

8: Non-life providers of investment fund products

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.

Where a firm also offers pension savings related products e.g., SIPPs, defined benefit / contribution employment related schemes, please refer to Sector 7 of Part II when dealing with these products.

This sector does not aim to provide guidance to life assurance companies, other than for the purposes of providing institutional funds as described in paragraph 8.1 (c). Guidance on other life assurance products can be found in Sector 7.

Overview of the Sector

8.1 The guidance contained within this section is directed at firms offering the following types of investment vehicle:

- (a) *Retail investment funds* - authorised unit trusts (AUTs) and open-ended investment companies (OEICs).
- (b) *Other investment fund-based products/services* - which may comprise one, or a combination of, regular savings schemes (including those relating to investment trusts), regular withdrawal schemes, ISAs (in their various forms), and fund platforms.

Typical investors using retail funds and associated products/services vary depending upon the product, but include private individuals, regulated firms investing as principal (e.g., life companies), other regulated firms (including nominee company subsidiaries) acting on behalf of underlying customers, other corporates, personal and corporate occupational pension schemes, charities and trusts.

- (c) *Institutional funds* - authorised and unauthorised collective investment schemes and unitised life assurance funds that are dedicated to investment by institutional investors.

Investment in such funds is often restricted to UK investors that are exempt from taxation on capital gains - for example, Charity Commission registered charities and HMRC approved pension schemes.

8.2 For most firms, investors in retail funds will be mainly, but not exclusively, UK resident.

8.3 Guidance for those involved in managing private equity funds is contained within Sector 13: *Private equity*.

The money laundering risks relating to investment fund products

Risk Based Approach

8.4 As outlined in Part I Chapter 4, all firms must develop a risk-based approach to mitigating the risk of their products and services being used for the purposes of money laundering or terrorist financing. Firms start from the premise that most customers are not money launderers or terrorist financiers. However, firms should have systems in place to identify and highlight those

customers who, on criteria established by the firm, may indicate that they present a higher risk.

- 8.5 Firms should assess the risk of the products they provide, the services they offer and the relationships that they have with their customer. Where a low degree of risk is determined then Simplified Due Diligence (SDD) may be applied. Where a high risk is identified then Enhanced Due Diligence (EDD) measures must be applied; in other circumstances, standard Customer Due Diligence (CDD) will apply.

Retail funds

Product/Service Characteristics

| Risk Factor | Inherent Risk | Industry Standard | Risk Mitigation | Residual Risk |
|---|----------------------|--|--|----------------------|
| Unrelated third-party payers/subscribers which could disguise the source or destination of laundered funds. | High | As a rule, third party payments are only accepted in limited specific scenarios (determined by firms in line with their risk appetite) or where made to/from another regulated entity. | Monitoring seeks to identify exceptions which will be reviewed and, where necessary, appropriate due diligence measures will be performed on the third party. | Low |
| Ability to pay in or withdraw cash | High | No receipt or payment in cash is possible. | No receipt or payment in cash is possible. | Low |
| Ability to switch from one fund / product to another | Medium | Products allow switching between funds / products held with the same firm, but the registered owner remains the same. | Monitoring seeks to identify suspicious transactions | Low |
| Ability to transfer holdings to a third party to try and mask the audit trail | High | Products allow stock transfers to enable registration under an alternative name. | Transfer is often to another regulated entity. Appropriate due diligence is performed on the new client. Monitoring seeks to identify suspicious transactions. | Low |
| Products which enable high turnover of funds | High | For retail investors, products intended for medium to long term investment purposes. Use of investment funds and products is by its nature ad hoc. | Monitoring seeks to identify suspicious transactions. | Low |

Transactions

| Risk Factor | Inherent Risk | Industry Standard | Risk Mitigation | Residual Risk |
|--|---------------|---|---|---------------|
| Transaction activity is high in value | High | No receipt or payment in cash is possible. For retail investors, products intended for medium to long term investment purposes. Use of investment funds and products is by its nature ad hoc. Intermediary distributor relationships are of an expected higher volume given the aggregated nature of trades undertaken for their underlying investors. | Intermediary/distributor business can be large in value, but these are normally other regulated firms in equivalently regulated jurisdictions. Monitoring seeks to identify suspicious transactions. Certain products have annual investment limits imposed on them (ISA / JISA). | Low |
| Transaction activity is high in volume | High | No receipt or payment in cash is possible. For retail investors, products intended for medium to long term investment purposes. Use of investment funds and products is by its nature ad hoc. Intermediary/distributor relationships are of an expected higher volume given the aggregated nature of trades undertaken for their underlying investors. | Intermediary/distributor business can have high volumes of trading as they represent their underlying investors, but these are normally other regulated firms in equivalent jurisdictions. Private clients tend to invest for the medium to long term and therefore transactions will be infrequent. Monitoring seeks to identify suspicious transactions. Certain products have annual investment limits imposed on them (ISA / JISA). | Low |

