EFAMA response to the FATF Public consultation on the Draft Risk-Based Approach Guidance For the Securities Sector

I. GENERAL REMARKS

The European Fund and Asset Management Association[1], EFAMA, welcomes the FATF initiative to publicly consult stakeholders on the implementation of the Risk-Based Approach (hereafter RBA) and in particular the objective to provide a Guidance specific for the securities sector. EFAMA is closely monitoring the recent regulatory developments at the EU and the international level in the field of anti-money laundering and counter-terrorist financing, in particular as to the due diligence duties of the asset management sector. The objective of the effective and consistent application of the RBA across different jurisdictions is fully embraced by the EFAMA members. At the same time it is essential that the right means and the appropriate channels are used in order to meet this objective.

In this regard, EFAMA considers it important and helpful that the FATF consultation document is acknowledging the important role that the different distribution and business models play for the identification of the end-investor and the application of the RBA. In particular in the case of investment funds it is welcome that the different distribution models and types of business relationship with the investors and financial intermediaries are taken into account and there is an effort to further clarify their impact on the fulfillment of the due diligence of the asset manager in respect to the AML requirements. In this respect, the statement that the undertakings of collective investments don't always have access to the information related to the identity of the investor due to the different distribution and acquisition models is indeed representing the current regulatory and business landscape for investment funds. In many jurisdictions it is often the case that investment funds do not have a direct relationship with the end-investors, as the final investor acquires the shares or units of a fund from a distributor, usually a credit institution that maintains also the custody account and needs to comply with all requirements under money laundering law vis-à-vis the end investor. Therefore, it is unnecessary in those cases to perform double-checks.

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

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We consider, however, that there is room for further clarity and precision as to the role each player in the distribution channel has to assume, as well as for further inclusion of sector-specific recommendations to regulate the money laundering requirements for asset managers in an appropriate manner. We acknowledge the effort for a consistent application of the RBA via this initiative, and would support further initiatives to mitigate the current disparities at the level of national regulation, which not only have a negative impact on the competitiveness of the European asset management industry, but also increase the market risks at the global level.

In our response we aim at giving a comprehensive presentation of the situation in the industry and the practical implications of some of the FATF proposed guidelines and we provide comments and suggestions that would increase clarity and regulatory consistency. We hope this can be useful input for FATF in order to ensure a harmonized set of practices at the international level, which could then serve as a reference for future regional and national legislation in that area.

II. EFAMA COMMENTS ON THE CONSULTATION PAPER

In order to make our comments more targeted and explicit, we have listed them below as per the number of the chapter and the paragraph they are referring to. For changes and additions proposed to the text, these are indicated by strikethrough or bold-italics.

Chapter 1.4.1 Terminology

Given that the Consultation Paper acknowledges the diverse business and distribution models in the securities sector and their relation as regards the application of RBA (see para 20 a.o), we would suggest to include in the section of terminology a definition of "investor" and "customer", as well as one for the "formal agreement" on the basis of which a contractual relationship is formed. This would be in particular important in those cases where the investor is not a direct customer of the securities provider – for instance the investor is the customer of the intermediary with whom the provider has the contractual relationship – and would enable further clarification of the scope of the requirements and the burden of application.

For the same reason, the following definitions are necessary: "financial intermediary", "third party on which a security provider relies for the AML/CFT requirements", "outsourcing"[2].

Chapter 1.4.2 Key Characteristics of the Securities Sector

EFAMA would suggest to include in the key characteristics to be taken into account for the RBA the securities business in which the sector in question is invested, e.g. real estate, alternative investment funds etc.

[2] The Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions published on 26 June 2017 by the Joint Committee of the European Supervisory Authorities can be used as a reference.
https://www.eba.europa.eu/documents/10180/1890686/Final+Guidelines+on+Risk+Factors+%28JC+2017+37%29.pdf

Chapter 1.4.3 Securities Providers (services and activities)

In para 20 where the different business relationship to investors as regards investment funds are referenced, we consider the following clarification is necessary:

"(…)Depending on how the investment fund is sold***,*** ~~and~~ with whom the business relationship is established~~,~~ ***and who is the registered owner of the shares/units,*** the investment fund may be required to treat an investor as its customer or may be required to treat an intermediary as its customer."

