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 funds, which may be regulated or regulated and based in equivalent or non-equivalent jurisdictions ("funds"). 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 18: *Wholesale Markets* and sector 9: *Discretionary and advisory investment management (c.f. paragrapghes 9.20 to 9.22).* 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. It is important to draw a distinction between funds that are personal investment vehicles (set up by private wealth management) and those for a commercial purpose with, usually unrelated, investors (e.g. hedge funds). However, 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 and trusts (or the equivalent in civil law jurisdictions), so that the assets and liabilities may be restricted to the fund itself. Sub-funds typically take the form of different classes of shares, fund allocations to separately incorporated trading vehicles or legally ring-fenced portfolios. The investors in the funds are the beneficial owners and the source of funds.

20.3 Funds may also operate a "master/feeder" arrangement, whereby investors, from different tax jurisdictions, invest via separate feeder funds that hold shares only in the master fund. Feeder funds may also on occasion invest/deal directly and therefore a firm may provide services to a fund that is acting in its own right while at the same time being a feeder fund of another, master, fund.

20.4 Dependent upon the structure, a fund is controlled by 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.

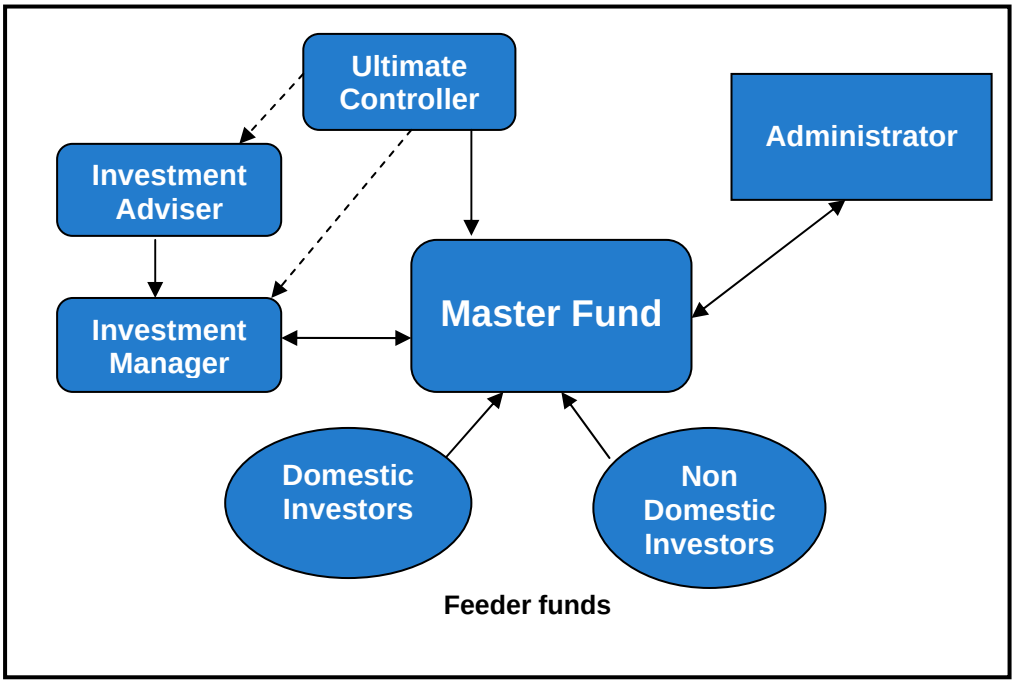
20.5 The complexity of the structures and multiple relationships associated with funds can often give rise to particular difficulties/uncertainties. It is, therefore, important that a firm knows who it is dealing with (an Executing/Clearing broker should not focus on the prime broker) and is clear about what it needs to achieve: who are the principal controllers (e.g. who has the

day-today decision making functions?) and the owners of the assets (who is investing into the fund(s)?).

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.

Note that the precise structure in each case will vary.



