



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B10/21C

19 July 2019

The Chief Executive
All Stored Value Facility Licensees

Dear Sir/Madam,

Stored Value Facility Sector: Money Laundering and Terrorist Financing Risk Assessment Report (Report)

I am writing to share the captioned report prepared by the Hong Kong Monetary Authority (HKMA), which updates the money laundering and terrorist financing (ML/TF) risk assessment for the stored value facility (SVF) sector¹. The Report includes analysis of threats and vulnerabilities as well as areas for further actions.

The latest assessment confirms that, based on business operating data and inputs by SVF licensees, typologies and analysis by the Joint Financial Intelligence Unit as well as supervisory observations from the first two years since the commencement of the licensing and regulatory regime, the SVF sector continues to carry a **medium level of ML/TF risk**. It is noted that while the majority of the SVF sector continues to be characterised by lower ML/TF risks as determined by small stored value, limited functionality and predominant use for transport and low-value retail transactions, pockets of higher ML/TF risks have emerged. These include some SVF products with functions such as overseas cash withdrawal, cross-border remittance and person-to-person fund transfers, which may introduce higher vulnerability for illicit fund flows. The findings and conclusions in the Report are consistent with those for other jurisdictions.

The HKMA has been, and will continue to be, working closely with other competent authorities as well as SVF licensees to address the identified ML/TF risks in the sector. These efforts include, among others, further enhancing the regulatory framework and thus resilience of the SVF sector to ML/TF risks, while maintaining the functionality aimed at customer convenience and ease of use; strengthening SVF licensees' understanding of ML/TF threats; supporting innovative means by which SVF licensees implement financial crime controls effectively and exploring the greater use of technology and analytical tools in supervisory work.

¹ Please also refer to the HKMA's circular on *Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report* issued to SVF licensees on 2 May 2018.

The assessment and recommendations in the Report are being incorporated holistically into an enhanced framework of SVF account management, which aims to manage various risks including, among others, ML/TF risk. Amendments will also be made as appropriate to the *Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Stored Value Facility Licensees)*, on which the industry will be consulted in due course.

SVF licensees should study the Report carefully, consider the relevant insights and implications, and review and update where appropriate institutional ML/TF risk assessments accordingly. Implementing a risk-based and proportionate approach to anti-money laundering and counter-financing of terrorism work relies upon good understanding of the ML/TF threats, vulnerabilities and risks, and targeting resources and activities at areas of higher risks.

If you have any questions regarding this letter, please contact Mr Dixon Lam at 2878-8721 or aml@hkma.iclnet.hk.

Yours sincerely,

Carmen Chu
Executive Director (Enforcement and AML)

c.c.: Financial Services and the Treasury Bureau (Attn.: Ms Eureka Cheung)

Encl.



HONG KONG MONETARY AUTHORITY

STORED VALUE FACILITY SECTOR

MONEY LAUNDERING AND TERRORIST FINANCING RISK ASSESSMENT REPORT

July 2019



Overview

1. This assessment by the Hong Kong Monetary Authority (HKMA) focuses on money laundering and terrorist financing (ML/TF) risks of the stored value facility (SVF) sector in Hong Kong and provides an overall risk rating for the sector. Using the latest data and analysis provided by the industry¹ and the Joint Financial Intelligence Unit (JFIU)², the HKMA updated its work done as part of the overall Hong Kong ML/TF risk assessment³.
2. Since the commencement of the licensing and regulatory regime for the SVF sector in 2016⁴, there has been significant growth in the number of SVF accounts, transaction volume and transaction value. SVF licensees provide services including prepaid cards as well as mobile and internet payments, and have actively rolled out different services and expanded business networks over the past two years domestically, and cross-border in some cases, to enhance customer choice and experience.
3. The assessment considers the risks of SVF products with different functionalities, taking into account risk mitigating measures implemented by different SVF licensees. Analysis of available data after two years of operation confirmed that the majority of the SVF sector remains characterised by lower risks as determined by small stored value, limited functionality and predominant use for transport and low-value retail transactions, while also revealing pockets of higher ML/TF risks in certain products. In particular, risks are emerging in such functions as overseas

¹ The HKMA updates its understanding of institutional, sectoral and territory-wide ML/TF risks on an ongoing basis using a variety of information. For example, each SVF licensee is required to submit its institutional risk assessment on a regular basis, as well as completing a financial crime data return and an information collection template of customer and transaction figures bi-annually.