We consider this clarification is necessary given that in the current wording it is unclear how the asset manager is to define with whom the business relationship is established. We would agree with some flexibility as to this identification given the diverse types of contractual agreements, however the absence of concrete criteria could lead to legal uncertainty and risk of a national authority determining a certain approach of the asset manager as non-compliant with the AML/KYC rules, whereas another authority considering the opposite. For this reason, one of the main criteria when identifying who is the customer should be the registered owner of the shares/units (as already foreseen in para 219 of ESAs Joint Guidelines[3]).

It should, however, be ensured that sufficient flexibility is maintained for adapting in different cases. In particular, it needs to be taken into consideration that a register of investment funds' shares and units is not maintained in all countries and the shares may be securitized in a global certificate held in custody at a securities depository. In such cases the custodians are obliged to apply the provisions of the AML regulation to the investors. In those cases, we would then propose to add the following text: ***"In implementing the recommendations of the FATF Guidance on Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion and the FATCA Agreements, it should also be taken into consideration that investment funds may no longer issue individual share certificates as there is a requirement to securitize all units in a global certificate, which doesn't foresee any right for individual investors to acquire issuance of individual share certificates. In those cases, given that all issued shares/units of mutual funds are held in safe custody by a security provider, that needs to apply the RBA, the additional application by the manager of the fund is not feasible neither necessary."***

Moreover, we would propose to include the following text in Diagram I (Illustration of way in which shares/units in UCI shares/units are distributed) in order to include discretionary mandates:

"Place order to buy or sell shares/units on behalf of underlying customers ***or for the benefit of underlying customers".***

Finally, in paragraph 27 and the reference made to the clearing firms not having a direct relationship with the underlying customers in some jurisdictions, a further clarification needs to be made. It shouldn't be a priori considered that a clearing member is not to perform appropriate due diligence. This will depend on the type of business relationship with the underlying customer, i.e. if the clearing member is the one appearing in the fund's register, the participants to the platforms are the customers of the clearing firm and the later the customer of the investment fund, whereas if the underlying customers of the clearing firm are the ones appearing in the fund's register, then they are the customers of the fund and not the clearing firm. However, our previous reference to the absence of register in some jurisdictions should be also taken into consideration.

[3] See footnote 2

Chapter 5.1 Allocating Responsibility under an RBA

In para 48, securities providers are requested to consider national risk assessment among others when identifying and assessing their own ML/TF risk. It should, however, be kept in mind that an important number of securities providers operate on a cross-border basis, which would render the factor of the risk posed to a certain jurisdiction not sufficient. Assessing the risks stemming from the framework of several jurisdictions in which they are active, is equally important.

Chapter 5.1.1 Identifying ML/TF risk

While EFAMA fully shares the goal of enabling greater information sharing between competent authorities, financial institutions and other interested parties, the GDPR and other data protection related restrictions should be also referenced here and fully taken into consideration. Moreover, in the regional EU level, it will be of particular importance to ensure such intelligence-sharing post-Brexit.

Chapter 5.1.2 Assessing ML/TF risk

Concerning the duty to assess risks and ensure the appropriate and skilled resources are in place for that, the proportionality principle should be respected. As the size of the securities sector varies massively, these requirements should be proportionate to the size of the obliged entity, as well as to the size of the business of each sector.

Chapter 6 Risk assessment

In paragraph 59, the categorization of risks includes “inherent and residual risks based on established controls”. This risk assessment seems to cover both the mapping of AML/CFT risks - which as part of the general risk mapping includes inherent and residual risk after mitigation measures - and the vetting process of each client leading to risk based due diligence. It would be better to further specify which types of risks are covered in this risk assessment process.

In paragraph 61 one of the factors which a securities provider should consider when identifying and assessing indicators of ML/TF risk, are the distribution channels through which the securities provider distributes its products. Given the diversity of existing distribution models and the different risks associated to them, EFAMA would appreciate further specifications on that point. This can be set out by a set of attributes, so that securities providers can build an assessment model depending on the attributes in place each time. In addition, as a securities provider may operate a number of different distribution models in different parts of its business, the framework built should allow a general risk assessment and not different assessment for each model.

Moreover, as regards the intermediary risk mentioned in para 63, it should be further specified based on the type of intermediary:

- Distributors
- Sub-distributors and layers of sub-distribution
- Omnibus accounts
- Independent Financial Advisers
- Investment Advisers
- Transfer agents
- Agents originating deals

Chapter 6.1 Country/ Geographical Risk

As mentioned above, the proportionality principle needs to be respected. As the size of the securities sector varies massively, the requirement for assessing the risk linked to a jurisdiction needs to be proportionate to the size of the business conducted in each jurisdiction.