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

- **Ultimate Controllers**

  The ultimate controller is someone who controls the funds/assets in the fund (e.g. the person who gives the orders). The ultimate controller may be a different person/entity in different fund set-ups but is usually not the beneficial owner. Sometimes it can be the investment manager, the adviser, or directors of other related parties, who may delegate this responsibility. Whilst the controller is not necessarily the owner, in personal investment vehicles it may be the voting shareholders, directors, holders of founding shares, who can sell or change the assets. 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 20.18 below). Firms should also consider the legal agreements and ask who has control: ambiguity suggests more due diligence is needed.

- **Investment Manager**

  Funds are managed by an investment manager, which is a separate legal entity to the fund, and which is 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 as agent 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 section 9: *Discretionary and advisory investment management*).

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.

The relationship the investment manager has with investment advisers and ultimate controllers of the fund will vary depending upon the degree of control the investment manager has over the:

a) selection of investors;
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), CDD measures should be applied accordingly.

- **Investment Adviser**

Some funds appoint separate investment advisers who will advise the fund with regard to investment decisions undertaken on behalf of the fund, and on occasion, depending on the structure of the funds, may place orders with a firm. Where investment management making decisions are delegated to the investment adviser and/or where the firm is taking orders from the investment adviser, CDD measures should be applied accordingly.

- **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. An administrator may be responsible for identifying and verifying the investors for AML purposes. In certain circumstances it might be appropriate to rely on the activities of the administrator in respect of the source of funds.

Fund administrators are often regulated/licensed (e.g., in Ireland) but their responsibilities may vary (e.g. depending on the domicile of the fund). Firms should, therefore, satisfy themselves of the regulatory status and responsibilities of administrators, in particular with respect to AML. The responsibilities of the Administrator are normally outlined in the Offering Memorandum/Prospectus.

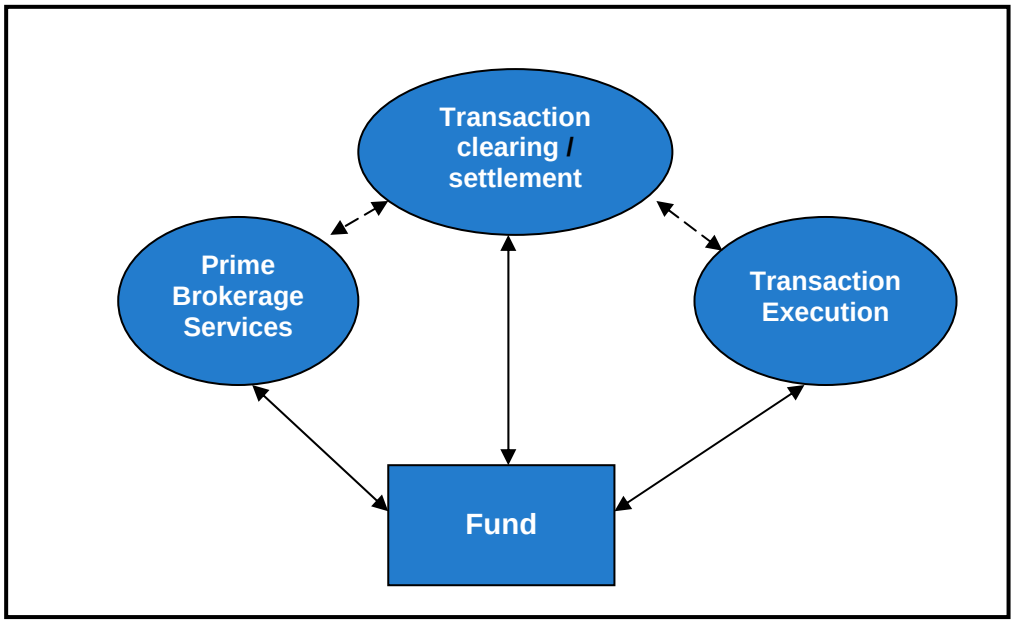
For some fund structures there may be different administrators for different feeder funds. It is important to identify all administrators whose responsibility it is to source investors and to apply due diligence measures accordingly.

