

20: Brokerage services to funds

Note: This sectoral guidance is incomplete on its own. It must be read in conjunction with the main guidance set out in Part I of the Guidance.

This sectoral guidance is intended for firms such as prime brokers, executing brokers and clearing brokers providing brokerage services to funds, which may be regulated or unregulated and based in jurisdictions which may or may not be assessed as low risk (“funds”), and to firms providing such services to investment managers in relation to their underlying fund clients. The guidance considers specific issues over and above the more general guidance set out in Part I, Chapters 4, 5, and 7, which such firms will need to take into account when considering applying a risk-based approach.

A firm’s business activities with such funds may also fall within the scope of other sectoral guidance, for example, sector 16: *Correspondent relationships*, sector 18: *Wholesale markets*, sector 8: *Non-life providers of investment fund products* and sector 9: *Discretionary and advisory investment management (c.f. paragraphs 9.22 to 9.24)*. As such, this sectoral guidance should be read together with other applicable parts of the guidance.

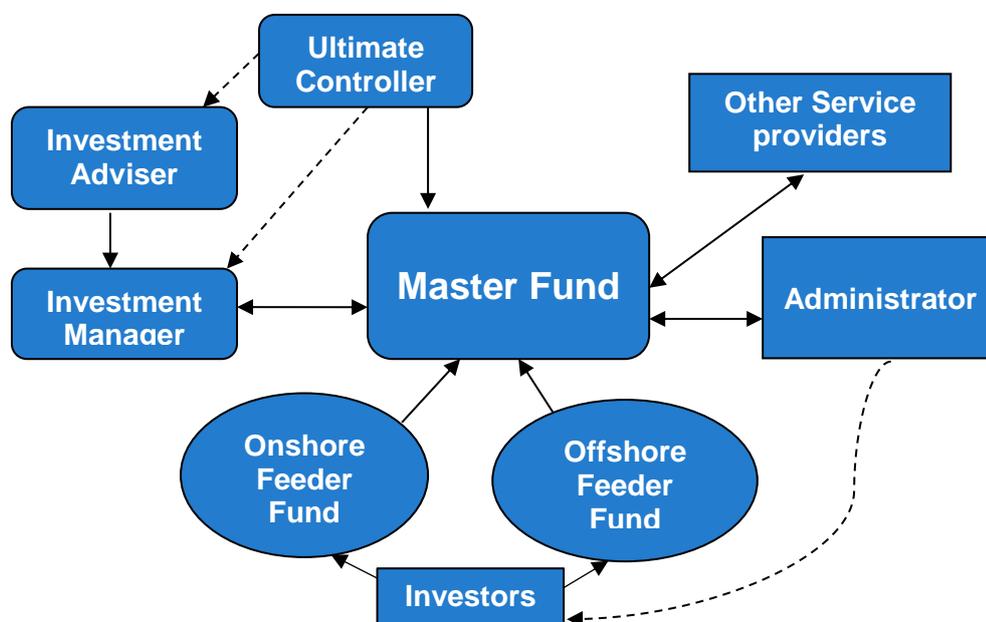
Overview of the sector

- 20.1 A fund is a vehicle established to hold and manage investments and assets. A fund usually has a stated purpose and/or set of investment objectives. Funds may be regulated or unregulated, listed or unlisted, open or closed-ended, and targeted at retail, institutional or other investors. The provision of brokerage services to funds may therefore pose a wide spectrum of money laundering risk, from low to high, as discussed at paragraphs 20.8 to 20.21 below. It is important to draw a distinction between funds that are personal investment vehicles (which may be set up and/or managed by private wealth managers) and those set up for a commercial purpose with, usually, unrelated investors (e.g. hedge funds) although, as both types of fund can use the same structures, the line between the two may sometimes be hard to distinguish.
- 20.2 Funds will normally be separate legal entities, formed as limited companies, limited partnerships or trusts (or the equivalent in civil law jurisdictions), so that the assets and liabilities may be restricted to the fund itself. Sub-funds of an umbrella fund typically take the form of different classes of shares, fund allocations to separately incorporated trading vehicles or legally ring-fenced portfolios. Sub-funds may or may not be separate legal entities from their umbrella fund. The investors in the funds are the beneficial owners of the fund and its source of funds.
- 20.3 Funds may also operate a “master/feeder” arrangement, whereby investors, typically from different tax jurisdictions, invest via separate feeder funds that hold shares only in the master fund. The most common set up is to have an onshore feeder for taxable investors and an offshore feeder for foreign or tax-exempt investors. Feeder funds may also on occasion invest/deal directly and therefore a firm may provide services to a fund that is acting on its own behalf while at the same time being a feeder fund of another (master) fund.
- 20.4 Dependent upon a fund's structure and legal form, the power to make decisions and provide instructions on behalf of a fund may rest with its directors, partners or trustees. However, in most instances the powers of the directors, partners or trustees will be delegated to the investment manager. It is not unusual to find that the key personnel of a fund are also the key personnel of the investment manager.

- 20.5 The complexity of the structures and multiple relationships associated with funds can often give rise to uncertainty. It is, therefore, critical that a firm establishes who it is dealing with, establishes whether that party is acting on its own behalf or on behalf of an underlying client, and generally understands which parties may present a money laundering risk in the relationship. Once these questions are answered, the precise steps to identify and verify the relevant parties will vary in each case.
- 20.6 The following diagram illustrates some of the key players in a fund, specifically a master feeder fund structure.

The fund's prospectus, offering memorandum or other documents will set out details of the fund structure, appointed service providers - the investment manager, administrator, prime broker, lawyers and auditors - together with a summary of the material contracts such as the administration, investment management and prime brokerage agreements.

Note that the precise structure in each case will vary and some of the responsibilities of each function outlined below may sometimes be amalgamated.



Note: both the Administrator and Investment Manager will usually act for the underlying feeder funds.

➤ **Ultimate Controllers**

Funds may or may not have an "ultimate controller".

In terms of day to day control, as explained above, the power to make decisions and provide instructions on behalf of a fund may rest with its directors, partners or trustees; and in most instances will be delegated to the investment manager (see below) who will make investment decisions in respect of the assets of the fund and place orders with the firm on behalf of the fund.

The investors in the fund (who are the ultimate beneficial owners of the assets within the fund) will not usually have control over the fund or its decision-making.