Client Characteristics

| Risk Factor | Inherent Risk | Industry Standard | Risk Mitigation | Residual Risk |
|--|---------------|--|---|---------------|
| Complex corporate ownership structures, which can make it easier to conceal underlying beneficiaries | High | Intermediaries and institutional clients are usually the subject of some form of regulation. Understand the ownership and control structure of companies, trusts etc. in line with Regulation. EDD undertaken for high-risk relationships. | CDD /EDD is performed on the client and any beneficial owners, where required. | Low |
| Request to use numbered accounts or anonymous accounts | High | No anonymous accounts allowed. | Anonymous accounts prohibited by Regulation. CDD /EDD is performed on the client and any beneficial owners, where required. Monitoring seeks to identify suspicious transactions. | Low |
| Client is involved in high-risk business activities e.g., cash intensive) | High | No receipt or payment in cash is possible. EDD undertaken for high-risk relationships. | No receipt or payment in cash is possible. CDD /EDD is performed on the client and any beneficial owners, where required. Monitoring seeks to identify suspicious transactions. | Low |

| | | | | |
|---|--------|---|---|------|
| Customers represented by a third party | Medium | These tend to be subject to court approval or ratification (e.g. Executors and POA Attorneys) | Evidence of official appointment obtained. In the case of Attorneys who are appointed under powers of attorney, firms identify and verify all attorneys (refer to Part I 5.3.99 re joint and several power of attorneys). | Low |
| Purpose of investing | Low | It may be assumed that most investors investing in retail funds will be doing so for the investment returns | Firms should, on a risk-based approach, ask for additional information about the purpose of the relationship, where this is appropriate | Low |
| Involvement of an individual in a prominent public position (PEP/RCA) | High | Regulations require EDD for PEP/RCA relationships. | Regular screening of public source information (e.g. World- check, Dow Jones). Enhanced CDD performed | High |

Delivery Channels

| Risk Factor | Inherent Risk | Industry Standard | Risk Mitigation | Residual Risk |
|---|---------------|--|--|----------------------------------|
| Ability to transact non face-to-face | Medium | Transactions can be placed in writing, by phone, post or by a platform, distributor or intermediary. | Platform, distributor, intermediary business involves other regulated firms. Private clients are subjected to additional CDD measures. . | Low |
| Ability to transact on a face-to-face basis | Low | Transactions can be placed in writing, by phone, post or by a platform, distributor or intermediary. | Direct relationship with employee of the firm. | Low |
| Correspondent Securities Relationships | High | Relationships are predominantly with equivalently regulated firms. | Increased level of CDD for cross-border relationships to include an assessment of the third party's systems and controls (e.g. Wolfsburg Questionnaire). | Dependent on findings (see 8.25) |

Geography

The level of geographic risk will be dependent upon the jurisdiction in which the client is domiciled. Firms will take note of their own internal country risk assessment which will be driven by assessments and information provided by government, regulators and other relevant bodies (e.g. FATF). Where the risk dictates, increased measures will need to be taken to mitigate the ML/TF risk.

When a retail customer originally invests whilst resident in the UK and subsequently moves abroad to a high-risk country, this should not necessarily lead firms to believe that this customer will be in a high-risk category unless there are other factors present (e.g. PEP status, adverse media identified, payments received from or requested to be paid to a bank in an unrelated third country).

8.6 On balance, therefore, investment funds and products that involve the restrictions / controls referred to above may generally be considered to be low risk in terms of their use for money laundering purposes. However, if the features of a product or service provide additional

flexibility (for example, where some or all of the risk mitigations referred to in the table following paragraph 8.5 are not applied), the firm should consider the potential increase in the money laundering risk given all the relevant factors and the need to mitigate that risk.

Institutional funds

- 8.7 Many institutional funds are open only to tax-exempt investors, such as pension schemes and charities. Overall, the majority of institutional funds business may be considered to be low risk, by virtue of the restricted types of investors, many of whom are themselves regulated, rather than because of a product's features.