- **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. These parties may be less relevant to a firm meeting its AML obligations, but they may give a more complete picture of the fund set-up.

20.7 The following diagram sets out the likely services a firm in the capital markets 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 section 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 to whom they are speaking (i.e. who gives order) to and in what capacity, in order to determine whom they are facing.

  The executing broker typically provides execution-only services to the investment manager and settles with a regulated prime broker(s).

- **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 provision of brokerage products and services to a fund. Prime brokerage is a portal to a suite of products and services offered by a prime broker such as 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. Some funds may appoint more than one prime broker. The precise relationships will depend on the products and circumstances. However, it is important to recognise that although a prime broker takes equitable title to assets, where an executing broker is giving-up to a prime broker the credit risk to the executing broker is with the prime broker and the AML risk to the executing broker will be with the fund, investment manager etc.

- **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 Funds are perceived as attractive vehicles for money launderers. There are seven primary factors giving rise to this perception:

- The identity of those who invest into the funds will, in most cases, not be known to the firm providing services to the fund;
- An unregulated or possibly lightly regulated fund may make it more difficult to ensure that the AML requirements applied to investors are of the appropriate standard;
- A fund can have complex structures and consequently may appear to lack transparency of ownership and control;
- A fund offers a private agreement between investors and the fund, and has traditionally been subjected to limited, or no, regulatory oversight or control;
- Money flows in and out of a fund in the form of new subscriptions and redemptions of investors' interests (subject to the fund's subscription and redemption terms) and the bank accounts of the fund may be held offshore, sometimes in jurisdictions with banking secrecy;
- The volume and size of fund trading activity and the complexity of underlying trading strategies; and
- The fund may accept nominee investments.

How to assess the elements of risk

20.9 The level of risk actually posed by the fund will depend upon the nature of the fund and its transparency. The risks can be determined through undertaking appropriate customer due diligence, and in particular through understanding to whom the fund is marketed and its structure and objectives, as well as the track record and reputation/standing of the investment manager and/or other relevant parties in control of the fund.

20.10 The status and reputation of other service providers, such as executing, clearing or prime brokers, the administrator, auditors and law firms may be a factor in determining the risks associated with a fund.

20.11 Where a firm agrees to undertake third party payments on behalf of a fund, the risks of money laundering and fraud is increased. A firm should therefore ensure it has adequate procedures and systems-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 with the firm.

Understanding the Business for Risk Purposes

20.12 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 red flags that warrant further investigation. Some of the questions firms may wish to consider include, where relevant, whether the size and reputation of the service providers (administrator, investment manager, auditor, lawyers etc) match the funds profile and whether the due diligence procedures for investors into the fund appropriate?

Whilst structures associated with funds are often complex and involve a number of jurisdictions, an important question is: does it make sense? For example, why is a fund regulated and listed in different jurisdictions? Also, where, an administrator is located in non-equivalent jurisdiction or specific concerns have been identified, closer inspection of the administrator's due diligence activities and background should be considered.

Who is a firm's customer for AML purposes?

20.13 Where the firm's customer qualifies for the treatment of simplified due diligence (see Part I, section 5.4), no customer due diligence is required. This would be true even where the firm is aware that its customer is acting on behalf of an underlying customer who would not itself qualify for simplified due diligence; no question of reliance under Regulation 17 will arise.

Who a firm should view as its customer, and who the firm should therefore subject to identification and verification procedures, may vary according to the business undertaken for funds. It is also important to recognise the answer to the question *who is the customer* may vary for FSA Conduct of Business and AML purposes. The following sets out examples of who may be viewed as the customer for AML purposes, and therefore should be subject to customer due diligence. Customer due diligence scenarios are also set out in Annex 20-I.

- Where the firm is acting as the investment manager or investment adviser[28] for a fund, see sector 9: *Discretionary and advisory investment management.*

- Where the firm is acting as an executing broker, the customer for AML purposes may be the fund, the investment manager, or both of them, depending upon the fund structure, the regulatory status of the parties and where appropriate the firm's risk-based approach and policies.