² Including typologies and analysis on SVF developed by the JFIU and shared with the HKMA as inputs to this risk assessment.

³ The Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report (Hong Kong ML/TF Risk Assessment) was published by the Government in April 2018 and can be found at <https://www.fstb.gov.hk/fsb/aml/en/risk-assessment.htm>.

⁴ Under the Payment Systems and Stored Values Facilities Ordinance, Cap. 584 (the PSSVFO) which can be found at <https://www.elegislation.gov.hk/hk/cap584> and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Stored Value Facility Licensees) (AML Guideline for SVF licensees) which can be found at https://www.hkma.gov.hk/media/eng/doc/key-functions/financial-infrastructure/infrastructure/svf/Guideline_on_AMLCFT_for_SVF_eng_final.pdf.



cash withdrawal, cross-border remittance and person-to-person (P2P) fund transfers, which may introduce higher vulnerability for abuse.

4. While the latest analysis confirms that limitations on product functionalities and thresholds applied as a result of the regulatory regime introduced by the HKMA in 2016 have reduced the overall vulnerability, there is a need, in view of the growth of the sector and developments in the international regulatory landscape as well as emerging ML/TF risks, to update the application of the risk-based approach for anti-money laundering and counter-financing of terrorism (AML/CFT) work of the SVF sector.
5. The findings and recommendations in this report are being incorporated holistically into an enhanced framework of SVF account management, which aims to manage various risks including, among others, ML/TF risk. Appropriate enhancement to the regulatory framework will help reduce identified vulnerabilities and the overall risk of the SVF sector, particularly as related to overseas cash withdrawal, cross-border remittance, P2P fund transfers and impersonation risk, while maintaining the functionality aimed at customer convenience and ease of use.
6. Taking into account all of these developments, the analysis confirms that the SVF sector continues to have a **medium level of ML/TF risk**⁵, comprising a medium level of threat and medium level of vulnerability, which is in line with the risks presented by SVF sectors internationally.

Development of the SVF Sector

7. At the end of December 2018, there were 16 SVF licensees offering products and services which mostly focus on the Hong Kong market. Thirteen⁶ of these were granted licences under the PSSVFO in 2016 and

⁵ A ML/TF risk assessment of the SVF sector was first carried out as part of the Hong Kong ML/TF Risk Assessment, based on only and limited operating data available for the sector in 2017. That assessment concluded that the SVF sector had a medium level of risk.

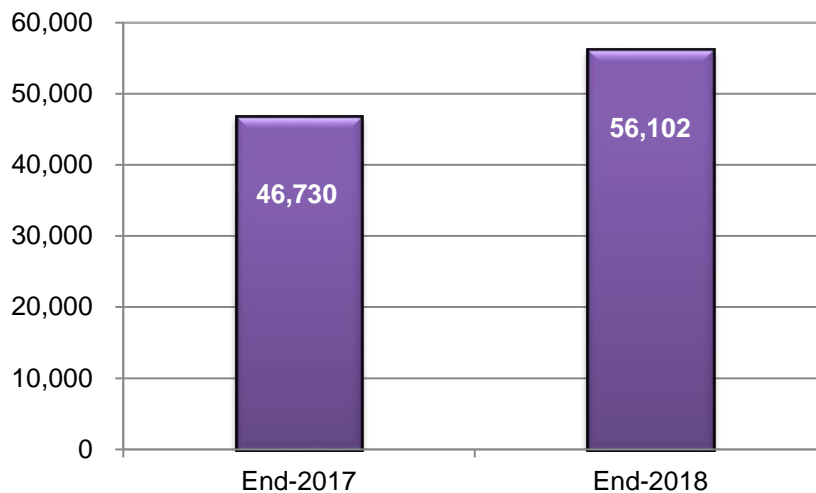
⁶ List of SVF licensees: (1) Octopus Cards Limited, (2) HKT Payment Limited, (3) TNG (Asia) Limited, (4) Alipay Financial Services (HK) Limited, (5) WeChat Pay Hong Kong Limited, (6) Optal Asia Limited, (7) K & R International Limited, (8) PayPal Hong Kong Limited, (9) UniCard Solution Limited, (10) 33 Financial Services Limited, (11) ePaylinks Technology Co., Limited, (12) Autotoll Limited and (13) Transforex (Hong Kong) Investment Consulting Co., Limited.