Moreover, as regards the credible sources a clear definition and designation by FATF would be pivotal for the use of this risk factor.

Chapter 6.2 Customer/Investor Risk

The reference to "negative news report" as a category of customers that may indicate a higher risk is far too wide and imprecise. Thus, we recommend to delete it.

Chapter 6.3 Product/Service/Transactions Risk

It should be stressed that the items under product risk may also fall under the scope of fund risk, as even though securities providers may not necessarily trade products ad instruments such as bearer shares, still they would indicate risks, if such products and instruments are found with a beneficial ownership structure.

Chapter 6.4 Distribution Channel Risk

As mentioned above (para 61), EFAMA would appreciate further specifications on the distribution channel risk, given the diversity of existing distribution models and the different risks associated to them. This can be set out by attribute, so that securities providers can build an assessment model depending on the attributes in place each time. In addition, as a securities provider may operate a number of different distribution models in different parts of its business, the framework built should allow a general risk assessment and not different assessment for each model.

Chapter 7.1 Customer/ investor Due Diligence and Securities and Related Money Transactions

As already mentioned in our remarks on the terminology, it is crucial to further define what is meant as "investor" and as "customer" and who is to be covered in the scope of the "business relation".

Moreover, we would suggest to add the case of insurance companies holding in their insurance products shares of portfolios managed by third parties service providers.

Chapter 7.1.1 Initial and Ongoing CDD

In paragraph 82 it is important to make a clarification as to the "customer" in a way that the CDD measures should apply for the entities registered in the subscription list.

Chapter 7.1.2 Ongoing due diligence

Concerning the "beneficial ownership" it should be clarified that in the cases of simplified due diligence the requirement to maintain updated information isn't always feasible or necessary, e.g. in the case of a listed entity or an AML supervised entity.

Chapter 7.1.3 The Securities' Provider's Customer

The requirement foreseen in paragraph 86 for the securities provider to obtain information about the intermediary's risk assessment of its underlying customer base will in practice be too difficult to be fulfilled, unless this is a regulatory requirement imposed to intermediaries.
It is important to specify that currently no intermediary provides a third party with its risk assessment on its underlying customer base, except when this is foreseen under specific agreements regarding AML/KYC due diligences. Thus, the FATF Guidelines can offer the following options:

- This requirement is applicable to both service providers and intermediaries, via the following addition to the text: ***"The intermediary should accept such request, under conditions set out in a business agreement with the securities provider. The intermediary acting on behalf of underlying investors will enter in a written agreement with the securities provider that will state:***
- ***the respective AML/CFT responsibility of each party;***
- ***that the intermediary will provide the securities provider with any data/information on CDD and on- going monitoring on first demand;***
- ***the completion of a standard questionnaire."***

- This requirement is only an option for service providers, via the following addition: ***"This requirement is to be fulfilled on an optional basis and it may be adapted to particular conditions (e.g. additional on-site control or other more thorough checks when an intermediary is a non-regulated entity or is located in a country presenting AML/CFT risks). As an alternative, the service provider should ensure – via a standardized questionnaire for example - that the intermediary has put in place an appropriate AML framework."***

We would also suggest that the FATF creates non-binding contract clause templates and a standard questionnaire (such as Wolfsberg questionnaire for the banking sector). Such a template/questionnaire should become a standard in order to avoid bilateral diversified negotiations and difficulties in obtaining information in cross-border business relationships.

In relation to para 87, as already mentioned in the case of the underlying customer of the intermediary, a distinction should be drawn on the basis of whether the intermediary is the registered owner of units or shares of an investment fund or whether the registered entity is the underlying customer of the intermediary. In the latter case, it should be possible for the provider to request such information– although in practice it may be difficult to obtain them among others due to data protection issues. However, if the intermediary is the customer of the securities provider, requesting and obtaining information on the intermediaries' customers won't be feasible. In such cases, the provider may only assess to an extent whether the AML controls are performed by the intermediary.

Chapter 7.1.4 CDD considerations

In relation to the controls foreseen in para 88, please see our previous comments in para 87.

EFAMA would also like to stress the complexity of the customer base, as many of the services in the securities sector are bespoke. We would also question the need for KYC measures in the case of low value retail investors.

