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27 January 2021

Mr. Christopher Hui, JP
Secretary for Financial Services & the Treasury
Financial Services & the Treasury Bureau
24/F, Central Government Offices
Tim Mei Avenue, Tamar Central, Hong Kong

Dear Mr. Hui,

Re: Consultation Paper on Legislative Proposals to Enhance Anti-Money Laundering and Counter-Terrorist Financing Regulation in Hong Kong

The Hong Kong General Chamber of Commerce is pleased to submit our views in response to the government's latest proposals to strengthen Hong Kong's Anti-Money Laundering and Counter-Terrorist Financing Ordinance by regulating virtual asset service providers and dealers in precious metals and stones.

This consultation exercise has given rise to a number of issues that we believe the government should also be addressing in the interest of relevance, appropriateness and proportionality. In particular, this concerns the suggestion to provide the Securities and Futures Commission with additional powers and wider jurisdiction.

Our comments on the above and answers to the consultation questions are as given in the attached. We hope these are useful to your deliberations.

Yours sincerely,

George Leung
CEO

Encl.

The Financial Services and the Treasury Bureau's Consultation Paper on "Legislative Proposals to Enhance Anti-Money Laundering and Counter-Terrorist Financing Regulation in Hong Kong" ("the CP")

Response by The Hong Kong General Chamber of Commerce ("HKGCC")

Introduction

HKGCC welcomes this opportunity to submit its response to the Bureau's proposals in the CP.

As our views on the proposals extend beyond our answers to the Consultation Questions in the CP, we set out below first our general comments on the CP, and then our answers to the Consultation Questions.

General Comments

1. We agree that any proposals to strengthen Hong Kong's Anti-Money Laundering and Counter-Terrorist Financing Ordinance ("AMLO") should comply with the guiding principles set out in the CP. In particular:

- the proposals should be proportionate, that is they "should be commensurate with the ML/TF and other risks of the concerned sectors and… not impose an undue regulatory burden" on businesses; and
- to the extent that the proposals are aimed at following international standards, they must still be "subject to appropriate adaptation to cater for local circumstances".[1]

2. With this in mind, we note that, for virtual asset service providers ("VASPs"), the recommendations of the Financial Action Task Force provide for three options of regulation: prohibition, licensing, or registration. The Bureau proposes a licensing system for VASPs (implicitly rejecting prohibition as an option), but a registration system for dealers in precious metals and stones ("DPMS"). While we agree that it would be inappropriate to prohibit VASPs in Hong Kong, given the opportunity to harness new technologies that trading in virtual assets provides, we would welcome an explanation of why the Bureau believes that a licensing system is appropriate for VASPs, but that a lighter-touch registration system is appropriate for DPMS.

3. One possible reason why a licensing system is considered appropriate for VASPs (although this not clearly stated in the CP) is that the Securities and Futures Commission (SFC) has already introduced, and is implementing, a licensing system for VASPs that trade in security tokens (whether or not in they also trade in other assets). It may therefore be considered logical that a licensing system is also introduced for VASPs that trade in virtual assets other than securities. We agree that it would be inappropriate for different systems of regulation to be imposed on VASPs, simply because of the nature of the assets that are traded on their platforms.

[1] CP para 1.12.

4. While differential regulation on VASPs should in principle be avoided (see comment 3 above), the proposals would involve a certain degree of inconsistent treatment between VASPs, which are already licensed by the SFC under the SFO, and those which will be licensed under the AMLO. While these inconsistencies are undesirable, they should not be removed at the expense of the proportionality principle that is guiding the Bureau's proposals. We therefore suggest that:

- The SFC should review the operation of licensing requirements imposed under its opt-in regime since its introduction in November 2019, and their proportionality, to assess whether they have been appropriate, or have unduly restricted business activities. This applies in particular to the restriction on offering services only to professional investors, and to the obligation to have in place appropriate risk management policies, both of which are, in theory at least, highly restrictive.
- The Bureau should take this opportunity to review the SFO's provisions to the extent that they are relevant to these proposals, after public consultation, with a view to relaxing or removing any provisions that are unduly restrictive.