[28] References to Investment Manager in this section also refer to Investment Adviser

In particular, where the firm is acting for another party, for example, the investment manager, who is itself acting as agent for the underlying fund, the following should apply:

- Where the agent is appropriately regulated (or equivalent), they will be the customer for AML purposes, and there is no requirement to look to the underlying fund as a customer, unless otherwise agreed by the parties. The investors into the fund are the beneficial owners..

- Where the agent is unregulated, or regulated within a non-equivalent jurisdiction, **both** the agent and the underlying fund will be considered to be the customer for AML purposes.

- Where the firm is acting as clearing broker and/or settlement agent the customer for AML purposes will be the fund. However, where a firm is taking instructions from the investment manager, the investment manager will also be a customer.

- Where the firm is providing prime broker services, the customer for AML purposes will be the fund. However, where a firm is taking instructions from the investment manager, the investment manager will also be a customer.

20.14 Information collected by other departments in a firm, such as risk, operations, legal or credit may be helpful in ascertaining the risk. However, as discussed, above, different entities may be considered to be the counterparty for the purposes of, for example, credit risk, FSA Conduct of Business rules, AML.

Customer due diligence

20.15 Due to the characteristics of funds outlined above, in addition to applying CDD measures to the customer and (where simplified due diligence cannot be applied to the customer) the beneficial owners, it is appropriate to identify, depending on the risk, other parties involved such as the fund itself, its managers/advisers, and the fund's ultimate controllers and understand their relationships and roles.

20.16 On occasion, practical aspects of fund management are conducted onshore as a result of the delegation of responsibility for certain activities to onshore entities that may be subject to regulatory oversight. The interplay of these relationships needs to be assessed when determining the extent of due diligence necessary.

20.17 Depending on the services the firm is offering or providing to the fund, a firm should have particular regard to:

- Whether the firm is to have the Master Fund as its customer.

  In such cases, firms will wish to obtain information from the Feeder Fund's offering memoranda/prospectuses and, in some instances, information on the fund's investors.

- Who places orders and transactions on behalf of the fund or makes the investment decisions for the fund(s).

  Often, this will be the investment manager, and the firm should review the investment management agreement to understand the scope of the manager's authority/control.

- Whether there are any regulated or other reputable servicing entities in the fund set up.

- Whether a fund's ownership/control structure comprises numerous layers of entities and/or is transparent and understandable, and ensuring that the firm has a good understanding of the structure rather than focusing on the strict legal form alone.

20.18 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. If any documents 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, 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.

20.19 Where the fund has a number of layers of entities in its ownership/control structure (e.g. linked feeder and/or intermediate funds), to the extent practical and on the basis of a firm's risk-based approach, this chain and the inter-relationships between the parties, whilst not necessarily subject to the guidance set out in Part I, Chapter 5, should be established and documented.

20.20 Where the fund is the customer, the requirements for identification and verification of corporate structures, trusts, and individuals etc, which are set out in Part I, Chapter 5 should be applied to the fund.

20.21 A firm should also identify the entities involved with the fund on which it is required to carry out due diligence e.g. customers, beneficial owners. A firm may also wish to carry out commercial due diligence on other parties.

Investment manager

20.22 The identity of the investment manager that has direct contact with the firm, or which instructs the firm on behalf of the fund must be verified, in accordance with the guidance relevant to their entity type, set out in Part I, Chapter 5. Where simplified due diligence can be applied to the investment manager (see Part I, Chapter 5, section 5.4) there is no duty to identify the underlying customer (i.e., the fund or its relevant investors) provided the firm has no relationship with the fund (if it has, the firm will need to perform CDD on the fund and its relevant investors, but may wish to consider reliance (c.f. Part I, paragraphs 5.6.4ff). As discussed above, though, under its risk-based assessment a firm may consider it appropriate to identify other parties involved.

20.23 Where, however, an investment manager is unregulated or not regulated in an equivalent jurisdiction, the firm must undertake CDD on the investment manager (even if the firm has a customer relationship with the fund). A firm may also consider additional checks, which could include considering requesting or obtaining proof of exempt status where the investment manager is operating from a jurisdiction where similar entities are usually regulated.