the remaining three are licensed banks⁷. Two more licences were granted to the SVF licensees⁸ in May 2019.

8. By the end of 2018, the total number of SVF accounts was 56.1 million, a 20% increase from 46.7 million accounts at the end of 2017 (Chart 1). Compared with the local population, this figure suggests that many customers have opened accounts with more than one SVF licensee.

Chart 1: Total number of SVF accounts ('000)

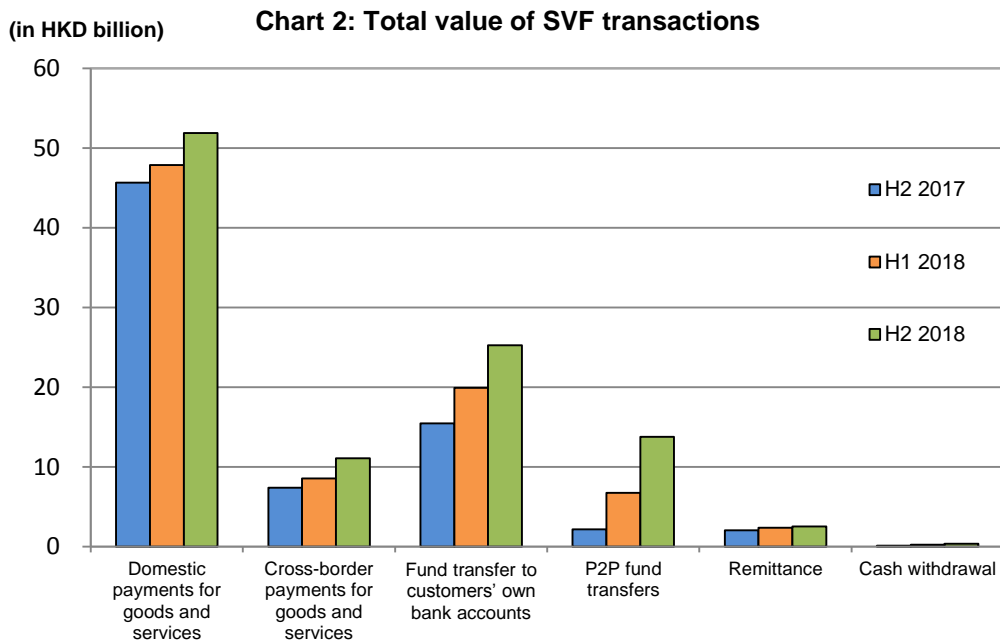


9. The total value of SVF transactions was HK\$192 billion in 2018⁹. The figure for H2/2018 increased by 44% to HK\$106 billion as compared with HK\$73 billion in H2/2017. The total value of SVF transactions with breakdown by usage types is shown in Chart 2:

⁷ A licensed bank is regarded as being granted a license pursuant to section 8G of the PSSVFO. Licensed banks issuing SVFs are: (1) The Hongkong and Shanghai Banking Corporation Limited, (2) Dah Sing Bank, Limited and (3) Bank of Communications (Hong Kong) Limited.

⁸ (1) Yintran Group Holdings Limited and (2) Geoswift Cards Services Limited have not yet commenced business as of end-May 2019.

⁹ For the purpose of this risk assessment, the total value of SVF transactions includes payments for goods and services, P2P fund transfers, fund transfers to customer's own bank accounts, remittance, cash withdrawal, etc., which were submitted by SVF licensees based on its internal classification.



