FATF and ensure the integrity of our financial system, we propose amending the AMLO to impose statutory AML/CTF obligations on the VASP and the DPMS sectors. The opportunity will also be taken to address other technical issues in the AMLO.

### **Guiding Principles**

- 1.11 Having regard to the FATF requirements and the nature of the corresponding business in Hong Kong, we propose expanding the scope of the AMLO to subject VASP and DPMS to the AML/CTF obligations under its Schedule 2. A licensing regime for VASPs and a two-tier registration regime for DPMS will be instituted under the AMLO such that competent authorities with adequate powers can be designated to monitor and supervise compliance of the relevant sector with the AML/CTF and other applicable regulatory requirements, and to apply a range of proportionate and dissuasive sanctions against non-compliance, as required by the FATF.
- 1.12 In drawing up the legislative proposals, we will be guided by the following principles –
- (a) The proposals should strike a balance between the need for introducing AML/CTF regulation and the need for maintaining the competitiveness of the concerned sectors;

- (b) The proposals should be commensurate with the ML/TF and other risks of the concerned sectors and do not impose an undue regulatory burden on the industries; and
- (c) The proposals should be consistent with the FATF Standards and international best practices, subject to appropriate adaptation to cater for local circumstances.

## **Legislative Proposals**

1.13 Guided by the above principles, we propose amending the AMLO to –

- (a) Introduce a licensing regime for VASPs, whereby any person seeking to conduct the regulated business of virtual asset trading platforms in Hong Kong will be required to apply for a licence from the Securities and Futures Commission (“SFC”) subject to the meeting of a fit-and-proper test, with licensed VASPs being subject to the AML/CTF requirements under Schedule 2 to the AMLO and other regulatory requirements for investor protection purposes;
- (b) Introduce a two-tier registration regime for DPMS, whereby any person seeking to conduct the regulated business of dealing in precious metals, precious stones, precious products, or precious-asset-based instruments in Hong Kong will be required to register with the Commissioner for Customs and Excise (“C&CE”), with those (and only those) seeking to engage in cash transactions at or above HK\$120,000 during their course of business to be subject to the AML/CTF requirements under Schedule 2 to the AMLO, in addition to meeting a fit-and-proper test for registration under the dedicated category;
- (c) Empower the SFC and the C&CE to supervise the

compliance of VASPs and DPMS respectively in accordance with the AMLO requirements.

1.14 We also propose to take this opportunity to address some technical issues under the AMLO which have been identified in the course of the Mutual Evaluation and other FATF contexts, including –

- (a) Amending the definition of “politically exposed person” (“PEP”), and empowering regulatory authorities to make guidelines to allow the exemption of enhanced CDD requirements in respect of former PEPs on a risk-sensitive basis;
- (b) Better aligning the definition of “beneficial owner” in relation to a trust under the AMLO with that of “controlling person” under the Inland Revenue Ordinance (“IRO”) (Cap. 112);
- (c) Providing for the use of digital identification schemes as recognised means to mitigate risks in situations where a customer is not physically present for customer identification and verification purposes;
- (d) Increasing deterrence against unlicensed money service operations by strengthening the level of criminal sanction; and
- (e) Consolidating the different provisions under various Ordinances enabling regulatory authorities to exchange supervisory information for AML/CTF purposes into a unified provision under the AMLO.

**Q1 Do you agree that Hong Kong should continue with efforts to strengthen the AML/CTF system having regard to international standards, in keeping with our status as an international financial centre that is safe and clean for doing business?**

**Q2 Do you agree that a balanced approach should be adopted for the current legislative exercise, complementing the need to have an effective system for tackling ML/TF risks in the VASP and the DPMS sectors in accordance with the FATF Standards, while minimising regulatory burden and compliance costs on the businesses?**

## CHAPTER 2

### REGULATION OF VIRTUAL ASSET SERVICE PROVIDERS

- 2.1 In recent years, trading in cryptocurrencies and other asset classes in the virtual world has significantly blossomed, and it is widely recognised that these virtual assets (“VAs”), for all their potentials, pose significant ML/TF risks to the international financial system. VAs are vulnerable to ML/TF risks because they allow greater anonymity and decentralization than traditional transfer, safe-keeping or custodian means, and such features can be easily abused to facilitate layering or conversion of crime proceeds into fiat money through interfaces with the financial system. VAs also pose considerable challenges for investor protection, due to their highly speculative nature and as evident in their frequent association with fraud, security breach, and market manipulation.
- 2.2 To address the ML/TF risks of VA activities, the FATF revised its Standards, under Recommendation 15, in February 2019 to require jurisdictions to regulate VASPs for AML/CTF purposes and supervise their compliance. In essence, the FATF requires jurisdictions to impose on VASPs the full range of AML/CTF obligations that are currently applicable to financial institutions and DNFBPs. Prohibition is a permissible option, or VASPs can be licensed or registered and subject to the same AML/CTF requirements as financial institutions and DNFBPs. Following the promulgation of the revised Recommendation 15, the FATF has set up a task force to monitor implementation progress, and major economies either have set up or are in the process of setting up regulatory and supervisory regimes for VASPs.
- 2.3 Whilst VAs are not legal tender and not generally accepted as a means of payment in Hong Kong, we have noticed some VA trading activities operating locally. To address the investor protection concerns so arise, the SFC announced a conceptual framework in November 2018 for the potential regulation of VA trading platforms in Hong Kong. Following discussion with operators in the market,

the SFC issued a position paper in November 2019<sup>4</sup> outlining a set of regulatory standards, which are comparable to those applicable to licensed securities brokers and automated trading venues, for the licensing of VA trading platforms in its regulatory sandbox (hereafter as the “opt-in regime”). The opt-in regime is voluntary in nature and only applies to those platforms which enable clients to trade VAs with securities feature. Platforms solely trading non-securities VAs are not covered.