However, in some cases, there may be one or more individuals who ultimately exercise control over the fund or its management (for example, having the right to replace its

management or to direct the sale or purchase of assets). In personal investment vehicles in particular there may be voting shareholders, directors or holders of founding shares with such powers. The place to look for those who are the ultimate controllers is usually the fund's offering memorandum (although the documents provided at the account opening stage may not be final – see 20.51 below), but in other instances refer to 20.38ff. Firms should, where appropriate, also consider relevant legal agreements and ask who has control: any ambiguity suggests further due diligence is necessary.

➤ **Investment Manager**

Funds are managed by an investment manager, which is a separate legal entity to the fund, and which is typically given authority to act as agent and manage the funds and investments held by the fund vehicle. It is often the investment manager that will make investment decisions and place transactions with a firm on behalf of the fund.

The investment manager plays a pivotal role within a fund structure, as it establishes and maintains the relationships with the prime broker and the clearing and executing brokers and will, in most cases, be the direct contact with a firm on behalf of the fund. A firm may also act as investment manager to a fund in addition to providing other services (see Sector 9: *Discretionary and advisory investment management*).

The firm may review the investment management agreement to understand the scope of the manager's authority/control.

Investment managers will usually be regulated but, depending upon the jurisdiction they are registered in or operate from, they may be subject to varying degrees of regulatory oversight. Firms should, therefore, satisfy themselves of the regulatory status and responsibilities of investment managers, in particular with respect to AML/CTF and compliance with applicable international sanctions regimes.

This sectoral guidance uses the term "Appropriately Regulated Investment Manager" to refer to investment managers assessed as presenting a low money laundering risk, for example taking account of whether they are based within the UK or the EU and subject to local law implementing the EU Fourth Money Laundering Directive (**4MLD**) (and supervised for compliance), in non-EU jurisdictions and subject to requirements in relation to CDD and record keeping which are equivalent to those laid down in 4MLD (and supervised for compliance), or in assessed low risk jurisdictions and applying equivalent CDD and record keeping requirements.

The relationship the investment manager has with investment advisers, with the directors (or equivalent) of the fund, and with the ultimate controllers of the fund (if any), will vary depending upon the degree of control the investment manager has over the:

- a) selection of investors (including compliance functions e.g. CDD or related checks);
- b) investment strategy of the fund; and
- c) placement of orders.

A fund may have more than one investment manager, known as sub-managers. Sub-managers are responsible for managing/investing part of the fund, and, depending on the structure of the fund, there may be more than one sub-manager. Where investment management making decisions are delegated to sub-manager(s), depending on the nature of the firm's interactions with the sub-manager (see 20.24) CDD measures may be required to be performed on the sub-manager as well as the investment manager (subject to the possibility of relying on the investment manager, in appropriate cases, as explained more fully at 20.57-20.59 below (*Reliance on third parties*)).

➤ **Investment Adviser**

Some funds appoint separate investment advisers who will advise the investment manager with regard to investment decisions undertaken in relation to specific financial instruments or markets, and on occasion, depending on the delegated duties, may place orders with a firm. Depending on the nature of the firm's interactions with the investment advisor (in particular, if they have authority to place orders on behalf of the fund), CDD measures may be required on the investment adviser.

➤ **Administrator**

Administrative services such as the day to day operation of the fund (e.g. valuations) and routine tasks associated with managing investments on behalf of investors (e.g. managing subscriptions and redemptions) will ordinarily be undertaken by a separate entity known as the fund administrator. Fund administrators may also perform the role of transfer agent and registrar. An administrator may also be responsible for identifying and verifying the investors for AML purposes.

Fund administrators are often regulated / licensed but their responsibilities may vary (e.g. depending on the domicile of the fund). The responsibilities of the administrator are normally outlined in the offering memorandum/prospectus.

The regulatory status and responsibilities of the administrator, in particular with respect to AML compliance, may be relevant to the firm's assessment of money laundering risk. In some cases, however, the investment manager may be responsible for appointment of the administrator and may retain responsibility for compliance with AML laws and regulations, being required to provide oversight of the outsourcing arrangement with the Administrator to ensure that the Investment Manager's regulatory standards are applied. In such cases, the regulatory status of the investment manager and oversight arrangements may be more relevant to AML risk than the regulatory status of the administrator.

➤ **Distributors**

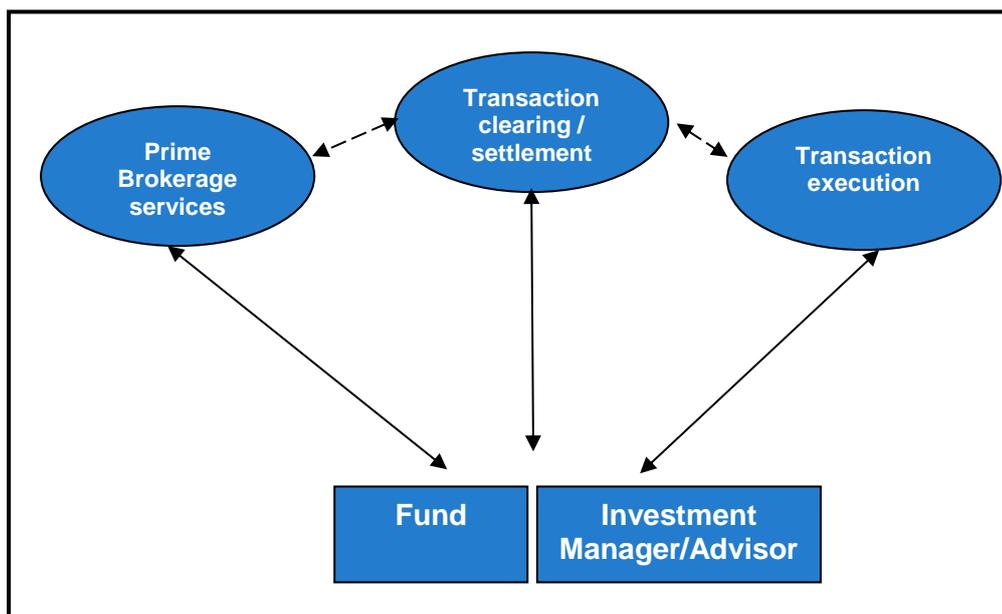
Some funds (and their managers on their behalf) may use third party distributors to distribute, sell and/or market their shares/units, particularly where the fund is marketed to retail investors. In some cases the fund may have a customer relationship with the distributor, rather than the underlying investor (who is the customer of the distributor) or may rely on the CDD undertaken by the distributor.

From the perspective of firms providing brokerage services to the fund, understanding the nature of its distribution arrangements may be relevant in understanding its AML risk profile – for example, understanding the geographies of its operations or the type of distributors to which the fund is marketed may provide relevant information about the investor base.