5. There are certain proposals in the CP on which the Bureau has not sought comments. This applies in particular to the proposed supervisory powers and proposed intervention powers to be given to the SFC.[2] It also applies to the proposed criteria for the fit-and-proper test, and the proposed regulatory requirements, for VASPs.[3] (The CP asks whether *further* criteria or regulatory requirements should be *added* to those it proposes, but not whether those it proposes are appropriate).

We are not sure why the Bureau has chosen not to consult on these issues. In the case of the proposed supervisory and intervention powers, if it is because the SFC already has the same or similar powers under the SFO, and the proposals are intended to be modeled on those, as noted above we suggest that the Bureau takes this opportunity to review the provisions of the SFO with a view to relaxing any that are unduly restrictive, in line with its guiding principle of proportionality and after public consultation. For example, we believe that the proposed powers of the SFC to enter the premises of VASPs,[4] and of the Registrar to enter the premises of DPMS,[5] in each case for "routine inspection", are unduly intrusive and disproportionate. As is the case under the Competition Ordinance, power of entry should at most only be allowed if there is a reasonable suspicion of contravention, a reasonable belief that evidence of the contravention may be found on the premises, and after obtaining a court warrant.

6. The proposals in the CP would extend the SFC's existing remit beyond the securities and futures industry, as it would have power to license and supervise VASPs that do not trade in securities tokens. To the extent that these may be banks or other financial institutions, this raises the question of whether the Hong Kong Monetary Authority (or other regulators) would have a role in the licensing or supervision of VASPs. While it is unusual for the SFC's remit to be extended in this way, as a pragmatic matter it may be the most practicable way to comply with the FATF's recommendations in the short

[2] CP paras 2.24 to 2.27.
[3] CP paras 2.14 to 2.19.
[4] CP para 2.24.
[5] CP paras 3.18, 3.19.

term. However, it does raise the more fundamental issue of whether the Government should ultimately move towards the model of a cross-sector financial regulator, as is the case, for example, in the UK and Singapore- this issue falls outside the scope of this paper.

Answers to 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?

We agree, with the proviso that any proposals to strengthen the AML/CTF system comply with the guiding principles set out in the CP. In particular:

- The proposals should be proportionate, i.e. they "should be commensurate with the ML/TF and other risks of the concerned sectors and… not impose an undue regulatory burden" on businesses; and
- To the extent they seek to follow international standards, they must be "subject to appropriate adaptation to cater for local circumstances".[6]

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?

Yes. See answer to Q1 above.

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

Yes. We believe that limiting the proposed licensing regime to VA exchanges, at least at the initial stage, is consistent with the guiding principle of proportionality (see answer to Q1 above), for the reasons set out in the CP.[7] This is subject to the comment on peer-to-peer platforms in our answer to Q5 below.

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?

We agree that items which are non-transferable, non-exchangeable and non-fungible be excluded from the definition of VA. However, we do not see any need to specify that, in addition to having these qualities, the items must also be of a "closed- loop, limited purpose" nature.

[6] CP para 1.12.
[7] CP paras 2.11 and 2.12.

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

While we agree that the proposals should be proportionate, i.e. limited to the extent necessary to address demonstrable current risks, the view has been expressed in our consultation with our members, referring to the experience on the Mainland, that it would be prudent for the legislation to allow for the regulation of peer-to-peer platforms in future, should the need arise.

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

Yes. It is difficult to see how a VASP could be regulated effectively in Hong Kong unless it has a locally-incorporated company in Hong Kong.

The text in the CP preceding Q6 suggests that, in addition to having a locally-incorporated company, a VASP must also have a "permanent place of business" in Hong Kong (albeit the latter requirement is not mentioned in Q6 itself). We are not sure what is meant by "permanent place of business" (many businesses close or change their places of businesses from time to time, and they are not in a position to know whether any place of business will be "permanent"). In any event, we would question the need for such a requirement, given the proposed conditions that would have to be met for a licence to be granted,[8] and the SFC's power to revoke the licence in appropriate circumstances.

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

We note that the CP does not ask whether the criteria it proposes are appropriate, and we reserve our view on this issue. Based on the information provided in the CP, the proposed criteria for the fit-and-proper test appear to be sufficient, and therefore proportionate.

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

We note that the CP does not ask whether the proposed regulatory requirements are appropriate, and we reserve our view on this issue. Based on the information provided in the CP, the proposed regulatory requirements appear to be sufficient, and therefore proportionate.