Investors and relevant investors

20.24 Shares or units in funds may be open to general subscription, or to purchase by any qualifying investors. Alternatively, funds may be established for the exclusive use of a closed group of private investors. Whereas the Investment Manager usually 'controls' a fund, investors in a fund should be viewed as representing the ultimate source of funds of the customer. Firms

should, therefore, consider whether or not there is a need for them to look at the underlying investors in such vehicles. This will depend up on the status of the fund (e.g. publically traded or private) and how it is operated in terms of dealing in its units/shares e.g. where such dealings are traded on a regulated market or exchange.

20.25 Where the fund is publicly traded, the underlying investors would be regarded as a class of beneficiary and so would not need to be verified individually. However, where the vehicle is being operated for private use by a specific group of individuals, those that have a 25% or more interest fund would be "relevant investors", on whom CDD should be undertaken as beneficial owners (see Part I, Chapter 5, paragraph 5.3.8ff).

20.26 Although it will often be the administrators to the fund, it is important to establish who in the fund structure is responsible for the CDD process. If the party responsible for verifying the identity of the Relevant Investors is regulated in an equivalent jurisdiction and satisfies the definition of 'third party' in the ML Regulations, the firm may, in line with its own risk-based approach, be able to rely upon the third party to apply appropriate CDD measures (except monitoring) in respect of any Relevant Investors (see Part I, paragraph 5.6.4ff).

20.27 However, where the party responsible for the CDD process is <u>not</u> regulated in an equivalent jurisdiction, the firm should, as part of the determination as to the level of assurance necessary, also satisfy itself with regard the AML procedures of the responsible party.

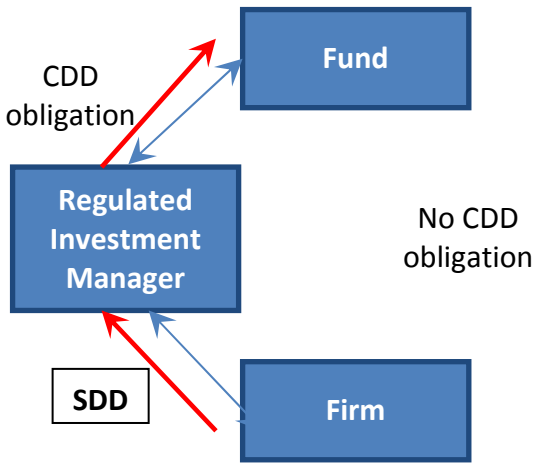
20.28 Whether a firm has to identify and take risk-based and adequate measure to verify the identity of relevant investors, will, however, depend on a number of factors. In general terms, two scenarios can be distinguished depending on whether the firm has a business relationship with the investment manager and/or the fund:

(a) Customer relationship with the investment manager *(*no *relationship with the fund)*

(i) Investment manager regulated in an equivalent jurisdiction

- Where the investment manager is the firm's customer and simplified due diligence (SDD) can be applied to the investment manager (see Part I, Chapter 5, section 5.4) there is no duty to identify the underlying customer (i.e., the fund and its relevant investors (if any)) although, as discussed above, under its risk-based assessment a firm may consider it appropriate to identify other parties involved.

Diagram 1

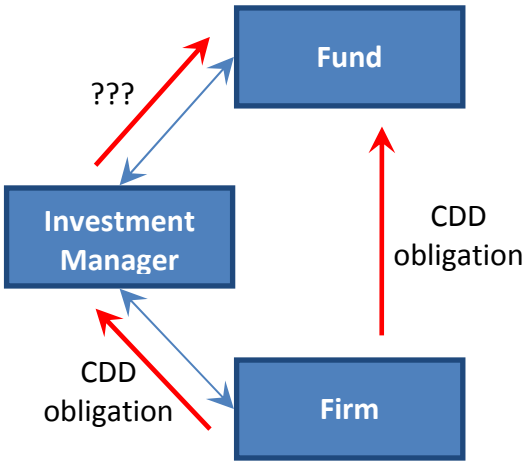


[Blue lines = customer relationship; red lines = CDD obligations]

The firm does <u>not</u> have a customer relationship with the Fund and receives instructions only from the investment manager. The firm is able to perform simplified due diligence (SDD) on the investment manager, subject to which it is not under any obligation to undertake CDD on the fund.