➤ **Other Relationships**

In addition to the above-mentioned entities, who are involved with the operation and management of the fund, other parties may also be involved, such as auditors, law firms, trustees, and custodians. Diligence on these parties may not be necessary for a firm to meet its AML/CTF and sanctions-related obligations, but understanding their roles and identities may give a more complete picture of the fund set-up.

20.7 The following diagram sets out the likely services a firm may provide to a fund (although, as discussed above, the firm could deal with the fund via a number of entities).



➤ **Transaction Execution**

Transactions or trading are undertaken for a fund by a firm commonly known as an executing broker. A fund may elect to execute transactions through one or more firms. The executing broker takes instructions from the fund or its appointed agent (usually the investment manager), but passes the transactions/trades to a clearing broker for clearing and settlement.

- An executing broker may give up a transaction to a clearing broker for settlement (see Sector 18: *Wholesale Markets*).
- In transactions that involve delivery vs payment (**DVP**), cash or securities are swapped between the executing broker and settlement/clearing agent or, on occasion, the custodian.

An executing broker should be clear with whom they are interacting (i.e. who gives the orders) and in what capacity, in order to determine who they are facing.

The executing broker typically provides execution-only services to the investment manager and settles with a regulated prime broker(s). The AML risk for the executing broker in these scenarios will be with the fund or its appointed agent (usually the investment manager).

➤ **Clearing/Settlement**

A fund may elect to execute transactions through one or more firms and elect to settle or clear such transactions through another firm known as the clearing broker. The clearing broker will settle the transaction/trades on behalf of the fund, and as such will handle the movement of funds or assets from the fund in settlement of the fund's transactions and liabilities.

➤ **Prime Brokerage Services**

Prime brokerage is the term used to describe the provision of a tailored package of markets products and services to a fund. Services offered by prime brokers include custody,

reporting, securities lending, cash lending and pricing (i.e. valuation services). Some prime brokers provide capital introduction, start-up services, credit intermediation, straight-through processing, futures and options clearing, research, contracts for difference and credit default swaps. Although prime brokers can offer an array of services, it is not uncommon for funds to appoint more than one prime broker as they see fit and for those prime brokers to be involved in transactions together on behalf of the fund. The precise relationship will depend on the products and circumstances

➤ **Multiple function brokers**

A firm may undertake more than one of the prime, clearing and executing broker functions set out above, depending upon the structure set up for the fund by the investment manager.

What are the money laundering risks associated with funds?

- 20.8 It is common, when providing brokerage services to funds in the UK capital markets, for the funds to be managed on a discretionary basis by an Appropriately Regulated Investment Manager. In practice, this means that the party making investment decisions on behalf of the fund is subject to AML/CTF legislation equivalent to that applying in the EU.
- 20.9 However, certain characteristics of funds render them susceptible to money laundering and therefore a potentially attractive vehicle to place, layer and/or integrate criminal funds into the legitimate financial system. A fund may be established in various legal forms (including but not limited to: private companies, partnerships or legal arrangements) and may have a complex beneficial ownership structure. Consequently, a fund may appear to lack transparency of ownership and/or control, which may be attractive to a money launderer wishing to obfuscate identification.
- 20.10 Funds are often established on a global basis, processing cross-border money flows in and out of the fund, generally through subscriptions and redemptions. At times, these cross-border transactions may involve countries assessed to have a weaker AML framework and those associated with heightened secrecy laws, creating barriers for relevant authorities to trace and freeze criminal assets. Furthermore, the volume, size and strategy of a fund's trading activity may be complex, and may therefore potentially be abused by a criminal to layer funds and/or asset ownership with the aim of concealing the illicit origin of such funds/assets.
- 20.11 A fund will typically utilise legitimate professional intermediaries to perform certain services for or on its behalf, to assist with market operations and/or general administration. A money launderer may echo this practice, employing corrupt professional intermediaries, nominees and/or corporate shell companies, with the aim of concealing criminal actor(s) and the origin of illicit gains. Certain vulnerabilities of the financial system associated with reliance on other financial institutions' CDD may also be exploited. It is therefore important for a Broker to understand and fulfil its CDD obligations relating to different parties in the transaction and ensure that adequate procedures are in place to mitigate money laundering risks. Paragraphs 20.12-20.66 provide guidance for firms to address these vulnerabilities.

How to assess the elements of risk

- 20.12 A fund's nature, status, and the degree of independent oversight to which it is subject should inform the firm's assessment of risk.
- 20.13 The risks can be determined through gathering information and undertaking appropriate CDD on the investment manager and, where applicable, the fund (as set out in paragraphs 20.22 to 20.29 below (*Who is a firm's customer for AML purposes?*)), and in particular through understanding to whom the fund is marketed and its structure and objectives, as well as the

regulatory status, track record and reputation/standing of the investment manager and/or other relevant parties in control of the fund.

- 20.14 A firm should also consider, as part of its wider obligations in respect of financial crime and to mitigate reputational risk, whether there are any risk indicators that warrant further investigation. As part of this consideration, firms may wish to include, where relevant, whether the size and reputation of the service providers (administrator, investment manager, auditor, lawyers etc.) match the fund's profile.
- 20.15 Whilst structures associated with funds are often complex and involve a number of jurisdictions, an important question is whether the structure makes sense. For example, does the fund have an unusual cross-border structure? Also, where an administrator is located in a jurisdiction not assessed as low risk, or specific concerns have been identified, closer inspection of the administrator's due diligence activities and background should be considered.
- 20.16 A firm should take a holistic view of the risks associated with a given situation and note that the presence of isolated risk factors does not necessarily move a relationship into a higher or lower risk category (*See Part 1 Chapter 4.24 - 4.82*).
- 20.17 Certain factors may be considered to be indicators that a fund and/or its investment manager may present a higher money laundering risk. The following is a non-exhaustive list of factors which may be considered indicators of higher risk:
- Investment managers, funds, or other relevant parties located in jurisdictions assessed as high risk by the firm;
 - Where there is an increased risk of sanctions exposure, for example funds with investors or investments in sanctioned jurisdictions;
 - A stand-alone, self-managed or managed fund where the investment manager is not an Appropriately Regulated Investment Manager. This may make it more difficult to ensure that the AML requirements applied to investors are of an appropriate standard;
 - Funds whose ownership structure is unduly complex as determined by the firm;
 - Where there is doubt as to the identity of underlying parties. This includes cases where an investment manager is unwilling to disclose a fund's legal name to the firm. This would also include cases where the firm considers it appropriate on a risk-based approach to obtain information about the beneficial owners of the fund, but such information is withheld;
 - Where a beneficial owner or ultimate controller of a fund is disclosed and that person resides in a jurisdiction assessed as high risk by the firm;
 - Where the fund is formed for the benefit of a Politically Exposed Person (**PEP**) or Relative or Close Associate (**RCA**), in particular when assessed by the firm as a higher risk PEP-connected relationship in line with guidance issued by the FCA¹;
 - If, during the course of conducting CDD, the firm uncovers adverse media relating to the fund or the investment manager, this may be an indicator of higher risk. Firms will want to ensure they identify and are comfortable with any potential risks relating to the adverse media, taking mitigating steps to address such risks where appropriate;
 - If the fund takes the form of a privately-controlled entity (including, in particular, a personal investment vehicle, private investment fund or SPV) and there are doubts as to its source(s) of funds and/or a beneficial owner's source of wealth.