- 2.4 As the world competes to embrace the development of financial innovation and technology, being an international financial centre we see a case to tap the potentials and harness the opportunities presented by VAs and their underlying technologies. It would be prudent for us to introduce VASP regulation whilst the sector is still developing, so as to mitigate the ML/TF risks of the sector, provide an appropriate level of investor and customer protection, and foster the development and adoption of financial innovation in a proper and orderly manner. The SFC’s opt-in regime provides a useful reference for statutory regulation of VASPs under the AMLO to implement the latest FATF requirements.
- 2.5 To implement the FATF requirement, we propose amending the AMLO to introduce a licensing regime for VASPs and subject them to a fit-and-proper test similar to that of other financial sectors. Licensed VASPs will be required to observe the AML/CTF requirements under Schedule 2 to the AMLO, as well as other regulatory requirements designed to ensure the protection of market integrity and investor interest. To ensure a level playing field, reference will be made to the opt-in regime operated by the SFC for VA trading platforms in determining the parameters of the VASP regime under the AMLO.

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<sup>4</sup> The Position Paper on Regulation of Virtual Asset Trading Platforms is available at [https://www.sfc.hk/web/EN/files/ER/PDF/20191106%20Position%20Paper%20and%20Appendix%201%20to%20Position%20Paper%20\(Eng\).pdf](https://www.sfc.hk/web/EN/files/ER/PDF/20191106%20Position%20Paper%20and%20Appendix%201%20to%20Position%20Paper%20(Eng).pdf)

## Scope and Coverage

- 2.6 In the FATF parlance, a VASP is a person who, as a business, engages in specified activities involving VAs. The specified activities cover (i) exchange between VAs and fiat currencies; (ii) exchange between one or more forms of VAs; (iii) transfer of VAs; (iv) safekeeping and/or administration of VAs or instruments enabling control over VAs; and (v) participation in and provision of financial services related to an issuer's offer and/or sale of a VA<sup>5</sup>. VA is defined as *“a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes”*.
- 2.7 Having regard to the FATF Standards and the risks presented by VA activities in Hong Kong, we propose to designate the business of operating a VA exchange as a “regulated VA activity” under the AMLO and require any person seeking to engage in the regulated activity to obtain a VASP licence from the SFC, subject to the meeting of a fit and proper test and other regulatory requirements. A VA exchange will be defined as any trading platform which is operated for the purpose of allowing an offer or invitation to be made to buy or sell any VA in exchange for any money or any VA (whether of the same or different type), and which comes into custody, control, power or possession of, or over, any money or any VA at any point in time during its course of business.
- 2.8 Peer-to-peer trading platforms (i.e. platforms that only provide a forum where buyers and sellers of VAs can post their bids and offers, with or without automatic matching mechanisms, for the parties themselves to trade at an outside venue), to the extent that the actual transaction is conducted outside the platform and the platform is not involved in the underlying transaction by coming into possession of any money or any VA at any point in time, are not covered under the above definition of VA exchange.<sup>6</sup>

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<sup>5</sup> Commonly referred to as initial coin offerings.

<sup>6</sup> The FATF Guidance Note on VA and VASPs states that peer-to-peer trading platforms may not constitute a VASP as defined under the FATF Standards.

2.9 Consistent with the FATF definition but in more specific terms, we propose to define VA as a digital representation of value that is expressed as a unit of account or a store of economic value; functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services or for the discharge of a debt, or for investment purposes; and can be transferred, stored or traded electronically.

2.10 The proposed definition of VA does not cover digital representations of fiat currencies (including digital currencies issued by central banks), as well as financial assets (e.g. securities and authorized structured products) already regulated under the Securities and Futures Ordinance (“SFO”) (Cap. 571). Closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible (e.g. air miles, credit card rewards, gift cards, customer loyalty programmes, gaming coins etc.) will also be carved out from the definition as it is not the FATF’s intention to catch these items. VAs purportedly backed by some form of assets for the purpose of stabilising their value (i.e. the so-called “stablecoins”) are covered by the definition as the FATF Standards apply equally to coins that are stable or not.

**Q3 Do you agree with the proposed scope and coverage of the regulated activity of operating a VA exchange?**

**Q4 Do you agree with the proposed definition of VA? Other than closed-loop, limited purpose items, are there other digital items that should be excluded from the definition?**

**Q5 Should peer-to-peer VA trading platforms be covered under the licensing regime?**

2.11 While a VA exchange would typically involve the five types of activities intended for regulation by the FATF, we reckon that the FATF-regulated activities may also exhibit themselves in business forms other than a VA exchange (such as a stand-alone VA payment or custodian system). A VA exchange is however by far the most prevalent and developed embodiment (in terms of both scale and

complexity) seen in Hong Kong. For consideration of harnessing the opportunities presented by financial innovation and digital transformation while mitigating the risks they pose, we see a case to tailor a licensing regime for VA exchanges.

- 2.12 For VA activities conducted outside VA exchanges, we note that their presence in Hong Kong is scanty and negligible. We note that VA payment systems or VA custodian services operating as a stand-alone business in Hong Kong are limited. We do not see initial coin offerings which are active in Hong Kong following repeated warnings by the SFC in the past few years. Over-the-counter trade and crypto-ATMs of limited scale exist, but they have to interface with financial institutions (for conversion into fiat currencies) which means that their money flow is traceable for AML/CTF purposes. Like any other legal or natural persons in Hong Kong, they are also subject to the statutory obligations of reporting suspicious transactions and implementing TFS promulgated by the United Nations Security Council. We will nevertheless keep in view the evolving landscape and consider the need for regulation when the market is ready. For now, flexibility will be built in the licensing regime such that it may be expanded to cover forms of VA activities other than VA exchanges where the need arises in future.

## **Licensing Requirements**

### Eligibility

- 2.13 Any person seeking to operate the regulated activity of VA exchange will have to apply for a licence from the SFC as a licensed VASP under the AMLO. Considering that the effective operation of a VA exchange will necessarily entail a permanent establishment of proper scale and construction to ensure governance and continuity, we propose that only locally incorporated companies with a permanent place of business in Hong Kong will be considered for the granting of a VASP licence. Natural persons or business establishments without a legal personality (e.g. sole

proprietors or partnerships) will not be eligible for a VASP licence. The physical presence requirement is instituted to ensure that local anchorage is available for the SFC to supervise the conduct of licensed VASPs and enforce regulatory requirements.