*(ii) Investment manager **not** subject to regulation in an equivalent jurisdiction*

Diagram 2



[Blue lines = customer relationship; red lines = CDD obligations]

The firm does <u>not</u> have a customer relationship with the fund and receives instructions only from the investment manager. It is, however, required to undertake CDD on <u>both</u> the investment manager and the fund on the behalf of which the investment manager is acting (i.e. simplified due diligence is <u>not</u> available).

The investment manager may or may not be subject to adequate customer due diligence obligations and <u>cannot</u> be relied upon under Regulation 17. Nonetheless, if the firm is able to satisfy itself on an ongoing basis that the CDD performed by the investment manager is adequate and available to the firm on request, it may elect to re-use the due diligence work carried out by the investment manager. Otherwise the firm will need to undertake its own due diligence measures (including on any relevant investors).

(b) Customer relationship with fund

- Where the fund is the firm's customer, then the firm may, if it considers it appropriate to do so under its risk-based approach, place reliance on a third party, which satisfies the definition in the ML Regulations, to perform CDD measures, including identification of beneficial owners (see Part I, Chapter 5, paragraph 5.6.19ff).

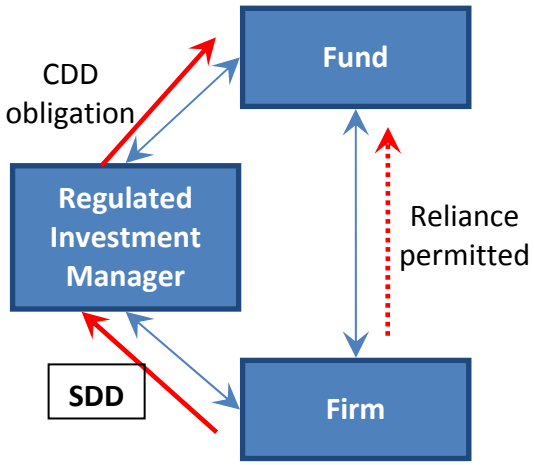
(i) Investment manager, administrator or investment adviser regulated in an equivalent jurisdiction

➢ Subject to the firm's risk-based approach, a firm may take steps to establish that reasonable measures are in place within the fund structure for verifying the identity of Relevant Investors in the fund; obtaining assurances from that party that there are:

- Relevant Investors whose identity will be disclosed to enable the firm to take appropriate measures to verify their identity, or
- no Relevant Investors.

Where a firm accepts such a representation, this should be documented, retained, and subject to periodic review.

Diagram 3



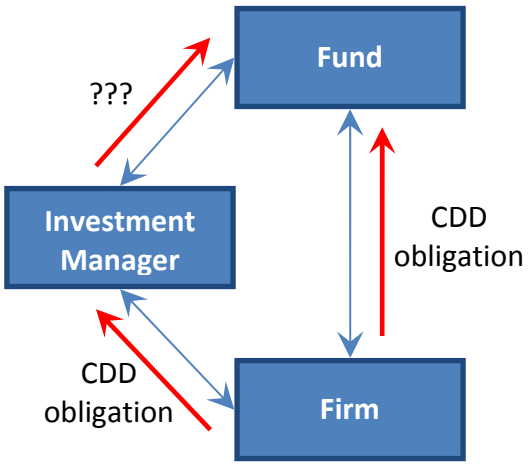
[Blue lines = customer relationship; red lines = CDD obligations]

The firm has a customer relationship with the fund, which has been introduced by the investment manager (investment adviser etc). The firm is required to undertake CDD on both the investment manager (investment adviser etc) and the fund.