Chapter 7.1.5 Enhanced CDD (EDD) &Simplified CDD (SDD)

In addition to the exemptions from the CDD and cases of SDD mentioned, we would also propose to include customers or intermediaries acting on their behalf that are AML supervised entities or regulated entities in a jurisdiction of low AML/CFT risks.

Moreover, in Box 1 where a list of examples is mentioned, we would propose to distinguish the examples between those referring to customers investing on their own account and those referring to intermediaries acting on another customer's behalf or at least mention that the table only partially applies for intermediaries.

Chapter 7.1.6 Relationship similar to Corresponding Banking Relationship in case of Intermediaries

We would suggest further clarifications on the notion of the "corresponding relationship" in order to further distinguish it from the relationship to an intermediary. Given that the draft Guidelines contain different requirements for intermediaries and corresponding entities (enhanced measures are required when dealing within corresponding relationship including requiring senior management approval), we consider that the definitions of each needs to be well differentiated, which for the time being is not the case. For instance, one criteria for the definition of the corresponding relationship can be the purpose of transferring funds to jurisdictions, in which the securities provider or its payment service provider doesn't have direct access. We also suggest that ***the correspondent isn't required to conduct on-going monitoring of transactions, sanctions screening nor assessment of AML/CFT controls of the respondent.***

Chapter 7.1.7 Reliance on Intermediaries

In this chapter, it would be good to underline that the foreseen requirements apply only for intermediaries acting on behalf of their clients and not on their own behalf. It would be therefore good to include the following categories of intermediaries:

i) third parties (custodian, registrar, transfer agents), who are entitled to perform CDD and on-going-due diligence, regarding transactions and sanctions lists screening as part of the service they provide ;
ii) intermediaries acting through segregated accounts who should perform CDD on their clients;
iii) intermediaries acting through omnibus accounts who should perform CDD on their clients and should be formally made responsible for on-going monitoring of their transactions as well as sanctions screening because service provider have no view on it.

It is also important to note that including periodic review in the intermediary relationships, where the review and update of the existing information forms a part, is a common practice in the investment funds industry. Therefore, although what is suggested in para 100 on intermediaries not being able to be relied upon to perform ongoing due diligence is commonly confirmed in regulations, it is inefficient. This needs to be further clarified. Also, as regards the requirement for the securities provider to obtain immediately the necessary information relevant to the CDD measures, we suggest to modify the text in order to ensure that the information can be obtained upon request and without delay, as in any case such request will be necessary:

"The securities provider should immediately obtain ***upon request*** the necessary information concerning elements (a)-(c) of the CDD measures set out in R.10 (...)".

Chapter 7.2.1 Risk Based monitoring

Para 113 requests transactions monitoring to be conducting on a continuous basis, taking into account also market events. In the case of asset management companies such transactions monitoring would rely on registrars, custodians and clearing firms. In this context, market events are not an appropriate criteria to be put in relation with subscription and redemption in the funds (it is used as criteria of control in market abuse monitoring as this is generally done via the use of data related to active management of portfolio). Trade volumes are thus not a measure of customer activity -such monitoring would require data from investors to which asset managers have no access. It would then be better to clarify in the case of asset managers what type of transactions are to be further monitored.

Chapter 8.1 Internal Controls and Governance

In paragraph 123, we suggest to further specify that even if the profiles of the intermediaries are taken into account in the risk assessment processes of the securities providers, it must be reminded that the provider must maintain only a supervisory role on the intermediaries.

Also, in para 126 and the requirement to ensure that escalation processes are in place for important decisions that directly affect the ability of the securities provider to address and control risks, the frequency of the provision of the information to the senior management is not precise neither the person in charge of providing this input. It may be sufficient to foresee an annual review of the risk assessment.

Finally, in paragraph 127, we would suggest adding that in the case of a company that is subsidiary or branch of a group, the requirement for the skilled compliance officer can be fulfilled at senior management level globally.

Chapter 8.2 Compliance Controls

It should be clarified that the securities provider is not in charge of performing the training of intermediaries, but must perform an overview of the training performed by the intermediaries.