**Q6 Do you agree that only locally incorporated companies may apply for a VASP licence?**

Fit-and-Proper Test

2.14 An applicant has to satisfy a fit-and-proper test, applicable also to other financial institutions regulated under the AMLO, to be considered for the granting of a VASP licence. The fit-and-proper test will cover all responsible officers and ultimate owners of the corporate entity, and any change in this relation would require prior approval by the SFC. In considering whether a person is a fit and proper person, the SFC will take into account, among other relevant considerations, whether the person has been convicted anywhere of an ML/TF offence or other offence in which the person is found to have acted fraudulently, corruptly or dishonestly; whether the person has failed or may fail to observe the AML/CTF or other regulatory requirements applicable to licensed VASPs; the experience and relevant qualifications of the person; and whether the person is of a good standing and financial integrity (e.g. not being the subject of any bankruptcy or liquidation proceedings).

2.15 To ensure the proper management of a licensed VASP, for accountability consideration an applicant will have to appoint at least two responsible officers to assume the general responsibility of ensuring compliance with AML/CTF requirements and other regulatory requirements, and be held personally accountable in case of contravention or non-compliance of the requirements. Similar to the requirement under the SFO for licensed corporations, all executive directors of a licensed VASP must be made responsible officers upon approval by the SFC.

**Q7 Should other criteria be added to the fit-and-proper test given the nature and risks of VASPs?**

## Regulatory Requirements

- 2.16 A licensed VASP will be required to observe the AML/CTF requirements stipulated in Schedule 2 to the AMLO.
- 2.17 On top of that, given the tech-savvy and highly speculative nature of the VA industry, we consider it necessary for licensed VASPs to be subject to a robust set of regulatory requirements to ensure that they have the capacity and know-how to operate the VA business properly, so as to mitigate the risks posed to investors arising from system failure, security breach or market manipulation.
- 2.18 With reference to the opt-in regime, we propose to empower the SFC to impose, and vary as need be, licensing conditions, on licensed VASPs, and implement regulatory requirements<sup>7</sup> covering, *inter alia*, the following –
- (a) Professional investors only – at the initial stage, the licensed VASP should only offer services to professional investors. The SFC will continue to monitor the market and reconsider its position as the market becomes more mature in future;
  - (b) Financial resources – the licensed VASP should have adequate financial resources, for operating its VA business, including a paid-up share capital of a specified amount and liquid assets, depending on the nature of its business;
  - (c) Knowledge and experience – the licensed VASP and its associated entities should have a proper corporate governance structure staffed by personnel with the necessary knowledge and experience to enable the effective discharge of responsibility;
  - (d) Soundness of the business – the licensed VASP and its associated entities (i.e., a separate corporate entity with

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<sup>7</sup> The SFC will prepare and publish for consultation the regulatory requirements, including the codes and guidelines, provided in paragraph 2.18 before commencement of the regime.

which the licensed VASP has a controlling relationship) should operate its VA business in a prudent and sound manner, and ensure that client and public interests will not be adversely affected;

- (e) Risk management – the licensed VASP should have in place appropriate risk management policies and procedures for managing ML/TF, cybersecurity and other risks arising from a regulated VA activity that are commensurate with the scale and complexity of the business;
- (f) Segregation and management of client assets – the licensed VASP should implement proper segregation of client assets by placing them in an associated entity. Adequate policies and governance procedures should also be implemented to ensure the proper management and custody of client assets including VAs;
- (g) VA listing and trading policies – the licensed VASP should implement and enforce robust rules for the listing and trading of VAs on its platform(s). The VA exchange should also perform all reasonable due diligence on VAs before listing them for trading;
- (h) Financial reporting and disclosure – the licensed VASP and its associated entities should observe prescribed auditing and disclosure requirements and publish audited accounts;
- (i) Prevention of market manipulative and abusive activities – the licensed VASP should establish and implement written policies and controls for the proper surveillance of activities on its platform(s) in order to identify, prevent and report any market manipulative or abusive trading activities; and
- (j) Prevention of conflicts of interest – to avoid any conflicts of interest, the licensed VASP and its associated entities should not engage in proprietary trading or market-making activities on a proprietary basis. Suitable firewalls should

also be instituted between the different functions of the corporate structure to avoid conflict of interests. The licensed VASPs and its associated entities should also have a policy to eliminate, avoid, manage, or disclose actual or potential conflicts of interests for their employees who deal with VAs.

- 2.19 The SFC will grant a licence only when the relevant requirements are met. Licensed VASPs will be subject to disciplinary and investigative proceedings and enforcement actions in case of non-compliance with the AML/CTF and other regulatory requirements promulgated by the SFC.

**Q8 Should other regulatory requirements be added to mitigate the risks of VASPs?**

Open-ended Licence

- 2.20 It is expected that a licensed VASP would need to make substantive investment in order to acquire the necessary scale and sophistication for operating a competitive VA exchange. A degree of certainty in the operating environment is necessary to encourage long term investment in the business. As such, we propose that a licensed VASP will be granted an open-ended licence, i.e., it will remain valid until the licensed VASP is revoked by the SFC, for example, due to misconduct or the licensed VASP ceases its operation.

**Q9 Do you agree that a VASP licence should be open-ended or should it be periodically renewed?**

**Exemption and Prohibition**

- 2.21 A VA exchange is a new line of business that is distinct from the more traditional services provided by financial institutions or DNFBPs regulated under the AMLO. As their businesses do not overlap, we do not propose any exemption in respect of the VASP

licensing requirement, except for VA exchange(s) that are already regulated as a licensed corporation in the opt-in regime. The latter has been subject to essentially the same set of AML/CTF and licensing requirements now proposed for VASPs.

2.22 With effect from a future date to be determined, which we propose to be 180 days upon commencement of operation of the licensing regime, any operators carrying on the regulated activity of operating a VA exchange will be required to possess a valid licence issued by the SFC. Any person carrying on such activities without a valid licence commits a criminal offence.

