HAN KUN
汉 坤 律 师 事 务 所
Han Kun Law Offices

Han Kun Newsletter

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Legal Updates

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1. Closer to International Practice – China's New AML Rules

Authors: TieCheng YANG | Yin GE | Ting ZHENG | Virginia QIAO

On 16 April 2021, the People's Bank of China ("**PBoC**") issued the *Measures for Supervision and Administration of Anti-Money Laundering and Counter-Terrorist Financing in Financial Institutions* (《金融机构反洗钱和反恐怖融资监督管理办法》) (the "**2021 AML Measures**"), following PBoC's issuance of a consultation draft of the same on 30 December 2020 (the "**Consultation Draft**"). The 2021 AML Measures will take effect on 1 August 2021 and supersede the 2014 *Measures for Supervision and Administration of Anti-Money Laundering in Financial Institutions (for Trial Implementation)* (《金融机构反洗钱监督管理办法(试行)》) (the "**2014 AML Measures**"). Under the general background of improving the anti-money laundering ("**AML**") and counter-terrorist financing ("**CTF**") capabilities of PRC financial institutions and fulfilling the follow-up remediation Financial Action Task Force on Money Laundering (FATF) has required in an international AML assessment, the 2021 AML Measures represent a solid step to unify and refine China's supervisory mechanism for AML and CTF and to bring China's AML regulatory regime more in alignment with international practices.

In this legal commentary, we analyze the key points of the 2021 AML Measures and the regulatory implications for PRC financial institutions, with a focus on how the new requirements under the 2021 AML Measures overlay the 2014 AML Measures.

Expanded applicable scope under the 2021 AML Measures

Compared with the 2014 AML Measures, the 2021 AML Measures expand the scope of institutions subject to AML obligations, which include small-sum online lending companies, consumer finance companies, non-bank payment institutions, and others. PBoC has further specified application of the 2021 AML Measures to various types of financial institution subsidiaries in its official response (the "**PBoC Reply**") to public comments collected during the public comment period for the Consultation Draft:

1. Wealth management subsidiaries ("**WMS**") of commercial banks: the 2021 AML Measures apply;
2. Subsidiaries of securities firms: the 2021 AML Measures apply to subsidiaries of securities firms, as both are licensed by the China Securities Regulatory Commission;
3. Subsidiaries of futures companies: the 2021 AML Measures will not apply to futures company subsidiaries, because their main business is not specifically considered financial in nature; and
4. Subsidiaries of fund management companies ("**FMCs**"): presently, FMCs will be required to undertake the AML obligations for the subsidiaries they have established. PBoC will study further whether such subsidiaries will be separately required to undertake AML obligations.

Notably, the 2021 AML Measures do not cover private fund managers. According to the PBoC Reply, private fund managers are not covered because: (1) the current definition and scope of "private fund manager" remains vague and may need further clarification from regulators; and (2) in light of their large

numbers, complex classification and limited workforce, it would be difficult from a practical perspective to unify regulatory requirements and substantially carry out AML work for private fund managers. PBoC intends to further study the potential money-laundering risks of private fund products in conjunction with the relevant competent authorities.

The following table summarizes the applicability of the 2014 AML Measures and the 2021 AML Measures by types of financial institutions:

Type of Financial Institution	2014 AML Measures	2021 AML Measures
1. policy-based banks, commercial banks, rural cooperative banks, rural credit cooperatives and township banks	√	√
2. securities firms, futures companies and fund management companies	√	√
3. insurance companies and insurance asset management companies	√	√
4. financial asset management companies, trust companies, finance companies of enterprise groups, financial leasing companies, auto finance companies and currency brokerage firms	√	√
5. WMS	×	√
6. subsidiaries of securities firms	√	√
7. subsidiaries of futures companies	×	×
8. subsidiaries of FMCs	×	To be further specified
9. non-bank payment institutions, bank card clearing institutions, fund clearing centers	×	√
10. small-sum online lending companies, consumer finance companies, lending companies	×	√
11. institutions engaged in fund sales business, exchange business, professional insurance agents and insurance brokerages	×	√
12. private fund managers, including institutions such as PFM WFOE, QDLP, QDIE and QFLP	×	×