¹ <https://www.fca.org.uk/publication/finalised-guidance/fg17-06.pdf>.

- 20.18 In addition to customer and jurisdictional risk factors, firms should consider product risk factors. The product risk will vary depending on the nature of activities carried out on behalf of the client. For example, services where client instructions are passed on, on a principal basis, to regulated institutions or exchanges may be considered lower risk from an AML perspective than services which require settlement of funds and/or financial instruments, or from services which require custody of securities and/or cash assets by the firm.
- 20.19 In particular, where a firm agrees to undertake third party payments on behalf of a fund, the risks of money laundering and fraud are increased. A firm should therefore ensure it has adequate procedures, systems and controls to manage the risk associated with those types of payments and receipts. A firm may wish to consider monitoring and/or undertaking periodic reviews of these types of payments and receipts, as well as ensuring appropriate levels of sign-off within the firm.
- 20.20 Part II Sector 8: *Non-life providers of investment fund products*, sets out factors relevant to the assessment of risk when providing services relating to certain types of open-ended retail and institutional funds. It sets out a number of restrictions and controls that would ordinarily point to a UK retail fund presenting a low risk in terms of use for money laundering purposes; and conversely explains that where the fund has features providing additional flexibility (e.g. permitting third party payments) there may be an increase in the relevant money laundering risk. It also explains that the majority of UK institutional funds (many of which are open only to tax-exempt investors, such as pension schemes and charities) may be considered to be lower risk than their retail counterparts by virtue of the restricted types of investor; but that the risk will increase in the case of "non-exempt" funds or share classes. The Sector 8: *Non-life providers of investment fund products* guidance is not directly applicable to the provision of brokerage services to funds, but firms may wish to have regard to it when assessing the risk posed by these fund types.
- 20.21 Generally, the status and reputation of other third parties associated with a fund (including service providers, such as other executing, clearing or prime brokers, administrators, trust and company service providers, auditors and/or law firms) may contribute to the risk assessment of the fund. The level of comfort and elements of risk will differ depending on the identity of the third party and its role; for example, whether the nature of its relationship would require the third party to undertake CDD measures on the fund.

Who is a firm's customer for AML purposes?

- 20.22 Who a firm should view as its customer, and to whom CDD measures should be applied, may vary according to the business undertaken for a fund, the nature of the firm's relationship with the investment manager,² and whether the investment manager is Appropriately Regulated. It is important to note that the answer to the question 'who is the customer?' may vary for FCA Conduct of Business, credit risk and AML purposes.
- 20.23 As explained more fully in this section (see paragraphs 20.24-20.29 and the summary table following), a firm taking instructions from an investment manager will always be required to undertake CDD on the investment manager. Whether CDD measures must also be applied to the fund will depend on the nature of the firm's interaction with the fund. Where the fund *is* the firm's customer (e.g. where the firm takes instructions from it or holds its assets – see paragraph 20.27), the fund should be subject to CDD. Where the fund is *not* the firm's customer, CDD on the fund is not required. Further enquiries may however be made and additional information sought on the underlying fund depending on the firm's assessment of the AML/CTF risk posed by the investment manager. The regulatory status of the investment manager will be a significant factor in that risk assessment. Therefore, where the investment manager is not

² References to investment manager in this section also refer to investment adviser.

Appropriately Regulated, firms will need to consider whether, on a risk based approach, they should 'look through' and conduct due diligence on the underlying fund. This position is summarised at the table at paragraph 20.29 below.

Context: correspondent relationships

20.24 As explained at paragraph 20.8 above (regarding the assessment of money laundering risk) it is common, when providing brokerage services to funds in the UK capital markets, for the funds to be managed on a discretionary basis by an Appropriately Regulated Investment Manager. In such cases, it is customary that a contractual relationship exists between the firm and the investment manager and that the firm will receive instructions from the investment manager.

- Where the firm is providing brokerage services to an investment manager, the investment manager is the firm's customer for AML purposes.
- Where an investment manager contractually delegates discretionary authority to act on behalf of a fund to a sub-manager, the sub-manager is a customer for AML purposes.
- In this context, whether CDD measures should also be applied to the underlying fund will depend on the nature of the firm's relationship with both entities, as explained below.

20.25 The ML Regulations³ define "correspondent relationships" as including relationships between and among credit and financial institutions, including where certain services are provided by a correspondent to a respondent, and including relationships established for securities transactions or funds transfers. Guidance issued by the Financial Action Task Force (**FATF**) recognises that correspondent relationships in the securities sector may include a relationship between a securities provider (correspondent) executing securities transactions on behalf of a cross-border intermediary acting as respondent for its underlying customers (referred to in this sectoral guidance as a "correspondent securities relationship").

20.26 Correspondent securities relationships exist in the context of providing brokerage services to funds; the broker (correspondent securities provider) may provide services to a domestic or cross-border intermediary, such as an Appropriately Regulated Investment Manager (respondent). The FATF guidance explains that, subject to compliance with applicable requirements relating to due diligence on the respondent/intermediary, a correspondent securities provider is not required to undertake CDD measures on the customers of the respondent/intermediary.⁴ A correspondent securities provider providing brokerage services should monitor the respondent institution's transactions (see paragraphs 20.60-20.66).

Is there a customer relationship with the fund?

20.27 Accordingly, in situations where a correspondent securities relationship exists within the context of providing brokerage services to funds, the underlying fund does not need to be treated as a customer for AML purposes unless:

- i. otherwise determined by the firm on a risk-based approach;
- ii. the firm takes instructions to execute and/or clear transactions from the underlying fund, either directly, or indirectly through an appointed third party agent (where the agent is not the investment manager) such as an attorney; or
- iii. the firm is contracting with and holding assets for safekeeping on behalf of the fund (e.g. as a custodian).