However, the firm is able to apply simplified due diligence (SDD) on the investment manager and can, subject to consent by the investment manager, place reliance upon it for the purposes of CDD on the fund under Regulation 17. Similarly, a firm may be able to place reliance on a regulated administrator for CDD on the fund, provided the requirements of Regulation 17 are satisfied.

(ii) Investment manager (administrator or investment adviser etc) not subject to regulation in an equivalent jurisdiction

Diagram 4



[Blue lines = customer relationship; red lines = CDD obligations]

The firm has a customer relationship with the fund, which has been introduced by the investment manager (or investment adviser etc). The firm is required to undertake CDD on both the investment manager (investment adviser etc) and the fund.

The investment manager may or may not be subject to adequate customer due diligence obligations, but cannot be relied upon under Regulation 17 of the Money Laundering Regulations 2007 ("Regulation 17"). The firm will need to undertake its own due diligence measures (including on any relevant investors).

20.29 Where a firm is required to carry out its own due diligence on relevant investors - and/or following its assessment of the money laundering risk presented by the fund it feels it is not appropriate to place reliance on a third party - the firm must identify and verify the identity of Relevant Investors in accordance with the relevant guidance set out in Part I, Chapter 5, paragraph 5.3.8ff.

Start-up funds

20.30 On occasion, a firm may offer services to, or establish a relationship with, a fund that is 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, where appropriate, due diligence on Relevant Investors.

Feeder funds

20.31 At a minimum, the Feeder funds within a Master/Feeder structure should be identified in accordance with the guidance in Part I, Chapter 5. The entity responsible for AML/CTF due diligence at 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 with paragraph 20.26.

20.32 Feeder funds will own the assets/money held by the master fund. As the feeder funds will be investors in the fund, 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 verified, as Relevant Investors/beneficial owners.

Variations on Customer Due Diligence

Enhanced Due Diligence

20.33 In addition to the situations outlined in Part I, section 5.5, as part of a firm's risk-based approach it may feel it necessary to undertake Enhanced Due Diligence on its customer and/or related parties e.g. a firm may consider obtaining independent validation from appropriate third parties.

Ultimate Controllers

20.34 Ultimate control may be exercised through a chain of entities between the fund and the ultimate controller. This relationship should be established and documented.

20.35 Where, because of the risk profile of the d fund, a firm feels it appropriate to undertake Enhanced Due Diligence, the identity of the fund's ultimate controller should be obtained and verified. 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 as appropriate be verified in accordance with the guidance for their entity type set out in Part I, section 5.3.

Feeder Funds

20.36 Where, because of the risk profile of the fund, a firm feels it appropriate to undertake Enhanced Due Diligence, the identity of the feeder fund should be verified in accordance with the guidance in Part I, Chapter 5, ensuring that the relevant investors of the feeder funds are subjected to the guidance set out in paragraphs 20.21ff.

Reliance on third parties

20.37 To avoid unnecessary duplication where an executing broker and a clearing broker are undertaking elements of the same exchange transaction on behalf of the same customer, which is not a regulated firm in an equivalent jurisdiction, the executing broker may be able to rely upon the clearing broker under the ML Regulations (see Part I, paragraphs 5.6.4ff) or otherwise take account of the fact that there is another regulated firm from an equivalent jurisdiction acting as clearing agent or providing other services in relation to the transaction.

20.38 Where a firm is acting as clearing broker or prime broker, from a risk-based perspective the firm should not rely upon a third party and should undertake full customer due diligence, including where relevant on beneficial owners, as set out in Part I, Chapter 5.

Monitoring

20.39 The money laundering risks to firms offering services to funds can be mitigated by the implementation of monitoring procedures. Guidance on the general monitoring requirements is set out in Part I, section 5.7. However, there are specific characteristics of funds which will be relevant, in particular the use of multiple brokers.

20.40 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.

20.41 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.

20.42 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.

20.43 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.

20.44 Firms relying on third parties under the ML Regulations to apply CDD measures cannot rely on the third party in respect of monitoring.