**Q10 Do you agree with the exemption arrangement and the 180-day transitional period for application of a VASP licence?**

2.23 To prevent local investors from being exposed to risks from unlicensed VA exchanges, we propose to prohibit any person from actively marketing<sup>8</sup>, whether in Hong Kong or elsewhere, to the public of Hong Kong a regulated VA activity or a similar activity elsewhere (i.e. services associated with a VA exchange), unless the person is properly licensed and regulated by the SFC for the purpose of conducting the regulated VA activity.

**Q11 Do you agree that, for investor protection purpose, persons without a VASP licence should not be allowed to actively market a VA exchange business to the public of Hong Kong?**

## **Powers of the Licensing Authority**

### Supervisory Powers

2.24 The SFC will be empowered to supervise the AML/CTF conduct of licensed VASPs and enforce other regulatory requirements in accordance with the AMLO stipulations. Such will include the power to enter business premises of the licensed VASP and its

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<sup>8</sup> Reference is made to a similar concept under section 115 of the Securities and Futures Ordinance.

associated entities for conducting routine inspections; to request the production of documents and other records; to investigate non-compliances and to impose administrative sanctions (including reprimand, order for remedial actions, civil penalty and suspension or revocation of licence) against non-compliances.

- 2.25 The SFC will be empowered to appoint an auditor to look into the affairs of a licensed VASP and its associated entities if it has reasons to believe that the licensed VASP has failed to comply with any regulatory requirements. The SFC may also apply to the Court, where the circumstances so require, for an injunction order to prevent a licensed VASP from further contravening the said requirements.

#### Intervention Powers

- 2.26 Considering that the default of a VA exchange would bring considerable loss for investors, we see a need to enable the SFC to protect client assets of a licensed VASP in the event of an emergency, and to prevent the dissipation of client assets in case of misconduct on the part of a licensed VASP. Drawing reference from similar empowering provisions under the SFO, we propose to provide the SFC with intervention powers to impose restrictions and prohibitions against the operations of a licensed VASP and its associated entities where the circumstances so warranted.

- 2.27 Specifically, we propose to empower the SFC to –
- (a) Prohibit the licensed VASP and its associated entities from entering into any further transactions, and/or require it to conduct its business only in a specified manner;
  - (b) Restrict the licensed VASP and its associated entities from disposing of (or otherwise dealing with) its property (including client assets and other property); and
  - (c) Require the licensed VASP and its associated entities to maintain its property in a specified manner with a view to

ensuring that it will be able to meet its liabilities.

## **Sanctions**

- 2.28 The VA business operates largely in the virtual world with a high inherent risk both in terms of ML/TF and other criminal activities such as fraud. The penalty level for unlicensed VA activities should be high enough to achieve the necessary deterrent effect. We propose that any person conducting a regulated VA activity without a licence shall be guilty of a criminal offence. In this connection, we propose that carrying out a regulated VA activity<sup>9</sup> without a VASP licence should be punishable, on conviction on indictment, to a fine of \$5,000,000 and to imprisonment for seven years; and, in the case of a continuing offence, to a further fine of \$100,000 for every day during which the offence continues.
- 2.29 We also propose to make it an offence for any person, in connection with an application for the grant of a licence, to make a false, deceptive or misleading statement in a material particular, which shall also be punishable on conviction on indictment to a fine of \$1,000,000 and to imprisonment for two years.
- 2.30 In case of non-compliance with the statutory AML/CTF requirements, the licensed VASP and its responsible officers will be subject to criminal proceedings and liable to a fine of \$1,000,000 and to imprisonment for two years on conviction on indictment. They may also be subject to a range of administrative sanctions, including suspension or revocation of licences, reprimand, remedial order and a pecuniary penalty (not exceeding \$10,000,000, or three times the amount of the profit gained or costs avoided, whichever is the greater) for misconduct such as contravening the AML/CTF or other regulatory requirements. The sanctions proposed are similar to those applicable to financial institutions regulated under the AMLO.

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<sup>9</sup> Including actively marketing, whether in Hong Kong or from a place outside Hong Kong, to the Hong Kong public, a regulated VA activity, or any service which would constitute a regulated VA activity if it is conducted in Hong Kong.

2.31 Given the risk of investor fraud associated with VA, we propose to make it an offence for any person to make a fraudulent or reckless misrepresentation for the purpose of inducing another person to acquire or dispose of a VA, whether or not the transaction is conducted (or proposed to be conducted) within or outside a licensed VA exchange. A person who commits this offence is liable to a fine of \$1,000,000 and to imprisonment for two years.

**Q12 Do you agree that the penalty level for carrying out unlicensed VA activities should be sufficiently high to achieve the necessary deterrent effect?**

**Q13 Do you agree with the proposed sanctions, including that it shall be a criminal offence for a person to make a fraudulent or reckless misrepresentation to induce someone to acquire or dispose of a VA?**

### **Statutory Appeal**

2.32 We propose amending Part 6 of the AMLO to expand the scope of reviewable decisions of the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal to cover appeals against future decisions made by the SFC in implementing the licensing and supervisory regime for licensed VASPs.

**Q14 Do you agree that the Tribunal be expanded to hear appeals from licensed VASPs against future decisions of the SFC?**

## CHAPTER 3

### REGULATION OF DEALERS IN PRECIOUS METALS AND STONES

- 3.1 DPMS are among the six categories of DNFBPs appointed by the FATF for AML/CTF regulation primarily due to their involvement in cash-based transactions, which may be abused by criminals to launder and disguise proceeds in valuable commodities (e.g. gold, diamonds or high-value jewellery), or by terrorist and their associates to finance terrorism abroad. Specifically, the FATF requires that DPMS which engage in cash transaction exceeding USD/EUR15,000 (approximately HK\$120,000) should be subject to the same AML/CTF obligations as other DNFBPs. Major economies have accordingly introduced AML/CTF regulation for their DPMS trade through a licensing or registration system.
- 3.2 Whilst domestically cash-based transactions in the DPMS sector have become less common nowadays, Hong Kong has a sizeable DPMS sector<sup>10</sup> which is not immune from ML/TF challenges. One consideration for not including the DPMS sector in the 2018 AMLO amendment exercise was that it was less ready than the other DNFBP sectors for AML/CTF regulation. Since then, the Government has stepped up efforts to raise the AML/CTF awareness of the DPMS sector and enhance their understanding of ML/TF risks through capacity-building seminars. We also issued a revised AML/CTF Guideline for the DPMS sector in 2018 to assist its development of best practices and procedures to guard against potential abuse for ML/TF. This notwithstanding, the FATF identifies the absence of DPMS regulation as a gap in the