ML/TF Threats in the SVF Sector

10. Qualitative and quantitative analysis has been conducted regarding the nature and extent of observed suspicion or suspected criminal activity associated with the SVF sector, based on supervisory observations of the HKMA as well as data and inputs from the JFIU and SVF licensees. Regarding the extent of activity as shown by JFIU statistics, SVF licensees filed around 1,200 suspicious transaction reports (STRs) from November 2016 to December 2018. In 2018, SVF licensees filed around 530 STRs, representing 0.7% of total STRs received by the JFIU and which was slightly below the number of STRs filed by each of the securities, insurance and money service operator sectors. There was an increase of over 110% in STRs between H2/2017 (around 140 STRs) and H2/2018 (around 300 STRs), which is in line with business growth.

11. Analysis has been made on the nature of observed suspicion or suspected criminal activity in the sector and various key typologies have been highlighted, particularly based on analysis by the JFIU, including the use of SVFs to purchase illegal goods online, the use of SVFs in illegal bookmaking and gambling activities, as well as various activities for money laundering (ML), notably through the use of SVFs for cash withdrawal at



overseas automated teller machines (ATMs).

12. The HKMA has also performed quantitative and qualitative analysis based on information collected from SVF licensees, such as risk assessments, financial crime risk data including material related to STRs as well as engagement and experience sharing in discussion forums with the industry¹⁰. While it is not always possible for SVF licensees to identify the precise nature of the suspected criminal threat or activity giving rise to the suspicion, where possible SVF licensees have sought to analyse and understand the nature of the criminal activity or predicate offence to improve risk understanding.
13. Based on SVF licensees' own interpretation and understanding of suspicious activities, approximately one-third of STRs were considered to be possibly related to suspected fraud. This observation is generally consistent with the Hong Kong ML/TF Risk Assessment where fraud is identified as by far the most prevalent predicate offence for ML. An increase in suspected online gambling and illegal bookmaking was observed in 2018, which was also reflected in a typology recently shared by the JFIU. In addition, a few STRs were considered by the filing SVF licensees to be possibly related to suspected unlicensed money services business, drug trafficking or smuggling activities. While ML is another major type of suspicion suggested in STRs, some SVF licensees may have adopted a highly cautious approach in regarding transaction of large amounts as suspicious for ML-related activities.
14. According to analysis of industry data, around 85% of STRs made in H2/2018 were related to accounts where due diligence had been conducted, while the remaining 15% involved SVF products subject to customer due diligence (CDD) exemption¹¹. Whilst there are more than 40 million SVF accounts which are exempt from CDD, only a few tens of STRs (out of a total of around 300 STRs) were filed on such accounts in H2/2018 reflecting the comparatively lower risk of these products with

¹⁰ For example, a workshop was held with industry representatives on 24 October 2018 where the threats and vulnerabilities of SVF sector were discussed.

¹¹ Subject to specific requirements on stored value, transaction limit and functionality of SVF product as stipulated in the AML Guideline for SVF licensees, there is no requirement to conduct CDD on the customer under certain scenarios.



small stored value and limited functionality under the regulatory requirements.

15. In sum, based on analysis of the nature and extent of suspected criminal activities, the threat to the SVF sector is assessed to be **medium** and concentrated in:

- (a) network-based SVFs being exploited for various fraud-related activities;
- (b) prepaid cards being loaded from opaque funding sources and misused for cash withdrawal in higher risk countries; and
- (c) P2P functionality being abused for illegal bookmaking activities.

16. Overseas experience suggests that SVF products may also have vulnerabilities that make them attractive for use in terrorist financing. While there has been no indication of such abuse to date in Hong Kong, the risk has been noted and generally reflected in SVF licensees' AML/CFT systems and controls, including screening systems.

ML/TF Vulnerabilities in the SVF Sector

17. The features of individual SVF products offered by the SVF licensees¹² vary to some degree, so that no two products share exactly the same vulnerabilities.