Defining the customer for AML purposes

- 8.8 The Money Laundering Regulations 2017 define a "business relationship" to include any business, professional or commercial relationship between the firm and its customer, which is expected to have an element of duration. Essentially, this definition would apply to any open-ended product relationship (e.g. managing an ISA), irrespective of whether it was for the purposes of lump sum or regular investment. Furthermore, a fund manager's obligation to redeem units at the request of the holder at some future time provides the relationship and element of duration necessary for the definition to apply in the case of any registered holder of units, however their holding was acquired.
- 8.9 The handling of third-party payments is an important feature of the typical risk profile of the fund management sector. Where the firm accepts payment from a third party at any point, that party should also be regarded as a customer and identified and verified as such.
- 8.10 Should an investor ask a firm to pay redemption proceeds to a third party, that third party should also be regarded as a customer (on whose behalf the registered investor may have been acting), and their identity should be verified on a risk-based approach, before any funds are remitted. In instances where the beneficial owner remains the same, then this can be treated as lower risk.
- 8.11 Firms may generally treat UK intermediaries, including fund platforms, as their customer, and not have to 'look through' them to the underlying investor. For relationships with fund platforms outside of the UK, the degree of risk and level of CDD required should be determined taking into account the nature of the relationship, where the counterparty is based, and the degree of risk of money laundering or terrorist financing presented by the relationship (see paragraphs 8.24 - 8.27).
- 8.12 CDD measures should remain limited to identifying and verifying the identity of the Intermediary and to verifying that the Intermediary has a robust and risk sensitive AML program in place and applies appropriate CDD measures to its customers and to its customers' beneficial owners.
- 8.13 Assuming the existence of appropriate and proportionate monitoring (as detailed in paragraphs 8.5 and 8.35-8.39) or other factors that suggest otherwise, firms are not required to assume that payment from an unidentified source is being made by a third party. In instances where a third party payment has been identified, CDD measures on the third party should also identify the source and account ownership to ensure such remittance has not been sent to disguise the source or destination of laundered funds.

Customer Due Diligence

Identity verification measures

- 8.14 Standard verification procedures for the type of customer concerned, and any beneficial

owner or controller, as described in Part I, Chapter 5, should be followed. Subject to the restrictions that apply generally to their use, various modifications to standard procedures are available. Typically, these would include:

- (i) application of simplified due diligence in relation to customers or products determined as presenting a low degree of risk, as described in Part I, Chapter 5;
- (ii) application of the measures described in Part I, paragraphs 5.3.95-5.3.98 in relation to the administration of deceased investors and Court of Protection Orders.

8.15 Where the firm is required to verify the identity of a customer that is being introduced by an appropriately regulated intermediary, reliance may be placed on the intermediary, following the guidance in Part I, paragraphs 5.6.4-5.6.23.

8.16 In the case of beneficial owners or controllers, unless the relationship is higher risk (by virtue of the products/services to be provided or the specific nature of the customer), the identity of beneficial owners and controllers may be confirmed by the customer themselves (see Part I, paragraphs 5.3.8 to 5.3.16).

8.17 Various types of small occupational pension scheme may invest in retail funds - in cases where SDD cannot be applied the verification procedures described in Part I, paragraphs 5.3.228 to 5.3.237 should be followed. Where the customer is a UK- based personal pension scheme (e.g. a SIPP), however, the firm should confirm that any third- party trustee or administrator that may deal with the firm has been appointed by the regulated scheme operator. This will be a factor to be considered by the firm when determining whether to apply simplified due diligence to such customers.

8.18 Whilst most business within this sector is conducted with individual investors on a non face-to-face basis, this should not mean that such interactions should be considered to represent a higher risk, provided there are sufficient safeguards and controls in place (see Part I paragraph 5.3.76 - 5.3.94). Given the lower risk of this sector being used for money laundering purposes, the usual measure taken in this respect is to ensure that the confirmation of a transaction or an acknowledgement letter is sent to the customer's preferred contact point (e.g., home address, e-mail, via digital means) and is not returned or queried by the occupant.

8.19 Relationships with institutional investors will often be undertaken on a face-to-face basis via dedicated relationship/sales focused employees.

Firms with legacy customers whose identity has not been verified due to the circumstances under which they became investors, and for whom the firm is unable to return the funds, are not expected to undertake specific exercises or projects to verify the identities of those customers retrospectively, but must do so upon future trigger events, as appropriate according to their risk-based approach. Firms that have undertaken such exercises or projects should ensure that sufficient records to evidence the work undertaken are maintained.

Additional customer information

8.20 While firms should request further information, on a risk- based approach, from an AML/CTF perspective, the principal objective in obtaining such information is to understand the motive for establishing the relationship and to permit assessment of any subsequent activity. The motive for investing in funds is usually self-evident: if it is anything other than medium to long-term investment returns then the objective should be recorded and taken into account in assessing the risk of the relationship.