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

We agree that a VASP licence should be open-ended, due to the need for business certainty as stated in the CP.[9] In addition, an open-ended licence would be

[8] CP paras 2.14 to 2.19.
[9] CP para 2.20.

proportionate, given the SFC's power to revoke the licence in any event, in appropriate circumstances.

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

We agree with the proposed exemption for VA exchange(s) that are already licensed by the SFC under the opt-in regime.

Regarding the proposed transitional arrangement, however, we see a problem with the proposed requirement that a VA exchange possess a licence by the expiry of 180 days from the commencement of the new licensing regime. The problem is that, while the VA exchange can control the date on which it submits its application, it cannot control the date when the SFC actually issues the licence. The operator might file its application well before the expiry of the 180-day period, but find that the SFC is, due to a heavy workload or other reasons, unable to process its application in time for the licence to be granted by the end of this period, leaving the operator with no option but to abandon its operations or plans, if it is to avoid committing a criminal offence.

To solve this problem, we suggest that the Bureau consider amending this proposal, so that the transitional period expires on the date of a (valid and complete) *application* for a licence, not the *issue* of a licence. This would be consistent with the Bureau's proposed transitional period for registration of DPMS (see Q21 below). There may be applications that are not initially valid or complete, and additional information or documents may require to be submitted before the application is valid and complete. The operator would have to take this into account and allow sufficient time for the possible need to provide such additional material when filing its application.

There should also be time limit requirements on the SFC to (a) confirm that applications are valid and complete; (b) request any additional information or documents that are necessary for this purpose; and (c) after such confirmation, process the application and issue the licence (or reject the application, with reasons, as the case may be).

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?

Yes. It is a corollary of the licensing requirement for a VA exchange business that persons without such a licence should not be allowed to actively market a VA exchange business in 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?

We agree with this proposition in principle. However, it begs the question of whether the penalty levels proposed in the CP (a fine of up to HKD 5 million, imprisonment of up to seven years, and a daily fine of HKD 100,000 during any continuation of the offence) are appropriate, or whether they are excessively harsh. It would be helpful for the Bureau to explain how it arrived at these levels, and why it believes that these levels

are necessary to achieve sufficient deterrence. In the meantime, we reserve our view on whether the proposed sanction levels are appropriate.

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?

We assume that the proposed sanctions referred to in this question are those other than the penalties for operating a VA exchange business without a licence (which are covered in Q12 above). These other proposed sanctions are referred to in CP paras 2.29 to 2.31. Our views are as follows:

- We agree that it should be a criminal offence to make a false, deceptive, or misleading statement in a material particular, in connection with a licence application.[10] This is subject to an appropriate *mens rea* requirement (for example, intentionally or recklessly) and defences (for example, honest belief in the truth of the statement) being specified.
- We also agree that it should be a criminal offence for a person to make a fraudulent misrepresentation for the purpose of inducing another person to acquire or dispose of a VA.[11] This is again subject to an appropriate *mens rea* requirement (for example, intentionally or recklessly) and defences being specified.
- As regards non-compliance with the statutory AML/CTF requirements, the maximum levels of any sanctions on the licensed VASP and its responsible officers should be consistent with those that already apply to other licensed activities under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615) ("AMLO"). The proposed "range of administrative sanctions" (of which the CP gives a few examples), which could also be imposed for contravening the AML/CTF "or other regulatory requirements", are difficult for us to comment upon, without full details of what these proposed sanctions and other regulatory requirements are.[12]

For all the sanctions listed above, as with the proposed sanctions for operating a non-licensed VA exchange business (see answer to Q12 above), we would welcome an explanation of the rationale for the proposed maximum sanction levels, and why they are considered necessary to achieve sufficient deterrence. In the meantime, we reserve our view on whether the proposed sanction levels are appropriate.

Q14) Do you agree that the [Anti-Money Laundering and Counter-Terrorist Financing Review] Tribunal be expanded to hear appeals from licensed VASPs against future decisions of the SFC?

We believe that the Tribunal should be limited to hearing appeals against decisions concerning AML/CTF matters, which is its proper remit. Appeals against SFC decisions in respect of VASP licensing and other matters should be handled by the

[10] CP para 2.29.
[11] CP para 2.31.
[12] CP para 2.30.