18. The SVF market is generally characterised by lower risk transactions. Purchases of goods and services accounted for about 62% of total value of transactions in 2018. The average transaction amount is HK\$20, which carries low ML/TF risks (see Chart 3). For example, Octopus cards, which accounted for more than half of total value of payments for goods and services of the SVF sector in 2018, have been demonstrated to be low-risk given their low maximum stored value, small average transaction amount, and the fact that they are almost exclusively used for transport and low-value retail transactions within Hong Kong¹³. Products with CDD

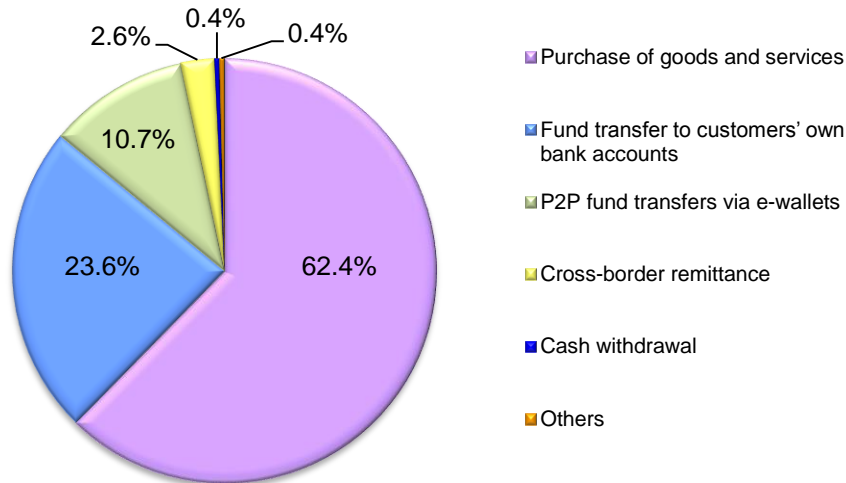
¹² Including 13 SVF licensees and 3 licensed banks (which are regarded as being granted a licence under the PSSVFO) issuing SVF products as of end-December 2018.

¹³ Octopus cards can be used at some outlets in Macau and Shenzhen.



exemption accounted for about 80% of total SVF accounts, of which around 80% are Octopus cards.

Chart 3: Total value of transactions by customer activities (2018)



19. About 24% of the total value of transactions represents fund transfers to customers' own bank accounts, which is in line with the observation that many customers may have topped up their e-wallets by credit cards to maximise spending and points awards and subsequently transfer the funds from e-wallets back to their bank accounts. Besides, merchants will also have business needs to transfer the sale proceeds of goods and services back to their own bank accounts. Fund transfers between accounts of the same person or entity generally carry lower ML/TF risks.
20. Therefore, of the total value of transactions in the sector, 86%¹⁴ presents low ML/TF risks, added to the fact that functionalities limit the attractiveness for exploitation for ML/TF. The remaining 14% of the total value of transactions are related to products and services that may present higher vulnerabilities for ML/TF. These include P2P fund transfers via e-wallets (11% of total value of transactions in 2018), while further analysis suggests that the average amount of such transfers is relatively low at HK\$378. Cross-border remittance services (2.6% of total value of transactions) offered by some SVF licensees, as well as SVF products such as prepaid cards with cash withdrawal functions (0.4% of total value

¹⁴ Consists of value of transactions of (i) purchases of goods and services (62%); and (ii) fund transfers to customers' own bank accounts (24%), which generally carry lower ML/TF risk.



of transactions), may also be vulnerable to being abused.