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<sup>10</sup> The DPMS industry plays a significant role in Hong Kong's import and export trade. Hong Kong is one of the world's major trading centres in gold. In 2019, Hong Kong exported \$204 billion worth of gold and \$20 billion worth of silver, platinum and other metals of the platinum group. Hong Kong also has an active trade in exporting diamonds, pearls, and other precious stones, which amounted to HK\$237 billion in 2019, as well as precious jewellery, the export of which amounted to HK\$62 billion in 2019. On top of that, Hong Kong has a large retail sector for jewellery and precious metal accessories, with 2 060 retail establishments employing over 12 000 people. Two of the top ten jewellers in the world are based in Hong Kong.

AML/CTF regime of Hong Kong, and recommends in the Mutual Evaluation Report that appropriate AML/CTF obligations be put in place for the DPMS sector as a matter of priority.

- 3.3 To implement the FATF requirement, we propose amending the AMLO to introduce a two-tier registration regime for DPMS and subject registrants engaging in cash transactions at or above HK\$120,000 to the AML/CTF obligations stipulated in Schedule 2 to the AMLO. The registration regime will be administered by the C&CE, who as the Registrar will maintain a Register of Dealers of Precious Metals and Stones for public information.

### **Scope and Coverage**

- 3.4 To allow the Registrar an oversight of the DPMS trade such that he can fully grasp the ML/TF risks involved and apply risk-based mitigation measures accordingly as required by the FATF, we propose that registration as a DPMS under the AMLO is required before any person (natural or legal) may, by way of business, conduct one or more of the following “regulated activities”<sup>11</sup> in Hong Kong –

- (a) Trading in (i.e. selling, offering for sale, purchasing or possessing for sale/resale), importing, or exporting precious metals, precious stones or precious products;
- (b) Manufacturing, refining, or carrying out any value-adding work (e.g. cutting, polishing, etc.) on precious metals, precious stones or precious products;
- (c) Issuing, redeeming, or trading in (as defined) precious-asset-backed instruments; or

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<sup>11</sup> The coverage of “regulated activities” draws reference from the FATF’s intention to encompass a wide range of persons engaged in the following DPMS business –

- (a) those who produce precious metals or precious stones at mining operations;
- (b) intermediate buyers and brokers;
- (c) precious stone cutters and polishers and precious metal refiners;
- (d) jewellery manufacturers who use precious metals and precious stones; and
- (e) retail sellers to the public, and buyers and sellers in the secondary and scrap markets.

(d) Acting as an intermediary for (a), (b) or (c) above.

3.5 We propose to define precious metals, precious stones, precious products and precious-asset-backed instruments<sup>12</sup> as follows –

- (a) “Precious metal” means gold, silver, platinum or any other metal in the platinum group<sup>13</sup> (i.e. iridium, osmium, palladium, rhodium or ruthenium) in a manufactured or unmanufactured state;
- (b) “Precious stone” means diamond, sapphire, ruby, emerald, jade, or pearl;
- (c) “Precious product” means any jewellery, watch, apparel, accessory, ornament or other finished product made up of, containing or having attached to it, any precious metals or precious stones or both, and at least 50% of its value is attributable to the precious metals or precious stones or both; and
- (d) “Precious-asset-backed instrument” means any certificate or instrument backed by one or more precious metals, precious stones or precious products that entitles the holder to such assets (in entirety or in part), but excluding securities, futures contracts, collective investment schemes or authorized structured products regulated under the SFO.

**Q15 Do you agree generally with the proposed scope of “regulated activities” and related definitions for DPMS, which draw reference from the FATF requirement and overseas legislation?**

**Q16 Are there any other business activities in respect of precious**

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<sup>12</sup> As precious metals and precious stones may exhibit themselves in various forms ranging from tangible jewellery to intangible paper gold, we consider that precious products embodying precious metals or precious stones and instruments backed by such assets should also be regulated to prevent regulatory arbitrage.

<sup>13</sup> The platinum group metals are six transitional metal elements that are chemically, physically and anatomically similar, including platinum, iridium, osmium, palladium, rhodium, and ruthenium.

**metals, precious stones, precious products, and precious-asset-backed instruments that should be covered under the registration regime?**

## **Two-Tier Registration**

- 3.6 Given the FATF requirement for DPMS engaging in large cash transactions to be subject to more rigorous AML/CTF scrutiny, there is a need to distinguish persons who engage in large cash transactions from those who do not for application of risk-based regulation. We propose that two categories of registration be introduced under the regulatory regime to reflect the FATF intention for DPMS who engage in cash transactions at or above HK\$120,000 to be subject to the same set of AML/CTF obligations now applicable to other DNFBPs, while allowing the rest a lighter touch of supervision.
- 3.7 It is proposed that registration under either of the categories below is required for any person seeking to carry on the business of regulated activities in Hong Kong –
- (a) **Category A:** For a person who does not intend to and will not engage in any specified cash transactions (i.e. by not accepting cash payment for transactions over the specified amount) in the course of carrying on a DPMS business, general registration under Category A will suffice for the person to conduct one or more of the regulated activities specified in paragraph 3.4 above. A specified cash transaction refers to the making or receiving, in respect of any transaction involving a regulated activity, a payment or payments in cash of at least HK\$120,000 in total, whether the transaction is executed in a single operation or in multiple operations which appear to be linked; and
  - (b) **Category B:** For a person who intends to or may engage in any specified cash transaction in the course of a DPMS business, registration under Category B is required for the

person to conduct one or more of the regulated activities specified in paragraph 3.4 above.

- 3.8 Migration between the two categories of registration is permissible upon application, provided that the applicable registration criteria are met.