Securities and Futures Appeals Tribunal. We believe this division of responsibilities is more reflective of the respective expertise of the two bodies.

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?

Yes.

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?

In line with the guiding principle of proportionality, we believe that the proposed scope of regulated activities is sufficiently wide. If and when it is demonstrated that there is a need for it to be expanded, this can be dealt with by a future legislative amendment.

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?

We raise the following questions on the rationale for applying AML/CTF requirements only on dealers who intend to or may engage in cash transactions above a certain financial level:

- Could the AML/CTF requirements be circumvented by engaging in a significant number of cash transactions, while ensuring that each is below the specified financial level?
- How would the requirement for a Category A registrant not to engage in a transaction above the specified financial level be monitored or enforced?
- Is there a risk of deterring dealers from growing their businesses to avoid becoming subject to the AML/CTF requirements?

We would therefore suggest that the proposed Category A and Category B be re-considered. If they are to remain, we would welcome an explanation of why the financial level of HKD120,000 is regarded as appropriate.

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?

On the assumption that the Category A/Category B distinction is to remain (see our reply to Q17 above) the proposed requirements in each category appear to be appropriate.

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?

Yes, in line with the guiding principle of proportionality.

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?

We raise the following issues on the rationale for exempting non-domestic dealers from the proposed registration regime:

- Non-domestic dealers could pose the same AML/CTF risks to Hong Kong as domestic dealers. The fact that a person (i) is not ordinarily resident in Hong Kong; (ii) does not have a "permanent place of business" in Hong Kong (see our comment at Q6 above on the meaning of this term); and (iii) carries out a regulated activity in Hong Kong for no more than 90 calendar days in any given year (the three proposed criteria for exemption) does not materially reduce those risks.
- The fact that it may be more difficult for the Registrar to supervise AML/CTF compliance of non-domestic dealers - one of the reasons cited in the CP for the proposal to exempt them from the proposed registration requirements- should not in our view be a relevant factor. Other Hong Kong legal requirements, such as those under the Competition Ordinance, apply to both domestic and non-domestic businesses, without distinction.

We therefore suggest that this proposed exemption be re-considered.

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?

Yes.

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

We note that there is a dramatic difference between the proposed sanctions on DPMS, and those on VASPs. For example, according to the CP proposals:

- If a person, in connection with a DPMS registration, makes a false, deceptive, or misleading statement in a material particular, the proposed maximum sanction is a fine of HKD50,000 and imprisonment for up to six months. However, if a person commits the same act in connection with an application for a VASP licence, the proposed maximum sanction is a fine of HKD1,000,000 and imprisonment for up to two years.
- Non-compliance with the statutory AML/CTF requirements would not be a criminal offence for DPMS, but it would be a criminal offence for VASPs.

The rationale for such a significant difference is not clearly explained in the CP. It would be helpful to have such an explanation, as well as an explanation as to why the proposed maximum penalty levels are considered appropriate to achieve sufficient deterrence.

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?

This question appears to imply that the Bureau is proposing that administrative (as opposed to criminal) sanctions be imposed on Category B registrants because this is the case with DNFBPs. Before answering this question, it would be useful to know the Bureau's reasoning on why it believes such alignment between DPMS and DNFBPs is appropriate.

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

Consistent with our views on appeals against the SFC's decisions regarding VASPs, we believe that the Tribunal should be empowered to hear appeals only against decisions regarding DPMS on AML/CTF matters. Appeals against other decisions by the Registrar concerning DPMS, for example regarding registration, should be dealt with through the existing mechanisms for appeal against decisions by the Customs and Excise Department generally.

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?

We have no objection to the proposal to add a confidentiality clause in the AMLO, to prohibit persons or entities that are subject to an investigation under the AMLO from divulging any information that may jeopardise the investigation. However, this provision needs to be subject to appropriate exceptions, for example, to exempt disclosure to professional advisers for the purpose of seeking advice. For this purpose, the confidentiality clause could be modelled on section 378 of the SFO. This would help to ensure a level playing field between investigators and those under investigation, in terms of disclosure of information that may jeopardise the investigation.

We have no comments on the other proposed miscellaneous amendments.

HKGCC Secretariat
January 2021