Enhanced roles and responsibilities under the 2021 AML Measures

Compared with the 2014 AML Measures, the 2021 AML Measures further specify and enhance for financial institutions aspects of existing internal AML control and risk management requirements. To do so, the 2021 AML Measures unify certain existing industry-specific AML rules, including (1) the *Measures for Administration of Anti-Money Laundering and Counter-Terrorist Financing for Financial Institutions in the Banking Industry* (《银行业金融机构反洗钱和反恐怖融资管理办法》); (2) the *Measures for Administration*

of Anti-Money Laundering and Counter-Terrorist Financing by Internet Finance Service Agencies (for Trial Implementation) (《互联网金融从业机构反洗钱和反恐怖融资管理办法(试行)》); (3) the *Measures for Administration of Anti-money Laundering and Counter-Terrorist Financing of Payment Institutions* (《支付机构反洗钱和反恐怖融资管理办法》); and (4) the *Notice on Strengthening the Supervision of Anti-Money Laundering Concerning Designated Non-Financial Institutions* (《关于加强特定非金融机构反洗钱监管工作的通知》) (collectively, the "**Industry AML Rules**"). In our reading, the 2021 AML Measures also improve certain existing requirements under the *Guidelines for the Management of Money Laundering and Terrorist Financing Risks by Corporate Financial Institutions (for Trial Implementation)* (《法人金融机构洗钱和恐怖融资风险管理指引(试行)》) (the "**Risk Management Guidelines**") and the *Guidelines on Self-Assessment of Money Laundering and Terrorist Financing Risk for Legal-Person Financial Institution* (《法人金融机构洗钱和恐怖融资风险自评估指引》) (the "**Self-Assessment Guidelines**").

I Self-assessment for money laundering and terrorist financing risks

The 2021 AML Measures require financial institutions to conduct self-assessments of money laundering and terrorist financing risks and, based on their operations and risk profile, to establish comprehensive internal control systems as well as to formulate corresponding risk management policies.

According to the 2021 AML Measures, financial institutions are required to (1) establish a self-assessment system for money laundering and terrorist financing risks at the headquarters level; (2) assess money laundering and terrorist financing risks on a regular or irregular basis; and (3) report the self-assessment results to PBoC within 10 working days from the date of sign-off by the board of directors or senior management.

Notably, the Self-Assessment Guidelines provide implementation requirements for money laundering risk self-assessments by specifying certain general principles, key factors, and core methods. The Self-Assessment Guidelines are compulsory for corporate financial institutions and non-bank payment institutions in China, while other types of institutions (e.g., bank card clearing institutions, fund clearing centers, etc.) may conduct self-assessments by reference to the Self-Assessment Guidelines.

II Setting up internal AML systems

The 2021 AML Measures unify various requirements as set out in the Industry AML Rules by defining financial institution AML mechanisms, human resources support, AML information systems and technical support, amongst other requirements.

Beyond the 2014 AML Measures and the Industry AML Rules, the 2021 AML Measures specifically stipulate (1) performance assessment systems; and (2) reward and punishment mechanisms shall be established and linked with AML/CTF responsibilities of the board of directors, board of supervisors, senior management and other relevant AML/CTF functions. We understand these provisions to provide overarching principles for the existing implementation requirements under the Risk Management Guidelines.

III Establishment of internal audit mechanisms

The 2021 AML Measures further enhance internal AML audit requirements for financial institutions compared to the 2014 AML Measures. Financial institutions are required to establish internal audit mechanisms for AML/CTF and perform internal/external audits to review the internal control effectiveness of their AML/CTF systems. The audits are required to ensure comprehensive coverage of both onshore and offshore branches/holding subsidiaries. In addition, the audit report is to be submitted to the board of directors or its authorized special committee.

The above requirements are new compared to the 2014 AML Measures, but they are not without precedent. Similar requirements are stipulated in the Risk Management Guidelines, according to which corporate financial institutions are required to conduct internal audits to investigate and assess the compliance and effectiveness of AML management systems.

IV Supervision of offshore branches and holding subsidiaries

Compared to the 2014 AML Measures, the 2021 AML Measures increase management requirements for financial institutions' offshore branches and holding subsidiaries to prevent foreign AML regulatory risks. Financial institutions must require their offshore branches and holding subsidiaries to implement the 2021 AML Measures to the extent permitted by the laws of the country (region) in which they are located; if the country (region) in which they reside has more stringent requirements, they will be required to comply with relevant provisions of the country (region). If the requirements of the 2021 AML Measures are more stringent than the relevant provisions in the country (region) where they are located, but the laws of the country (region) prohibit or restrict implementation of the 2021 AML Measures, the financial institution must take appropriate additional measures to address the AML/CTF risk and report to PBoC. These requirements mirror existing requirements under the Risk Management Guidelines.

Moreover, the 2021 AML Measures require financial institutions' headquarters to submit to PBoC annual reports that describe the AML/CTF regulations and supervision to which the institution's offshore branches and holding subsidiaries are subject in the country (region) where they are located.