8.21 High risk retail relationships (e.g. politically exposed persons (PEPs), or account holders associated with higher-risk territories), should, however, be treated with caution. Firms

should give due consideration to the nature and purpose of the relationship by obtaining more information concerning the customer's rationale for using its services and demonstrating their source of wealth.

- 8.22 Furthermore, firms will need to take a risk-based approach in identifying a customer's potential status as a PEP and the level of EDD that is necessary. Firms are required to take adequate steps to determine PEP status and the level of risk posed by the relationship - e.g. domestic UK PEPs versus relationships with PEPs from countries where the risk of corruption is perceived to be higher. Where the money laundering risk is determined to be higher, firms should increase the level of EDD measures undertaken for such relationships, beyond what they would for lower risk domestic PEP relationships (see also Part I paragraphs 5.5.13 - 5.5.36).
- 8.23 Activity monitoring of retail investors can be equally, if not more, effective by comparing the behaviour of one customer with that of others (see paragraphs 8.35 – 8.39).

Correspondent Securities Relationships

- 8.24 A “Correspondent Securities Relationship” is a cross-border relationship between a fund provider/platform (Correspondent) and a regulated and supervised intermediary investing on behalf of its underlying customers (Respondent). A Correspondent Securities Relationship does not require the Correspondent to conduct CDD on the customers of the Respondent.
- 8.25 The degree of risk in a Correspondent Securities Relationship should be determined bearing in mind the risks inherent in the product and service, and the risks posed by the nature and jurisdictions of operation of the Respondent. The risk assessment will essentially follow the firm’s standard approach.
- 8.26 Correspondents should not enter into, or continue, a Correspondent Securities Relationship with shell banks or shell securities providers and should satisfy themselves that Respondent institutions do not permit their accounts to be used by shell banks or shell securities providers.
- 8.27 In relation to Correspondent Securities Relationships, a firm will apply its standard customer due diligence approach, based on its determination of the ML/TF risk presented following its risk assessment. In addition to performing CDD on the Respondent itself, the Correspondent should also understand:
- Nature of business - firms must gather sufficient information about the Respondent to fully understand the nature of its business. The amount of information gathered on the customer may be on a risk-based approach and may take into consideration the following (non-exhaustive list):
 - Type of Respondent – an assessment of the credit or financial institution type;
 - Business model – the customer base (types of underlying customer) of the Respondent and the products and services it offers;
 - Country of operations – is the Respondent based in a country which has AML/CTF requirements that are equivalent to the ML Regulations?
 - Does the Respondent have operations in high-risk jurisdictions?
 - Reputation and supervision - firms must determine the reputation and supervision of the Respondent using credible, publicly available information.
 - Firms should have regard to the following:
 - The disciplinary record of the Respondent – has the Respondent been subject to recent regulatory enforcement for inadequate AML/CTF systems and controls?
 - Regulated status of the Respondent – whether the respondent is regulated.
 - AML Regime – is the Respondent based in a country with an effective AML/ CTF regime?
 - Jurisdiction in which the Respondent is regulated - whether the Respondent is subject

to adequate AML/CTF supervision.

- Assessment of the firm's AML/CTF controls - firms must assess the Respondent's AML/CTF framework. This may be applied on a risk-based approach, with a varying degree of scrutiny depending on the risks identified. Firms may also wish to leverage established industry questionnaires or similar to meet this requirement. Additionally, the Correspondent may wish to speak with representatives of the Respondent to obtain comfort that the Respondent's senior management recognise the importance of anti-money laundering/terrorist financing controls.
- Senior management approval - firms must obtain senior management approval before establishing a new Correspondent Securities Relationship. The firm should determine who constitutes "senior management" for the purposes of the Relationship approval process.