Chapter 8.4 Training and Awareness

The following additions are suggested in para 135:

"135. The effective application of AML/CFT policies and procedures depends on the understanding of securities providers' staff on the relevant requirements and accompanying processes they are required to follow and the risks these processes are designed to mitigate. This training is designed to mitigate potential ML/TF risks occurring by, at or through a securities provider. It is therefore important that staff receive AML/CFT training, which should be:

- Relevant to the securities provider's ML/TF risks and business activities and up to date with the latest legal and regulatory obligations and internal controls;

- Obligatory for all appropriate staff***, including senior management;***
- Tailored, where applicable, to particular lines of business within the securities provider, equipping staff with a sound understanding of specialised ML/TF risks they are likely to face and their obligations in relation to those risks; this may be particularly important with regard to staff responsible for identifying fraud and market abuse, which may be reportable as a suspicious transaction;

- Effective, as measured, for example, by requiring staff to pass tests as part of the training or by monitoring levels of compliance with the securities provider's AML/CFT controls and applying appropriate measures where staff are unable to demonstrate the level of knowledge expected;
- Regular, relevant, and not a one-off exercise when staff are hired, in line with INR. 18, and;
- Complemented by AML/CFT information and updates that are disseminated to relevant staff, as appropriate.

136. Overall, the AML/CFT training should also seek to build a culture in which compliance is embedded in the activities and decisions by its staff. ***Training may be performed in the service provider entity by an external company, but in this case the service providers remains responsible for the quality of the training."***

ANNEX A. EXAMPLES OF OUNTRIES' SUPERVISORY PRACTICES FOR THE IMPLEMENTATION OF THE RISK-BASED APPROACH TO THE SECURITIES SECTOR

In relation to the example of Central Bank of Ireland's AML/CFT Supervision of the Funds Sector, in particular the statements that the fund must appoint an Irish FSP to administer the fund and that the FSP is essentially the gate-keeper to the fund as it is the point of contact in the customer relationship between the investor and the fund and it is the FSP that provides the AML/CFT capability to the fund to discharge its AML/CFT obligations, we have the following observations:

This summation understates the core role and responsibilities of the fund in this jurisdiction. The fund will always retain responsibility for its AML/CFT compliance with the FSP providing a service to assist them in doing so. It is incorrect to liken this to a gate-keeper role. The FSP does not have a direct contractual relationship with the investor, unlike that of the fund. By way of an example the fund may have executed distributor agreements with distributor/intermediaries and perform due diligence on that relationship themselves. Additionally the FSP does not have a sales and marketing role and consequently does not have a direct relationship with the investor, the nature of which is strictly at arm's length. The FSP will contract to provide certain AML/CFT services to the fund, this does not absolve the fund from its own obligations.

It is important that the guidance accurately reflects the multiple roles and responsibilities and the AML/CFT obligations are generally met via the FSP and the fund processes combined and not just via those of the FSP, particularly given overall responsibility for compliance is always that of the fund and any delegation to assist the fund in meetings its obligations is contractual in nature.

ANNEX B. SUSPICIOUS ACTIVITY INDICATORS IN RELATION TO SECURITIES

We would like to propose this additional indicator: ***Frequent change of bank account details for redemption proceeds in particular when directly followed by redemption requests.***

Also, please see below our comments to a number of indicators suggested in this Annex.

- I.1 A securities provider is often not aware and thus cannot assess the economic rationale of a customer's transaction.
- I.4 Same comment as above regarding the economic rationale.
- I.5 This would apply in the case the customer is not an intermediary or a respondent.
- I. 11 On the information regarding the customer's investment profile the securities provider can request for a confirmation of fulfillment of this requirement by the intermediary.
- I.13 This is an indicator only when a customer is not acting as an intermediary.

- II.1 Volume of transactions may not be a useful indicator, in particular in the case of intermediaries with a corresponding relationship
- II.2 This indicator would apply only for third party relationship or corresponding relationship where the accounts are opened into segregated accounts
- III.1 Even if insider trading or market abuse can be considered as linked to AML/CFT risks, it is hard to see a case in the investment fund industry where a similar control on the customers' side may be effective
- III. 3 We don't consider this as an effective indicator
- III.6 This indicator needs to be further clarified.
- IV. 8 Knowledge of this indicator is merely not feasible.
- IV. 18 This indicator applies for customers that don't act on behalf of others, i.e. that aren't intermediaries
- VI. 8 This indicator needs further clarification
- VI. 11 Investment fund transactions to be excluded from the application of this indicator, given that in many cases the investments and related transactions are of a longer term
- VI. 16 This indicator applies for customers that don't act on behalf of others, i.e. that aren't intermediaries
- VI. 18 This indicator applies for customers that don't act on behalf of others, i.e. that aren't intermediaries

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