Cross-border sharing of AML data

Although the 2021 AML Measures fill in gaps for AML management for certain types of institutions, financial regulators have further room for rulemaking. For instance, Article 5 of the 2021 AML Measures requires the confidentiality of client identity data and transaction information (the "**AML Data**") that is lawfully obtained during the performance of AML/CTF duties or obligations and prohibits its provision to third parties (unless stipulated by laws). This obligation mirrors confidentiality requirements under Article 5 of the *Anti-Money Laundering Law of the People's Republic of China* (《中华人民共和国反洗钱法》).

Based on the confidentiality requirements, the Risk Management Guidelines specifically provide further guidance in relation to cross-border sharing of AML Data as follows:

1. Corporate financial institutions must strictly limit the scope of AML Data to be shared during the course of cross-border business and cross-border regulatory supervision, and establish appropriate internal

systems for cross-border data transmission, risk control, and authorization procedures;

2. Where an offshore regulator requires a corporate financial institution to provide AML Data for AML/CTF purposes, the corporate financial institution shall inform the offshore regulator to submit a request through diplomatic, judicial assistance, or financial regulator cooperation channels;

3. No information may be shared with third parties regarding domestic judicial freezes, judicial inquiries, suspicious transaction reports, or AML investigations by administrative agencies; and

4. A corporate financial institution can provide AML Data to offshore clearing agencies only upon obtaining client consent, unless it is for AML purposes and involves the remittance and registration information of institutional clients.

These provisions may raise concerns among multi-national financial group operations in China because of their implications vis-à-vis data localization and cross-border transfers from China to offshore affiliates for storage/processing of know-your-customer data (which may fall within the scope of AML Data).

On 13 February 2020, PBoC and the China Financial Standards Technical Committee issued the *Personal Financial Information Protection Technical Specification (JR/T 0171-2020)* (《个人金融信息保护技术规范(JR/T 0171-2020)》) (the "**PFI Specification**"). The PFI Specification provides that a financial institution may share personal financial information ("**PFI**") with an offshore institution (including its headquarters, parent company or any of its branches, subsidiaries and other affiliates necessary for the completion of such business), provided that the following conditions are met:

1. Due to business needs, it is truly necessary to provide the information to an offshore institution;

2. The explicit consent of the PFI subject has been obtained;

3. A security assessment of the cross-border transfer of PFI has been undertaken to ensure that the data security protection capabilities of the offshore institution meet relevant security requirements;

4. The financial institution ensures that the offshore institution effectively performs its duties and obligations by signing an agreement with the offshore institution, conducts on-site inspections, etc.; and

5. Adherence to national laws and regulations and relevant rules, measures and standards of industry regulatory authorities.

In the PFI Specification, the scope of "PFI" broadly covers personal information acquired, processed, and maintained by financial institutions through the provision of financial products and services, including account information, identity information, financial transaction information, personal identity information, property information, borrowing and lending information, and other information reflecting certain circumstances of a specific individual.

The scope of AML Data under the 2021 AML Measures overlaps to some extent with the scope of PFI as defined in the PFI Specification. However, PBoC has not clearly differentiated between AML Data and PFI, nor has it provided detailed guidance on the convergence between the 2021 AML Measures and the PFI Specification (and other applicable data protection rules), which may lead to uncertainties in the

concurrent application between the two sets of regulatory rules. This could present financial institutions with certain challenges for data compliance under the AML regulatory regime and PFI protection regime. In terms of legal effect, it should be noted that the PFI Specification is a recommended standard for the financial industry, which is to provide practical guidance to financial institutions in the field of PFI protection. In practice, we do not rule out the possibility that the financial regulators may consider the PFI Specification an important reference when conducting relevant supervisory inspections or law enforcement actions. Therefore, the PFI Specification may serve as operating guidelines for financial institutions. We recommend that the cross-border sharing of AML Data should be carefully considered and addressed by financial institutions. As a prudent approach, and where applicable, financial institutions will need to comply in parallel with the AML Data and the PFI requirements when sharing AML Data cross-border.

Outlook

With the continuous development of the AML regulatory framework in China, we anticipate that further rules and/or detailed guidance will be formulated to fill in certain gaps as discussed in this legal commentary, e.g., the applicability of the 2021 AML Measures by subsidiaries of FMCs and private fund managers, the cross-border sharing of personal data under the AML regulatory regime, and personal financial information protection regime.

We will also continue to monitor relevant regulatory updates and share our views with readers in a timely manner.