Timing of verification

- 8.28 The obligation to verify a customer arises at the point when it is clear that they wish to enter into an arrangement with the firm, either to buy or sell units in a fund or to establish some form of investment scheme or account. In addition, given the definition of "business relationship" (see paragraph 8.8) the transfer of units from an existing holder to a third party will also give rise to an obligation to verify the identity of the recipient.
- 8.29 Firms must verify a customer's identity as soon as practicable after first contact with the customer, but are not prevented from entering into the relationship or commencing the initial transaction before the checks are completed (see Part I paragraph 5.2.3 - 5.2.5). Firms should take all reasonable steps to verify the customer's identity within a reasonable time. Where the firm is unable to verify the identity of the investor within that time it may cease proactive pursuit of evidence of identity and must, at that point, consider if the circumstances give any grounds to suspect money laundering or terrorist financing, and act accordingly (see Part I, paragraph 5.2.7 - 5.2.8).
- 8.30 If, however, after such reasonable time, and where the firm has no grounds to suspect and is satisfied that the risk of money laundering is minimal, subject to its terms of business or the status of a contract to purchase units in its funds directly, it may terminate the relationship and return any monies received to their source. Alternatively, and particularly in purchases of units where the contract has been completed, the firm should block/restrict any funds or assets pending eventual verification (see Part I, paragraph 5.2.9).
- 8.31 From the point at which the firm ceases proactive pursuit of evidence of identity, but where it has no suspicions:
- (a) it must not accept further investments (ad hoc or regular savings) from the customer until they provide the evidence of identity required by the firm;
 - (b) it must permit the investor to withdraw, redeem or transfer their investment upon production of the evidence of identity required by the firm;
 - (c) it should otherwise continue to act in accordance with any relevant terms of business and regulatory obligations until such time as the relationship may be terminated (this would include issuing periodic statements, making normal dividend/interest payments and administering the customer's investments according to their instructions where these do not involve the investment or withdrawal of capital); and
 - (d) it must take steps to remind customers (individually or generically, as appropriate according to their risk-based approach) that evidence of identity may still be required, noting the consequences of failure to comply with the firm's request.
- 8.32 Where the firm has become suspicious that it may be dealing with the proceeds of crime, it must:
- (a) make the relevant report to the NCA;
 - (b) request a defence against money laundering (DAML) from the NCA prior to

- processing money in or out of the accounts; and
- (c) desist from continuing to apply CDD measures in relation to that customer, where that would result in the commission of an offence under:

- (i) section 21D of the Terrorism Act 2000 (tipping off: regulated sector); and/or
- (ii) section 333A of the Proceeds of Crime Act 2002 (tipping off: regulated sector).

- 8.33 A customer may wish to redeem their investment or exercise a right to cancel a purchase transaction before the firm has been able to verify their identity. In such circumstances, the firm should consider whether or not the circumstances might suggest grounds for suspicion of money laundering or terrorist financing and a need to submit a SAR seeking a DAML from the NCA, before returning any funds to the customer (see also paragraph 8.34 below).
- 8.34 Firms should exercise caution in the event that a holder seeks to transfer units to someone else before the firm has been able to verify their identity. This will either be soon after the units were acquired and while the firm is still attempting to verify the transferor, or where the firm has blocked/restricted the investment having been unable to complete satisfactory customer due diligence and not having received a DAML following submission of a SAR.
- 8.35 Firms are recommended to include in their terms of business, or otherwise advise the customer at the outset, that they may return or block/restrict the customer's investments until the necessary evidence of identity can be obtained.

Monitoring

- 8.36 As mentioned in paragraph 8.23 above, one of the most effective ways of monitoring the activity of an investor is to compare it with that of the “typical investor”. This may vary for different types of customers (e.g. private individual compared to a corporate investor).
- 8.37 Other than in the case of regular savings/withdrawal schemes, the use of investment funds and products is by its nature ad hoc. Even with regular savings and withdrawal schemes, however, there is nothing unusual in ad hoc additional, or top-up, subscriptions. However, whilst there may be various legitimate reasons for redeeming an investment after a relatively short period of time, most retail investment is made for the medium to long-term.
- 8.38 As such, firms in this sector will place some reliance upon the alertness and experience of its staff to spot unusual activity. However, firms may also consider the implementation of basic exception reporting to identify, for example, short-term investment by individuals, in line with its risk-based approach. Disposals so identified might be reviewed in the context of the original purchase (e.g. is it within the charge-back period for a subscription by debit card?), against market conditions, or in the light of any specific information the firm has about the investor. The exercise of cancellation rights is relatively rare and should be considered in a similar way.
- 8.39 As per paragraph 8.5 above, examples of other monitoring that firms may choose to undertake in line with its risk-based approach, include monitoring for:
- Third party payments
 - Switches from one fund/product to another
 - Transfer of holdings to a third party
 - High turnover of funds
 - Transaction activity which is high in value/volume

8.40 Transfers involving either a regulated firm (or a nominee company subsidiary) or arising from the distribution of assets from a trust or the estate of a deceased, give less cause for concern over a subsequent transfer of the holding by the recipient. However, the purchase of units by one individual and transfer to another, and so on, is unusual and may indicate that money or other consideration is changing hands in the background with the aim of avoiding verification of the identity of those in the middle of the chain. Firms should be alert to such activity and take appropriate steps to investigate the nature and purpose of any unusual patterns that emerge.