³ The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**ML Regulations**). <http://www.legislation.gov.uk/ukxi/2017/692/contents/made>.

⁴ <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/RBA-Securities-Sector.pdf> (para 107).

For the avoidance of doubt, outside the scenarios identified at sub-paragraphs i - iii above, the firm may (in line with the FATF guidance) treat the investment manager and not the fund as a customer, even if the investment manager is (for credit risk purposes, for example) contracting with the firm as agent for its underlying fund customers.

20.28 Where the fund is not required to be treated as a customer for AML purposes, the firm should nonetheless consider obtaining, at a minimum, the fund's name and any other information, on a risk-based approach, it considers necessary to support effective screening to comply with applicable international sanctions regimes. Where a firm decides not to obtain the aforementioned information, it should document its rationale accordingly.

Summary: who should be subject to CDD?

20.29 For illustrative purposes, the following table sets forth the parties in respect of whom CDD measures are required to be carried out by the firm where it has (i) a correspondent securities relationship with the investment manager only, or (ii) a customer relationship with both the investment manager and the fund for AML purposes:

	Correspondent securities relationship between firm and investment manager only	Customer relationship between firm and fund (refer 20.27 (i – iii))
Appropriately Regulated Investment Manager	<ol style="list-style-type: none"> 1. The investment manager is a customer requiring CDD. 2. The fund is not a customer and therefore CDD is not required. The firm should nonetheless consider obtaining, at a minimum, the fund's name and any other information, on a risk-based approach, it considers necessary to support effective screening to comply with applicable international sanctions regimes. 	<ol style="list-style-type: none"> 1. The investment manager is a customer requiring CDD. 2. The fund is also a customer requiring CDD.
Any other investment manager	<ol style="list-style-type: none"> 1. The investment manager is a customer requiring CDD. 2. The fund is not a customer and therefore CDD is not required. The firm should nonetheless consider obtaining, at a minimum, the fund's name and any other information, on a risk-based approach, it considers necessary to support effective screening to comply with applicable international sanctions regimes. 3. In the context of a correspondent securities relationship, the firm may consider undertaking risk-based due diligence on the underlying fund. 	

Variations of Customer due diligence

- 20.30 As illustrated in the table above, where there is a correspondent securities relationship between the firm and the investment manager, the investment manager is a customer requiring CDD. Where the Investment Manager is Appropriately Regulated, the relationship may be considered by the firm as lower risk (in the absence of other risk factors – see paragraph 20.17). However, due to the nature of a correspondent securities relationship, specific risk-based enhanced customer due diligence (**EDD**) will be required by the firm for investment managers which do not reside in the UK or an EEA member state, pursuant to the ML Regulations (see paragraph 20.35 below). Additionally, a correspondent securities relationship with an investment manager which is not Appropriately Regulated is likely to further require EDD, on a risk based approach (see paragraph 20.36 below).
- 20.31 Where there is a customer relationship between the firm and the fund, and the investment manager is Appropriately Regulated, it may in some cases (e.g. for listed or regulated funds assessed as presenting a low risk), be possible to apply Simplified Customer Due Diligence (**SDD**), adjusting the extent, timing or type of CDD evidence obtained. Otherwise, the fund can be identified by obtaining independent documentation, and/or the firm may satisfy elements of its CDD obligations by obtaining a signed 'Assurance Letter' (See Annex II) from the investment manager. Partial or full reliance on the investment manager may be permitted in appropriate situations pursuant to Regulation 39⁵ (see paragraphs 20.57-20.59 below).
- 20.32 Although SDD may be permissible in certain cases where there is a customer relationship between the firm and an assessed low risk listed/regulated fund, if the investment manager is not Appropriately Regulated, it would be unusual for a fund to be considered low risk where it is managed by a higher risk investment manager. More commonly in this scenario, CDD or EDD will be required on a risk-based approach and in accordance with the guidance set out in Part I, paragraphs 5.3 and 5.5.

Customer due diligence: Investment Managers

- 20.33 Where the firm determines that a business relationship exists with an investment manager, the identity of the investment manager must be verified, in accordance with the guidance relevant to their entity type, set out in Part I, Chapter 5.
- 20.34 When the firm is providing services to an Appropriately Regulated Investment Manager which has been assessed as presenting a low AML/CTF risk residing within the UK or an EEA member state, SDD may be applied.
- 20.35 Where the firm establishes a correspondent securities relationship with an Appropriately Regulated Investment Manager which does not reside in the UK or an EEA member state, firms should consider how to satisfy the specific EDD obligations arising under the ML Regulations. As noted above, Part II, Sector 16: *Correspondent Relationships*, explains that within the scope of correspondent relationships there are relationships representing different types of risks, which necessitate differing levels of controls, and different ways of satisfying the requirements of regulation 34 of the ML Regulations in lower risk cases. In this context, a firm may satisfy the relevant requirements by adopting a similar approach to due diligence as outlined in Sector 16, paragraphs 16.31-16.32 (i.e. the guidance applicable to correspondent trading relationships). An understanding of the respondent's customers (the underlying fund(s)) may be useful to assess the risk posed by the relationship. This application of correspondent relationship due diligence is supported by the additional requirements related to the underlying fund as outlined in 20.28.

⁵ <http://www.legislation.gov.uk/uk/si/2017/692/regulation/39/made>.

- 20.36 In cases where the firm establishes a correspondent securities relationship with an investment manager which is subject to a regulatory regime but is not Appropriately Regulated, a firm may satisfy the relevant requirements by adopting a similar approach to EDD as outlined in Sector 16, paragraphs 16.28-16.29, which includes an assessment of the investment manager's AML/CTF controls. In the context of providing brokerage services to funds, further consideration should be given to undertaking risk-based due diligence on the underlying fund, to obtain a more encompassing view of the risks posed by the relationship as a whole.
- 20.37 Where an investment manager is unregulated, EDD should be undertaken, as set out in Part I, paragraph 5.5. The firm may satisfy the requirements in relation to correspondent securities relationships by adopting a similar approach to EDD as outlined in sector 16, paragraphs 16.28-16.29, which includes diligence on the investment manager's AML/CTF controls (such enquiries could include establishing why the investment manager is unregulated). In the context of providing brokerage services to funds, further consideration should be given to undertaking risk-based due diligence on the underlying fund, to obtain a more encompassing view of the risks posed by the relationship as a whole.