### Requirements for Category A Registration

- 3.9 Category A registration is simple and straightforward. Any person who intends to carry on a DPMS business may approach the Registrar for registration. Registration is almost automatic, subject only to the filing of an application which is accompanied by a valid business registration certificate<sup>14</sup>, addresses of all premises in Hong Kong pertaining to the place of business, and a declaration that the registration is obtained for a lawful purpose (the purpose being to engage in one or more of the regulated activities). Category A registrants are not subject to the AML/CTF obligations stipulated in Schedule 2 to the AMLO or any registration conditions other than the requirement to notify the Registrar of any subsequent changes in particulars.

- 3.10 A Category A registration will remain valid for as long as the DPMS continues to stay in business, subject only to the payment of an annual fee. The Registrar may refuse or cancel a Category A registration only if the registrant is found to have ceased business operations, gone into liquidation or bankruptcy, have been struck off the Companies Register (in the case of a company), have engaged in specified cash transactions without a Category B registration, or have made a fraudulent, misleading or deceptive declaration in the application, or if the Registrar reasonably suspects, at any time throughout the registration period, that the registration obtained is no longer for a lawful purpose. The objective of establishing Category A is to enable the Registrar to maintain an up-to-date understanding of the overall landscape of

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<sup>14</sup> For hawkers licensed under the Hawker Regulation (Cap. 132AI) who are exempted from business registration, they may register under Category A on the strength of their hawker licence without a business address.

the sector, without placing any undue regulatory burden on the DPMS concerned.

### Requirements for Category B Registration

3.11 Application for Category B registration, like other DNFBSs regulated under the AMLO, is subject to the meeting of a fit-and-proper test by the applicant, in addition to the requirement for a valid business registration certificate and addresses of all premises in Hong Kong pertaining to the place of business. In determining whether an applicant is fit and proper, the Registrar will consider all relevant matters, including whether the applicant (or any directors or ultimate owners) has been convicted in Hong Kong or elsewhere of an ML/TF offence or a serious offence<sup>15</sup>; has been convicted in Hong Kong or elsewhere of an offence in which the person is found to have acted fraudulently, corruptly or dishonestly; has been the subject of any bankruptcy or liquidation proceedings; or has failed or may fail to observe the AML/CTF and other applicable requirements.

3.12 Category B registrants will be subject to the AML/CTF obligations under the AMLO when they engage in specified cash transactions and supervised by the Registrar in this regard. A Category B registration will be valid for three years and renewable upon expiry where fit-and-proper requirements are met. For avoidance of doubt, an applicant failing to obtain registration status under Category B may still apply for registration under Category A provided that the applicant will not engage in specified cash transactions.

**Q17 Do you agree with the proposal to have a two-tier registration regime, such that registrants who do not engage in large cash transactions can be separated from those who do, with the former being subject to simple and mere registration requirements and the latter to standard AML/CTF requirements currently applicable to other DNFBSs?**

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<sup>15</sup> Offences specified in Schedules 1 or 2 of the Organized and Serious Crimes Ordinance or similar offences elsewhere.

**Q18 Do you agree generally with the respective requirements for Category A and Category B registrations, including that Category B registration should be renewed every three years?**

**Exemption**

3.13 It is noted that some financial institutions have a substantial footprint in the DPMS trade (e.g. buying and selling gold or issuing paper-gold). To avoid regulatory overlap, we propose to exempt financial institutions that are already regulated under the AMLO (viz. banks, licensed corporations, insurance institutions, money service operators, and stored value facilities) from the registration requirement, where they conduct the regulated activities of DPMS as an ancillary to their principal business.

3.14 The exemption does not apply to other DNFBPs supervised under the AMLO, as presently they are obliged to observe the AML/CTF requirements in Schedule 2 only when they engage in “specified transactions”, which do not include the regulated activities of DPMS. Exempting DNFBPs would create a loophole whereby they become unsupervised if they do engage in DPMS business. In any event, DNFBPs are mostly professional service providers who seldom operate another business outside their profession.

**Q19 Do you agree that financial institutions which are already regulated under the AMLO should be exempted from the registration regime when carrying on a DPMS business that is ancillary to their principal business?**

3.15 Having regard to the fact that dealers from other jurisdictions visit Hong Kong occasionally for jewellery trade fairs organised throughout the year, we propose to exempt these non-domestic dealers from registration as they pose lower ML/TF risks due to their transitory nature. From an operational point of view, it would also be impractical for the Registrar to supervise the AML/CTF compliance of these dealers as they do not have a

permanent establishment in Hong Kong and may have been regulated already in other jurisdictions. We propose to exempt a non-domestic dealer from the registration regime if all the following conditions are met –

- (a) The person is a natural person who does not ordinarily reside in Hong Kong, or is a legal person incorporated outside Hong Kong and is not registered under the Companies Ordinance (Cap. 622) as a non-Hong Kong company;
- (b) The person does not have a permanent place of business in Hong Kong; and
- (c) The person carries out a regulated activity in Hong Kong for no more than a total of 90 calendar days in any given year.

3.16 To mitigate the ML/TF risks of non-domestic dealers, they will be required to file a cash transaction report with the Registrar when they engage in a specified cash transaction in Hong Kong, and within one day upon completion of the transaction (and in any event before their departure from Hong Kong). A non-domestic dealer who fails to observe this requirement commits an offence and is liable to a fine at level 5 (\$50,000) and imprisonment for three months<sup>16</sup>. Such cash transaction reports will enable the Registrar to detect suspicious transactions and conduct follow-up investigations as necessary.

**Q20 Do you agree that non-domestic dealers who visit Hong Kong only occasionally should be exempted from the registration regime, subject instead to the requirement of filing cash transaction reports with possible sanctions for failure to do so?**

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<sup>16</sup> The suggested penalty level makes reference to that for failing to report a suspicious transaction under the Organized and Serious Crimes Ordinance (Cap. 455).

## **Transitional Arrangement**

3.17 To facilitate the trade's migration to the registration regime, DPMS who have been in operation immediately before commencement of the regime will be allowed 180 days to apply for registration. During the transitional period, DPMS carrying on a business of regulated activities will be deemed to have been registered for the purpose until such time when an application is granted.