2. A First Look at the RMB 18.2 Billion Anti-Monopoly Penalty Decision

Author: Angus XIE

On the morning of April 10, 2021, the State Administration for Market Regulation ("**SAMR**") issued on its website an administrative penalty decision and an administrative guidance document against a major digital undertaking for abuse of its dominant position in the domestic digital retail platform services market due to its exclusive dealing behaviors, so-called "choosing one of two". The administrative penalty imposed amounted to RMB 18.228 billion, 4% of the undertaking's 2019 domestic revenue. The penalty is the largest penalty yet imposed in Chinese antitrust enforcement, far exceeding the previous record of 6.088 billion set in 2015, and is probably also the largest administrative penalty incurred in any industry in China.

The penalty was based on provisions of the Chinese Anti-Monopoly Law that prohibit abuse of market dominance. Specifically, the Anti-Monopoly Law stipulates that dominant undertakings are prohibited from "requiring counterparties to deal exclusively with themselves without justifiable reasons" (Art. 17, para. 1, subpara. 4). Upon its investigation, SAMR determined the digital undertaking's "choosing one of two" behaviors to constitute such exclusive dealing.

Analyzing monopolistic conduct involving abuse of market dominance generally requires a step-by-step inspection of market definition, dominant market position, abusive conduct and the effect of elimination of competition. This is also the analytical framework SAMR presents in its penalty decision, which is as follows:

Market definition

Ordinarily, market definition is the first step in identifying anti-monopoly behaviors including an abuse of market dominance. Two factors constitute market definition, namely the relevant product market and the relevant geographic market. Here, SAMR defined the relevant market as the "domestic digital retail platform services market", based on the Anti-Monopoly Law and general practice, as well as taking into consideration the unique characteristics of the digital platform economy and the specifics of this case.

The definition of the relevant product market is particularly notable in this case. SAMR considered the following factors in determining that digital retail platform services constitute a market distinct from traditional retail business services: (1) the cross-side network effect triggered by the two platform user groups (namely the retailers and consumers) and an analysis of substitutability; (2) the geographic region and service periods covered by undertakings and their operational costs, ability to match potential consumers, and efficiency in responding to market demands; (3) and differences in the scope of products offered to consumers, degree of shopping convenience, and degree of efficiency in comparing and matching products.

This methodology for defining the relevant product market serves as a reference for future cases associated with the digital platform economy. Prior to this case, digital platform operators often regarded

traditional offline operators as competitors, therefore assuming their market power to be insufficient to constitute a dominant position in the market. SAMR may not accept this position in their future enforcement actions. If only digital services are considered in defining the relevant product market, the market share of digital platform undertakings will increase significantly across numerous industries, greatly increasing their risk of being deemed dominant. Please see the following analysis on dominant position.

Dominant position

SAMR started its analysis of the dominant market position with traditional parameters including market shares and market concentration level. SAMR found that the domestic digital retail platform services market in China is highly concentrated with few competitors, and that this particular digital undertaking held substantial market share (consistently higher than 60% in the past five years). Further, SAMR analyzed the undertaking's influence over the market, particularly highlighting its ability to set the price of services, to determine the amount of internet traffic for each operator on its platforms, and to control distribution channels. This, together with the undertaking's strong financial resources and advanced technology, placed the undertaking in a dominant market position.

In addition, SAMR generally found that the undertaking held a dominant position in the domestic digital retail platform services market because other operators were highly dependent on the undertaking in their business transactions due to the network effect and the lock-in effect features of the platform economy, while it also recognized the high barriers to entry and the undertaking's significant advantages in related areas such as logistics, payment services, cloud computing, etc.

Abusive conduct

In terms of the abusive conduct, SAMR found that, since 2015, the undertaking abused its dominant position in the domestic digital retail platform services market by engaging in "choosing one of two"—prohibiting operators on its platforms from operating and participating in promotional activities on other competitive platforms, thereby restricting operators to conduct transactions only with itself, and ensuring this with a combination of punitive and remunerative measures—and determined such acts were in violation of the Anti-Monopoly Law, which prohibits dominant undertakings from "requiring their counterparties to deal exclusively with themselves without justifiable reasons" (Art. 17, para. 1, subpara. 4).

Specifically, according to the penalty decision of SAMR, the undertaking primarily engaged in "choosing one of two" by prohibiting operators on its platforms, verbally or in written agreements, from operating on other competitive platforms, and prohibiting such operators from engaging in promotional activities on those platforms.