Customer due diligence: Funds

- 20.38 Where the firm is required to conduct CDD on the fund, in appropriate circumstances of assessed low risk, and depending on whether the investment manager is Appropriately Regulated, and whether the fund itself is Appropriately Regulated, partial or full reliance may be permitted, pursuant to Regulation 39, and/or SDD may be applicable to the fund.
- 20.39 When carrying out CDD on the fund, the identity of the fund must be verified, in accordance with the relevant guidance set out in Part I, Chapter 5. Firms should be satisfied when performing CDD that they understand the nature of the fund, including information related to the fund's strategy, its target objectives and investor base. This information may also help firms satisfy requirements related to establishing the nature and purpose of a proposed business relationship (see Part I, Chapter 5, paragraphs 5.3.23ff). On a risk-based approach, depending on the circumstances of the fund and its relationship with the firm, it may be relevant for the firm to consider some or all of following aspects of CDD on the fund.

Fund structure

- 20.40 Where the fund ownership and control structure comprises of numerous fund entities or portfolios, to the extent practical and on the basis of a firm's risk-based approach, firms should establish and document the structure of the fund.
- 20.41 Master-feeder fund structures allow feeder funds using the same investment strategy to pool their capital and be managed as part of a bigger master fund investment pool. Where the firm's customer is a master fund within a master/feeder structure, the feeder funds should be identified. A firm should consider whether, under the ML Regulations or based upon its risk-based approach, the identity of the investors in the feeder funds needs to be obtained and verified, as beneficial owners.
- 20.42 On a risk based approach, the entity responsible for AML/CTF due diligence of the feeder funds (ordinarily the administrator, registrar or transfer agent) should also be identified, as a firm may consider it necessary to place reliance on this entity pursuant to paragraphs 20.57-20.59.
- 20.43 Umbrella fund structures allow separate portfolios which provide different strategies or rights to investors within an overarching fund structure. The sub-funds within the umbrella fund structure are separate portfolios and may or may not be separate legal entities. Where the firm's customer is a sub-fund, the firm should consider whether, under the ML Regulations or on a risk based approach, the umbrella funds should be identified.

Ultimate Controllers

- 20.44 Depending on the fund ownership and control structure, the ultimate control may be exercised, for example, by individuals at the fund (including directors or trustees), or through a chain of entities between the fund and the ultimate controller. Firms should satisfy themselves that they have established any other parties who ultimately control the fund, and who need to be identified as controlling "beneficial owners" (see Part I, paragraphs 5.3.8-5.3.16 and 5.3.126-5.3.127). In the context of a personal investment vehicle, for example, there may be founder shareholders or others with specified control rights.
- 20.45 Standard identity information in respect of the fund's ultimate controller(s) where they are not the investment manager should be obtained, and the identity of the ultimate controller(s) should be verified in accordance with the guidance set out in Part I, section 5.3.

Investors

- 20.46 Investors that have a relevant interest in a fund are its beneficial owners (**Relevant Investors**); what constitutes a relevant interest will depend on the form of the fund (e.g. where the fund is in the form of a legal entity (e.g. a company), investors that have a 25%⁶ or more interest in the fund are its beneficial owners). Subject to paragraph 20.48 below, such Relevant Investors should be identified and verified in accordance with the guidance set out in Part I, Chapter 5, paragraph 5.3.8ff.
- 20.47 The distribution of the fund may have a bearing on its type of investors, likely number of investors and how investments are made. Shares or units in funds may be open to general subscription, including on a stock exchange, or to purchase by any qualifying investors. Alternatively, funds may be established for the exclusive use of a closed group of private investors including hedge funds established for high net worth investors. The investors are also ultimately the fund entity's source of funds/wealth.
- 20.48 The distribution of the fund, together with the regulatory status of the fund and its related parties, may impact the approach to identification and verification of Relevant Investors, on a risk based approach.
- Where the fund is publicly traded on a regulated market, there is no requirement (subject to the firm's risk-based approach) to establish whether there are any Relevant Investors.
 - For open-ended funds (whether unlisted or listed on an unregulated market), based on the size of the fund and nature of investor base and/or additional information from the Investment Manager, firms may be able to satisfy themselves that there are no Relevant Investors within the fund.⁷
 - Where the fund is itself Appropriately Regulated but unlisted, the application of SDD or reliance measures to assessed low risk funds may impact the firm's approach to the identification or verification of Relevant Investors (see paragraphs 20.52 and 20.53 below).
 - For other unlisted and unregulated funds, it is likely to be necessary to identify any Relevant Investors, or to take steps to confirm there are no such investors.
- 20.49 As noted above in paragraph 20.6, firms should be aware of the involvement of third party distributors. In such circumstances and on a risk based approach, firms may wish to obtain

⁶ Where funds take the legal form of trusts, the 25% threshold does not apply. However, where such funds are widely distributed open-ended funds they will ordinarily be listed, regulated and/or not available for investment by individuals (see paragraph 20.48) Some fund types may be commonly called 'trusts' but in fact take the form of legal entities (e.g. investment trusts), in which case the usual 25% ownership or control test will apply.

⁷ For example, some funds may only accept investment from limited investor types (such as pension schemes), such that there are no individual 'beneficial owners' (and any such investors would not have individual 'beneficial owners' and/or would be SDD eligible).

further information on the underlying investor base. Establishing the nature of distribution arrangements may itself assist in understanding the fund's investor base. Where the distributor itself is a Relevant Investor, it should be identified and verified in accordance with the guidance set out in Part I, Chapter 5, paragraph 5.3.8ff.

Information and start-up funds

- 20.50 On occasion, a firm may offer services to, or establish a relationship with, a fund that is in process of formation or a start-up. Start-up funds are funds that are in the pre-investor phase, and as such it is not appropriate to consider undertaking due diligence on the Relevant Investors; until the start-up phase is complete the investors and their status (as relevant or not) may change, depending on who else invests in the fund. In these circumstances, a firm should review the Relevant Investor situation and undertake, when appropriate to do so, due diligence on Relevant Investors.
- 20.51 For information and start-up funds, if any documents required to complete CDD on the fund are not final at the account opening stage, confirmation could be sought from an independent and reliable source attesting that key information will not change in the final version (i.e. details of administrators, investment managers) or, in the event they may change, that the firm will be informed as soon as reasonably practicable. In this situation, a firm might decide, on a risk sensitive basis, to accept such confirmation. Final versions of the documentation should, however, be obtained and reviewed before the account is finally approved.