**Q21 Do you agree with a 180-day transitional period and the deemed registration arrangement for incumbent dealers to facilitate their migration to the registration regime?**

## **Powers of the Registrar**

3.18 The Registrar for DPMS will be empowered to supervise the AML/CTF conduct of Category B registrants and enforce any registration conditions in accordance with the AMLO stipulations. Such will include the power to enter the DPMS' place of business for routine inspection; to investigate non-compliance and to request the production of records, documents or other materials; and to impose administrative sanctions to ensure the AML/CTF compliance of Category B registrants.

3.19 In respect of Category A registrants, the Registrar will also be empowered to enter the DPMS' place of business for routine inspection and request production of records or documents to ensure that they do not unlawfully engage in specified cash transactions. As Category A registrants are not subject to the AML/CTF obligations set out in Schedule 2 to the AMLO, the Registrar's powers to investigate non-compliances with Schedule 2 requirements and impose sanctions accordingly will not apply to them.

## Sanctions

3.20 A person commits an offence in any of the following circumstances, and is liable on conviction to a fine at level 6 (\$100,000) and to imprisonment of six months –

- (a) Conducting by way of business one or more of the regulated activities without a Category A or Category B registration;
- (b) Engaging in a specified cash transaction whilst carrying out any regulated activity without a Category B registration; or
- (c) Purporting to be a registered DPMS when the person does not have a valid Category A or Category B registration.

3.21 A person commits an offence if the person, in connection with a registration, makes a false, deceptive or misleading statement in a material particular, which should be liable to a fine at level 5 (\$50,000) and to imprisonment for six months.

3.22 A Category B registrant who contravenes the AML/CTF requirements in the AMLO will be subject to disciplinary proceedings and a range of administrative sanctions, including reprimand, remedial order and a pecuniary penalty not exceeding \$500,000<sup>17</sup>. We do not propose to impose criminal sanctions for non-compliance.

**Q22 Do you think the proposed sanction is adequate in deterring the operation of a DPMS business without registration?**

**Q23 Do you agree that Category B registrants should be subject to the same administrative sanctions as other DNFBPs, and not to criminal sanctions, for non-compliance with the AML/CTF requirements in the AMLO?**

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<sup>17</sup> This level is consistent with the maximum administrative fine that may be imposed against other DNFBPs for non-compliance with the AMLO.

## **Statutory Appeal**

3.23 We propose that the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal, established under the AMLO, be empowered to hear appeals against future decisions made by the Registrar in implementing the registration and supervisory regime for DPMS.

**Q24 Do you agree that the Tribunal be expanded to hear appeals from registrants against future decisions of the Registrar?**

## CHAPTER 4

### MISCELLANEOUS AMENDMENTS

- 4.1 Taking the opportunity of amending the AMLO, we propose to introduce certain miscellaneous amendments to address some technical issues identified in the Mutual Evaluation Report and other FATF contexts.

#### **Politically Exposed Persons**

- 4.2 The FATF Standards require financial institutions and DNFBPs to conduct enhanced CDD on foreign politically exposed persons (“PEPs”) as well as their family members and close associates due to the higher ML/TF risks they entail. The FATF refers PEPs to individuals who are or have been entrusted with prominent public functions by a foreign country. Adapted under the AMLO, a PEP is defined as an individual who is or has been entrusted with a prominent public function in a place outside the People’s Republic of China. A PEP is subject to enhanced CDD pursuant to section 10 of Schedule 2 to the AMLO.
- 4.3 During the Mutual Evaluation, the FATF notes that reference in the FATF Recommendations to a “country” applies equally to territories or jurisdictions, and as such enhanced CDD requirements under the AMLO should apply also to PEPs from other parts of China outside Hong Kong. We propose to amend the definition of PEP under the AMLO, from one in a place outside the People’s Republic of China to one in a place outside Hong Kong, to implement the FATF’s recommendation. To allow more flexibility in the treatment of former PEPs who are no longer entrusted with a prominent public function, in accordance with the relevant FATF Guidance, we also propose to amend section 10 of Schedule 2 to the AMLO to enable the adoption of risk-based approach in conducting enhanced CDD for former PEPs (i.e., enhanced CDD may not be required for former PEPs with lower

risks).

## **Beneficial Ownership of Trust**

- 4.4 The Organisation for Economic Co-operation and Development (“OECD”) conducted a review of Hong Kong’s legislative framework for Automatic Exchange of Financial Account Information (“AEOI”) in 2018 and made a number of recommendations for better aligning the relevant provisions of the IRO with the requirements of the Common Reporting Standards promulgated by the OECD. One of the recommendations, which the Government implemented by way of the Inland Revenue (Amendment) (No. 2) Ordinance 2019, was to clarify that the concept of beneficial owner (“controlling person” under the IRO), in relation to a trust, covers trustees and beneficiaries (including class of beneficiaries).
- 4.5 We propose to align the definition of “beneficial owner” of a trust under the AMLO with that of “controlling person” of a trust under the IRO as they mean to implement the same concept of beneficial ownership originating from the FATF Standards. A unified definition will reduce the compliance cost of financial institutions, which have to implement both the AMLO and the IRO requirements. Specifically, we propose to amend the definition of “beneficial owner” to clarify that, where a trust is concerned, it includes trustees, beneficiaries, and class(es) of beneficiaries

## **Non-Face-to-Face Situations**

- 4.6 Non-face-to-face (“NFTF”) business relationships or transactions (e.g. where the customer is not physically present during the onboarding stage) are traditionally considered by the FATF to be higher risk situations warranting enhanced CDD measures. In light of recent development in financial technology, the FATF has relaxed its regulatory stance and accepts that reliable and independent digital identification systems with appropriate risk

mitigation measures may help lower the ML/TF risks of NFTF customer identification and transactions.

- 4.7 Against this development, we propose to amend section 9 of Schedule 2 to the AMLO, which deals with NFTF situations, to add the use of independent and reliable digital identification systems for customer identification and verification purposes where a customer is not physically present as a permissible way to satisfy the requirements under section 9, so as to provide more flexibility for financial institutions and DNFBPs in adopting NFTF technologies.