At the same time, the digital undertaking adopted a combination of remunerative and punitive measures to ensure the implementation of its "choosing one of two" policy. On the one hand, the undertaking supported compliant operators with internet traffic while, on the other hand, monitoring whether operators operated or participated in promotional activities on other competitive platforms by using manual and technological inspections. Upon finding non-compliance, the undertaking punished operators on its

platforms by using its market power, platform rules, and data and algorithms. These punishments included reducing resources and support for promotional activities, disqualifying the operator's participation in promotional activities, lowering the operator's search rankings, canceling other major rights and interests, etc. Through combining these measures, the undertaking effectively imposed "choosing one of two" requirements on operators on its platforms.

Effect of eliminating or restricting competition

SAMR found that the digital undertaking established a lock-in effect by prohibiting distributors on its platforms from operating or participating in promotional activities on other competitive platforms. This eliminated and restricted competition in the domestic digital retail platform services market, first by eliminating and restricting competition and potential competition from other competitive platforms and second by harming the interests of the operators on its platforms, hindering the optimization of allocation of recourses, limiting innovation in the platform economy, and ultimately harming the interests of consumers.

Message for digital undertakings

Overall, since the end of 2020, anti-monopoly enforcement in the digital economy has gained increased attention. SAMR issued on November 10, 2020 the *Antitrust Guidelines for the Platform Economy (Draft for Comments)*, of which the Anti-Monopoly Committee of the State Council promulgated the formal version on February 7, 2021. On December 11, 2020, the CPC Central Committee Politburo specifically requested in its assembly to "strengthen anti-monopoly and prevent the unregulated expansion of capital". During the 2021 Lianghui, the Government Work Report again emphasized that it is necessary to "step up efforts against business monopolies and guard against unregulated expansion of capital, and ensure fair market competition." Likewise, an amendment to the Anti-Monopoly Law and "enforcement of anti-monopoly" are respectively highlighted in the reports of the NPC Standing Committee and the Supreme People's Court. The People's Bank of China, the Ministry of Transport, the Civil Aviation Administration of China, and other industry regulators have also specifically proposed to strengthen anti-monopoly work in their respective industries, which will all involve the supervision of digital operations.

It is apparent that anti-monopoly has become a highly contentious legal field across the broader society, and the legislative, executive, and judicial branches are observing with great attention. It is generally accepted that the investigation of this digital undertaking is the beginning—not the end—of anti-monopoly enforcement in the digital economy.

Under these circumstances, undertakings in the digital economy should actively take relevant measures to strengthen internal anti-monopoly compliance, and establish a top-down risk management system for anticompetitive behaviors, so as to minimize risks associated with non-compliance. Achieving an edge in compliance will enable digital undertakings to gain a head start in an ever-changing competitive environment.

It is worth noting that, in this case, in addition to the administrative penalty decision, SAMR also issued for the first time an administrative guidance letter, guiding the digital undertaking to: (1) conduct a

comprehensive internal review in accordance with the Anti-Monopoly Law and inspect and regulate its own business practices; (2) notify concentrations of undertakings once they meet the notification thresholds outlined in the *Provisions of the State Council on Notification Thresholds for Concentrations of Undertakings*, and not to implement concentrations of undertakings that have or may have the effect of eliminating or restricting competition; (3) not use technology, platform rules, data and algorithms, etc. to implement anti-competitive agreements and abuse its market dominance and eliminate or restrict market competition.

The administrative guidance letter also sets out detailed and comprehensive requirements and advice for the digital undertaking, requiring it to take on the responsibility as a leading platform enterprise (including fair and just use of data; data protection in accordance with law; adoption of fair, reasonable and nondiscriminatory principles in cooperating with operators on its platforms), to complete the internal compliance control systems (including to specify requirements and processes for anti-monopoly regulatory compliance management, to improve internal compliance mechanisms such as adopting compliance consultations, compliance inspections, compliance reporting, compliance examinations, and regularly running compliance trainings for senior officers and employees), and actively maintain fair competition to promote innovation and development. Other digital undertakings could refer to these guiding principles, especially those with dominant positions in specific industries.

Important Announcement

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If you have any questions regarding this publication, please contact:

Beijing	**Wenyu JIN**	**Attorney-at-law**
	Tel:	+86 10 8525 5557
	Email:	wenyu.jin@hankunlaw.com
Shanghai	**Yinshi CAO**	**Attorney-at-law**
	Tel:	+86 21 6080 0980
	Email:	yinshi.cao@hankunlaw.com
Shenzhen	**Jason WANG**	**Attorney-at-law**
	Tel:	+86 755 3680 6518
	Email:	jason.wang@hankunlaw.com
Hong Kong	**Dafei CHEN**	**Attorney-at-law**
	Tel:	+852 2820 5616
	Email:	dafei.chen@hankunlaw.com