Simplified customer due diligence (SDD)

- 20.52 Where funds are publicly traded on regulated markets and/or where funds are themselves Appropriately Regulated, if the firm has assessed a fund to present a low money laundering risk, the requirements set out in Part I, Chapter 5, paragraphs 5.4.2ff permit the application of SDD.
- 20.53 Firms may wish to consider the following factors on a risk-based approach when determining whether SDD can be applied:
- The regulatory status of the fund and its related parties, including the Investment Manager and entities responsible for CDD on investors;
 - The AML risk of the jurisdiction in which the fund, its related parties and investors are located; and
 - The nature and transparency of the fund and its investor base, for example certain pension funds (see Part I, Chapter 5, paragraphs 5.4.4 & 5.3.228ff).

- 20.54 Where relevant, SDD measures firms may apply include adjusting the extent, timing or type of CDD, including the quantity and source of identification and verification pursuant to the guidance in Part I, Chapter 5, Annex 5-III.

Enhanced Customer Due Diligence (EDD)

- 20.55 Where higher AML risk factors are present, including those highlighted in 20.17 & Part I, paragraph 5.5, as part of a firm's risk-based approach, the firm may feel it necessary to undertake EDD on the fund. Firms should seek to apply EDD measures that address the specific increased risk factors. In addition to the measures in Part I, Chapter 5, Annex 5-IV, firms may wish to apply the following EDD measures as relevant:
- Establishing in greater detail the purpose of the fund, for example the nature and location of the fund's investments;

- Obtaining further information on the investor base to better document the source of funds for the fund;
- Increased quantity and source of verification on Relevant Investors; and
- Increased due diligence to establish commercial rationale for complex ownership and control fund structures.

Coded Accounts

20.56 Where the firm is providing brokerage services to an investment manager who places orders in respect of underlying funds, the investment manager may request that its transactions are recorded by the firm using coded sub-accounts (e.g. to ensure that the front office is not party to commercially sensitive information) Whilst the firm may choose, following an assessment of the risks associated with the investment manager and their rationale for making use of such accounts, to allow the use of coded accounts on systems accessed by the front office, these arrangements should not interfere with the firm's ability to monitor for suspicious activity and the firm should still comply with 20.28 and 20.29. In such circumstances, the coded accounts would not generally be considered "anonymous accounts" for the purposes of the ML Regulations (the establishment of which is prohibited by regulation 29(6)) given that, whilst the front office systems may use coded accounts, sufficient information is available to the firm to ensure transparency and appropriate risk management. The situation described above should be distinguished from the following two scenarios:

- An investment manager places orders in respect of underlying fund(s) and refuses to reveal the identity of the underlying fund(s). *For the avoidance of doubt, whilst the use of a coded fund is not in and of itself a high risk indicator, where an investment manager is reluctant to reveal the name of the fund, this does indicate high risk as it prevents appropriate sanctions screening; hinders the firm's ability to assess the money laundering risk presented by the investment manager's business; and the concealment of the fund's identity/identities is itself a potential risk indicator.* A firm should be able to demonstrate the sufficiency of the risk based approach it is taking in such cases.
- The firm has a CDD obligation in relation to the fund(s), but the investment manager refuses to reveal the identity of the underlying fund(s). *This is prohibited, as the firm has an obligation to conduct CDD on the fund(s) and cannot do so.*

Reliance on third parties

20.57 In assessing the involvement of other regulated firms in a fund structure, it may be relevant to consider the jurisdiction where the other firm is based, its regulated status, and also, where the other firm is part of a group, whether it applies relevant group-wide AML policies and procedures which are equivalent to those required by the ML Regulations.

20.58 Regulation 39 of the ML Regulations sets out the parties on whom reliance can be placed (see Part I, paragraphs 5.6.4-5.6.11). These include regulated firms in non-EEA jurisdictions who are subject to requirements in relation to CDD and record keeping which are equivalent to those laid down in 4MLD and who are supervised for compliance with those requirements in a manner equivalent to that specified in 4MLD.⁸

20.59 Where an executing broker and a clearing broker are undertaking elements of the same exchange transaction on behalf of the same customer, and the clearing broker has conducted

⁸ Reliance cannot be placed on third party firms in high risk third countries (as defined in Part I, paragraph 5.5.11). However, this may be possible where the third party firm is a branch or subsidiary of a firm established in the UK or EEA which is subject to national legislation implementing 4MLD, supervised for compliance with those requirements, and the branch or subsidiary complies fully with group-wide policies and procedures established for the purposes of 4MLD (see regulation 39(3)-(5) of the ML Regulations).

CDD on the customer, the executing broker may be able to rely upon the clearing broker under the ML Regulations (see Part I, paragraphs 5.6.4ff).

Monitoring

- 20.60 There is a requirement to conduct ongoing monitoring. Guidance on the general monitoring requirements is set out in Part I, paragraph 5.7. The implementation of such monitoring procedures can mitigate money laundering risks to firms offering services to funds. There are, however, also specific characteristics of funds which will be relevant to firms' consideration of appropriate monitoring procedures, in particular the use of multiple brokers.
- 20.61 Customers may choose to allocate execution, clearing and prime brokerage between different firms and many customers may use more than one execution broker. The reasons for this include ensuring that they obtain best execution, competitive rates, or to gain access to a particular specialism within one firm. This will restrict a firm's ability to monitor a customer, as they may not be aware of all activity or even contingent activity associated with the transactions they are undertaking.
- 20.62 Monitoring funds' activity will be affected by the fact that firms may only have access to a part of the overall picture of their customer's trading activities. The fact that many customers spread their activities over a number of financial firms will mean that many firms will have a limited view of a customer's trading activities and it may be difficult to assess the commercial rationale of certain transactions.
- 20.63 The nature and extent of any monitoring activity will therefore need be determined by a firm based on a risk-based assessment of the firm's business profile. This will be different for each firm and may include an assessment of the following matters:
- Extent of business undertaken (executing, clearing, prime brokerage or a mixture of all three);
 - Nature of funds who are customers (e.g. geographic location);
 - Number of customers and volume of transactions;
 - Types of products traded and complexity of those products; and
 - Payment procedures.
- 20.64 In the context of a correspondent securities relationship, when providing brokerage services to underlying funds, the correspondent broker should, to the extent possible, monitor the respondent investment manager's transactions in order to detect any changes in the respondent's risk profile or any unusual activity or deviations, and request further information thereon.
- 20.65 Firms should ensure that any relevant factors taken into account in determining their monitoring activities are adequately documented, and are subject to appropriate periodic review.
- 20.66 Firms relying on third parties under the ML Regulations to apply CDD measures cannot rely on the third party in respect of monitoring.