### **Unlicensed Money Service Operation**

- 4.8 With the enactment of the AMLO in 2012, any person who operates a money service business in Hong Kong must obtain a licence from the C&CE. Unlicensed operation is liable to a fine at level 6 (\$100,000) and imprisonment for six months. In the past, the actual sentence imposed by the Magistrate ranges from \$5,000 to \$10,000 for first-time offenders, with a few cases of suspended sentences.
- 4.9 Over the years, the C&ED has consistently uncovered cases of unlicensed money service operation (around 10 cases annually). In the Mutual Evaluation, the FATF considers that the sustained level of unlicensed operations suggests that the current sentencing level is not sufficiently proportionate and dissuasive. To increase the deterrent effect as recommended by the FATF, and considering the financial loss one may suffer from an unlicensed operation, we propose to make it an indictable offence for operating unlicensed money service business and increase the sentencing level to a fine of \$1,000,000 and imprisonment for two years.

### **Exchange of Supervisory Information**

- 4.10 Recommendation 40 of the FATF Standards requires that

competent authorities have a legal basis for providing co-operation with their foreign counterparts for the exchange of supervisory information relevant for AML/CTF purposes. Whilst such legal basis is currently provided for under the governing Ordinances of individual financial regulators (including the AMLO in the case of the C&ED and the Companies Registry (“CR”)), these provisions differ slightly from one another in terms of the scope, circumstances and counterparty of exchange.

- 4.11 To standardise the parameters for exchange of information in the context of AML/CTF supervision, we propose to replace sections 49 and 53ZI of the AMLO (which apply to the C&ED and the CR respectively) with a similar provision that applies to all regulatory authorities under the AMLO. We also propose to add a confidentiality clause under this provision to prevent persons or entities that are subject to an investigation under the AMLO from divulging any information that may jeopardize the investigation.

**Q25 Do you agree with the miscellaneous amendments proposed by the Government to address some technical issues identified in the Mutual Evaluation Report and other FATF contexts?**

## CHAPTER 5

### NEXT STEPS

- 5.1 We wish to hear views from the concerned sectors in taking forward the legislative exercise. We have therefore set out in this consultation document the conceptual framework and key parameters of the legislative proposals as well as the specific questions for consultation.
- 5.2 Stakeholders concerned are invited to offer their views and comments to us by 31 January 2021. Taking into account the views and comments received, and subject to progress in the preparatory work, we aim to introduce a bill into the Legislative Council in 2021.

#### Overview of Consultation Questions

- Q1 Do you agree that Hong Kong should continue with efforts to strengthen the AML/CTF system having regard to international standards, in keeping with our status as an international financial centre that is safe and clean for doing business?**
- Q2 Do you agree that a balanced approach should be adopted for the current legislative exercise, complementing the need to have an effective system for tackling ML/TF risks in the VASP and the DPMS sectors in accordance with the FATF Standards, while minimising regulatory burden and compliance costs on the businesses?**
- Q3 Do you agree with the proposed scope and coverage of the regulated activity of operating a VA exchange?**
- Q4 Do you agree with the proposed definition of VA? Other than closed-loop, limited purpose items, are there other digital items**

**that should be excluded from the definition?**

- Q5** Should peer-to-peer VA trading platforms be covered under the licensing regime?
- Q6** Do you agree that only locally incorporated companies may apply for a VASP licence?
- Q7** Should other criteria be added to the fit-and-proper test given the nature and risks of VASPs?
- Q8** Should other regulatory requirements be added to mitigate the risks of VASPs?
- Q9** Do you agree that a VASP licence should be open-ended or should it be periodically renewed?
- Q10** Do you agree with the exemption arrangement and the 180-day transitional period for application of a VASP licence?
- Q11** Do you agree that, for investor protection purpose, persons without a VASP licence should not be allowed to actively market a VA exchange business to the public of Hong Kong?
- Q12** Do you agree that the penalty level for carrying out unlicensed VA activities should be sufficiently high to achieve the necessary deterrent effect?
- Q13** Do you agree with the proposed sanctions, including that it shall be a criminal offence for a person to make a fraudulent or reckless misrepresentation to induce someone to acquire or dispose of a VA?
- Q14** Do you agree that the Tribunal be expanded to hear appeals from licensed VASPs against future decisions of the SFC?
- Q15** Do you agree generally with the proposed scope of “regulated activities” and related definitions for DPMS, which draw

reference from the FATF requirement and overseas legislation?

- Q16** Are there any other business activities in respect of precious metals, precious stones, precious products, and precious-asset-backed instruments that should be covered under the registration regime?
- Q17** Do you agree with the proposal to have a two-tier registration regime, such that registrants who do not engage in large cash transactions can be separated from those who do, with the former being subject to simple and mere registration requirements and the latter to standard AML/CTF requirements currently applicable to other DNFBPs?
- Q18** Do you agree generally with the respective requirements for Category A and Category B registrations, including that Category B registration should be renewed every three years?
- Q19** Do you agree that financial institutions which are already regulated under the AMLO should be exempted from the registration regime when carrying on a DPMS business that is ancillary to their principal business?
- Q20** Do you agree that non-domestic dealers who visit Hong Kong only occasionally should be exempted from the registration regime, subject instead to the requirement of filing cash transaction reports with possible sanctions for failure to do so?
- Q21** Do you agree with a 180-day transitional period and the deemed registration arrangement for incumbent dealers to facilitate their migration to the registration regime?
- Q22** Do you think the proposed sanction is adequate in deterring the operation of a DPMS business without registration?
- Q23** Do you agree that Category B registrants should be subject to the same administrative sanctions as other DNFBPs, and not to criminal sanctions, for non-compliance with the AML/CTF

**requirements in the AMLO?**

**Q24 Do you agree that the Tribunal be expanded to hear appeals from registrants against future decisions of the Registrar?**

**Q25 Do you agree with the miscellaneous amendments proposed by the Government to address some technical issues identified in the Mutual Evaluation Report and other FATF contexts?**