21. P2P fund transfer, a function mainly provided by e-wallets, exhibited rapid growth in both number and value of transactions, by around 700% and 500% from H2/2017 to H2/2018 respectively. Such functionality is observed to have become common over the last two years for Hong Kong residents, who use e-wallets to conduct small-value P2P fund transfers among peers, e.g. splitting the bill for meals. Internationally, as it is in the case of Hong Kong, P2P fund transfer is more vulnerable to abuse, as there is no underlying purchase or other identifiable reason for a transaction, while the average transaction value is still relatively low at HK\$378 in the current stage of development in Hong Kong.
22. Remittance services provided by SVF licensees increased by 24% from H2/2017 to H2/2018, mainly due to strong demand for remittance services from foreign domestic helpers. Currently, three SVF licensees provide remittance services in Hong Kong and processed about HK\$5 billion in remittance transactions in 2018. While remittance generally carries higher risks given the instant and cross-border nature of fund transfers, most of the remittances executed by SVF licensees were noted to be initiated by foreign domestic helpers and sent to the Philippines and Indonesia, with a low average amount of HK\$1,157 per transaction. This is commensurate with the population of foreign domestic helpers working in Hong Kong, most of whom are from these two countries.
23. Cash withdrawal increased by more than 190% from H2/2017 to H2/2018. More than 60% was withdrawn in Hong Kong at SVF licensee's dedicated service points (e.g. convenience stores) or ATMs, while the remainder was cash withdrawal in other jurisdictions via ATMs using prepaid cards. The functionality of cash withdrawal through ATM networks is recognised as potentially increasing the level of ML/TF risk as it may allow funding in Hong Kong and cash withdrawals in other jurisdictions, including higher risk jurisdictions.
24. The design by SVF licensees of CDD exempt products was guided by the thresholds as set out in the regulatory framework (e.g. maximum stored value of HK\$3,000, no cash withdrawal, no cross-institutional or



cross-border fund transfers) which help reduce vulnerabilities. For higher-risk products, SVF licensees generally adopted proportionate control measures, such as limiting the ability to transfer funds to within the provider network and setting transactional limits per customer, to commensurate with and mitigate the risks concerned. The relatively small market segment offering higher-risk products and services also helps limit the overall risk of the SVF sector, albeit the size of the entire market is growing.

25. While most of the SVF sector is of low risk, there is rapid development in P2P fund transfers and remittance as well as the offering of prepaid cards with high stored values and overseas cash withdrawal function, and the SVF sector is assessed to have an average **medium** level of vulnerability to ML/TF.

AML/CFT Policies, Procedures and Controls (collectively referred to as “AML/CFT Systems”) of SVF Sector

26. An assessment of the AML/CFT Systems, which manage and mitigate relevant risk, is also important to facilitate understanding of the overall vulnerability of the SVF sector. The analysis was based on the HKMA's supervisory engagement with SVF licensees including issuance of guidance, e.g. Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Stored Value Facility Licensees), conducting on-site examinations and off-site reviews, meeting with SVF licensees' senior management and board of directors, maintaining regular industry engagement through AML/CFT forums and collecting periodic financial crime risk data.
27. According to the HKMA's supervisory observations, SVF licensees have generally put in place AML/CFT Systems commensurate with their ML/TF risks, but the effectiveness of implementation varies considerably. Larger SVF licensees generally have more sophisticated AML/CFT systems with higher levels of relevant experience resulting in more effective risk-based approach. Where weaknesses are found in any AML/CFT Systems, the SVF licensees concerned would be required to take prompt remedial measures as appropriate. The HKMA also shares key issues and good



practices with the industry, through various forums and ongoing supervisory communications, to facilitate SVF licensees' understanding of risks and strengthen their AML/CFT Systems.

Next Steps

28. In view of the updated assessment of ML/TF risks in the SVF sector, the HKMA has identified a number of areas for further action:

- (a) Enhancing the regulatory framework and thus the resilience of the SVF sector to ML/TF risks, among other risk areas, while maintaining functionality aimed at customer convenience and ease of use;
- (b) Strengthening further understanding of ML/TF risks, by monitoring new typologies and addressing any information gaps. This will be achieved through ongoing cooperation with law enforcement agencies and other financial regulators;
- (c) Continuing risk-based supervision, including thematic reviews and industry training, to focus on areas of higher ML/TF risk and target effectiveness of AML/CFT Systems;
- (d) Strengthening the partnership with the SVF sector through engagement and guidance to enhance understanding and mitigation of risks by the licensees;
- (e) Furthering cooperation with regulatory authorities in other jurisdictions, in particular Mainland China, in view of the increasing cross-border usage of SVF products and services; and
- (f) Supporting innovative means by which SVF licensees implement financial crime controls effectively and exploring the greater use of technology and analytical tools in supervisory work.