Annex I – Schedule of Definitions and terms used in this sectoral guidance

Term	
Administrator	Explained at paragraph 20.6
Appropriately Regulated Investment Manager	Defined at paragraph 20.6 under the heading 'Investment Manager'
CDD	Customer due diligence
Coded accounts	Explained at paragraph 20.56
Correspondent securities relationship	Defined at paragraph 20.25.
Distributors	Explained at paragraph 20.6
EDD	Enhanced customer due diligence
FATF	Financial Action Task Force
Investment Adviser	Explained at paragraph 20.6
Investment Manager	Explained at paragraph 20.6
ML Regulations	The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
PEPs	Politically Exposed Persons
RCAs	Relatives or close associates (of PEPs)
Relevant Investor	Defined at paragraph 20.46
SDD	Simplified customer due diligence
Ultimate controller	Explained at paragraph 20.6
4MLD	The Fourth EU Money Laundering Directive (Directive (EU) 2015/849)

Annex II – Template Assurance Letter (see paragraph 20.30).

This is the template assurance letter referred to in paragraph 20.31. It is intended to provide additional support for CDD in circumstances where the firm has an obligation to do CDD on the fund; it is not a formal reliance letter under Regulation 39 of the UK ML Regulations.

From: Financial Institution Name (IM)
Address Line 1
Address Line 2
Address Line 3

DD/MM/YYYY

To: Financial Institution Name (Broker)
Address Line 1
Address Line 2
Address Line 3....

RE: Provision of Brokerage Services to Funds – Assurance Letter

You have informed us that your firm, [insert name of broker firm], is authorised by the Financial Conduct Authority ([FCA ref: insert firm reference here]) to provide certain regulated products and services, subject to applicable laws and regulations including the UK Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**UK ML Regulations**), as clarified by guidance issued by the Joint Money Laundering Steering Group (**JMLSG**) and approved by HM Treasury.

We understand that this letter is intended to serve as an attestation for the purposes of supporting compliance with applicable laws and regulations related to: anti-money laundering, counter-terrorist financing, anti-bribery and corruption, criminal facilitation of tax evasion and applicable international sanctions regimes (ISRs).

For the purposes of this attestation, ISRs mean economic, financial and trade-based sanctions imposed or administered by [the UK Office of Financial Sanctions Implementation or Department for International Trade, the US Office of Foreign Assets Control (**OFAC**), the European Union, the UN Security Council Sanctions Committee] [broker to amend to reflect the regimes it complies with], and any other applicable international sanctions regimes.

We confirm that we implement the following procedures and/or measures in relation to the underlying fund(s) we manage on a discretionary basis and in respect of which we have asked you to provide brokerage services (those funds are listed at Appendix A, in respect of which we have completed columns (a) to (c)) (**Funds**)), as part of our relevant Compliance programmes:

1. Customer due diligence (CDD) measures including the identification and risk-based verification of all investors⁹ into the Fund(s) which includes, where appropriate, identifying and taking reasonable, risk-based measures to verify the investors' beneficial owner(s). (With

⁹ The term 'investor', as used herein, means any 'direct investor' or 'indirect investor' in the fund(s), taking the form of a natural person, legal entity or legal arrangement. A 'direct investor' is an investor who invests in the fund(s) as principal and not for the benefit of any third party. An 'indirect investor' is an investor who invests in the fund(s) through an intermediary or nominee, who invests in the fund(s) on the 'indirect investor's' behalf. A 'Relevant Investor', as used in Appendix A to this letter, is any direct or indirect investor, or a beneficial owner of such direct or indirect investor, who is a natural person and whose interest in the Fund would require a firm conducting customer due diligence on the Fund to identify that natural person. In the case of a Fund taking the form of a legal entity, this comprises investors with an interest of 25% or more in the Fund.

respect to investors, in the event that any natural person(s) have a 25% or more interest in an unlisted Fund or otherwise ultimately control the Fund, the applicable sections of Appendix A (d-f) have also been completed);

2. Adopting measures to establish on a risk-based approach the source of funds of investors;
3. Enhancing scrutiny and due diligence with respect to investors (a) falling within the definition of politically-exposed-persons (PEPs)¹⁰, including establishing the source(s) of funds and wealth, and/or (b) identified as being incorporated, resident or based in a high risk third country¹¹;
4. Taking reasonable steps to ensure that no investor takes the form of a prohibited foreign shell bank (i.e. a bank with no physical presence in any jurisdiction);
5. Procedures for screening the names of all investors and their beneficial owners (where appropriate) against the lists of persons subject to sanctions issued pursuant to applicable ISRs, with a view to ensuring that no investors or (if relevant) their beneficial owner(s) are (a) subject to an asset freeze¹², and/or (b) subject to any restriction pursuant to the ISRs which would be relevant to their investment in the Fund and/or would restrict the provision of brokerage services to such persons;
6. That transactions are monitored with a view to detecting and reporting suspicious activity;
7. That we maintain appropriate records and supporting documentation of the CDD measures undertaken, for a period of at least five years from the later of either: (a) the date our relationship with you and the Fund(s) cease, or (b) or the last transaction with your firm and/or the Fund(s);

We confirm that the underlying CDD documentation will be made available to you, upon request, in line with the UK ML Regulations.

On behalf of the Investment Manager:

Name:

Position:

Signature:

¹⁰ Politically exposed person or PEP means an individual who is entrusted with prominent public functions, other than as a middle-ranking or more junior official, the PEP's family members and known close associates (as defined in applicable anti-money laundering legislation).

¹¹ Relating to jurisdictions designated by the Financial Action Task Force – 'High-risk and other monitored jurisdictions' and the European Union's list of 'high-risk third countries with strategic deficiencies'.

¹² Which for these purposes includes persons designated as Specially Designated Nationals or Blocked Persons by OFAC or Designated Persons in the UK or EU.

Appendix A

Details of underlying funds, including Relevant Investors (where applicable);

	The Fund			Relevant Investors		
<i>No.</i>	<i>(a) Fund Legal Name</i>	<i>(b) Registration Number (if applicable)</i>	<i>(c) Country of Incorporation (and domicile, if different)</i>	<i>(d) Legal Names of Relevant Investors (where applicable, or "N/A if there are none")</i>	<i>(e) Nationality (and country of residence, if different)*</i>	<i>(f) Date of Birth</i>
1						
2						
3						
4						
5						
6						
#						

* include dual citizenships if applicable