THE
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Dear Sir

RE: Consultation Paper – The Risk Factors Guidelines

The Investment Association welcomes the opportunity to respond to the joint ESA's consultation.

The Investment Association represents the UK asset management industry. Our members manage over £5 trillion in the UK of assets on behalf of UK, European and international clients, both retail and institutional. Collectively, our members make up the second-largest asset management industry in the world.

Below, we have provided our responses to the questions raised in your paper.

Yours

Adrian Hood
Regulatory and Financial Crime Expert

Q a: Do you consider that these guidelines are conducive to firms adopting risk-based, proportionate and effective AML/CFT policies and procedures in line with the requirements set out in Directive (EU) 2015/849?

The proposed Guidelines will undoubtedly assist firms adopting risk-based AML/CFT policies and procedures.

There seems to be no specific explanation of why sections of the Guidelines uses 'shall', 'should' or 'must'. It would be useful if the Guidelines could make it clear what the different usages indicate.

Para 8 - In the definition of source of wealth, generating wealth through owning a successful business or investment might be a more common or practical example. 'Savings' is overly generic. It should also be noted that 'Firms', as defined, should be linked to the terms 'Obliged Entities' in the Fourth Money Laundering Directive.

Chapter 5
5.1 Impact Assessment - In answer to the impact questions, we prefer the following options:

- Consistency with international standards - Option 2
- Structure - Option 2
- Addressees - Option 3
- Level of prescription - Option 2

Q b: Do you consider that these guidelines are conducive to competent authorities effectively monitoring firms' compliance with applicable AML/CFT requirements in relation to individual risk assessments and the application of both simplified and enhanced customer due diligence measures?

Yes, but the Joint ESAs need to continue to take action to ensure that the Guidelines are interpreted and implemented in a consistent way by the different national competent authorities.

To this end the ESAs should undertake to conduct periodic benchmarking exercises, and facilitate sharing of information and thinking between the national competent authorities.

Firms active across the EU should expect to see the relevant risks being treated consistently in the different member states. National competent authorities should not be able to use their own interpretation of a risk based approach to discriminate against non-local firms.

In the second bullet point of paragraph 10 of the proposed Guidelines, on CDD, we think that the findings from the business wide risk assessment will be one element in the decision on the level of CDD to apply. It is not the only factor that firms should be employing.

Given numerous recent developments would it not be appropriate to include 'sporting bodies' in the list in the first bullet point of paragraph 19 of the proposed Guidelines?

The meaning of the fourth bullet point in paragraph 19 is not immediately clear. It should be expanded and clarified.

Under the seventh bullet point of paragraph 19, should it not also be noted that all corporate and other legal entities are required, under Article 30 of the 4MLD, to provide obliged entities with information on their beneficial owners. Further, that many member states will be setting up public beneficial owner registers.

The fourth bullet of paragraph 20 is excessively vague. How can firms collect/use this sort of material in a practical way with any confidence? The *suggestion* that someone *associated with* the client *may* have handled the proceeds of crime has three degrees of uncertainty.

It should be noted that several of the risk factors set out in paragraph 21 will only become relevant once the business relationship has been set up, and are thus, more likely to be relevant to on-going monitoring of the client relationship (paragraph 62 on).

Paragraph 24, as it relates to enhanced due diligence, may be better placed (or repeated) in the section on EDD.

In the last bullet point of paragraph 30 it would be useful if some further detail were provided on how a firm should ascertain whether an intermediary is subject to effective AML supervision.

Paragraph 34 – the third bullet point raises the issue of whether all firms in the financial sector should be using the same risk classification scheme, or whether each firm should have its own way of classifying clients as high, medium and low. If the later, than it could be that one firm's high risk relationship would be classified as medium or even low, by another firm. This becomes particularly problematic within groups of financial services firms. For example, if a group applies a group risk rating policy across asset management, insurance and banking subsidiaries, then the asset manager may end up rating all of its clients as low risk. An independent asset manager, applying a bespoke risk rating approach, may rate identical client relationships as low, medium and high. This would have serious impacts on the ability of firms to apply SDD, as set out in paragraph 41.

Paragraph 44 – this should state that SDD measures should *serve to confirm* the low risk – not *enable the firm to be reasonably satisfied* that this is so. In practice, the measures should support the analysis, not deliver it.

Paragraph 48 – the last sentence should make it clear that this requirement is in addition to those set out previously. The addition of 'also' as the third would be effective.

Paragraph 49 – while we note that all PEPs are to be treated as high risk, and that EDD must be applied, it seems that the Guidelines recognise that different PEPs might be classified as representing different levels of high risk. Is this correct? And if so, what consequences would this have? Also, the third bullet point relates to monitoring, so should appear (or be repeated) in the section on monitoring (paragraph 62 on).

Chapter 8 – Investment Managers

Paragraph 195 should include EEA authorised CIS as a customer who should be deemed low risk.

Chapter 9 – Investment Fund Providers

Paragraph 204 - Another indicator of lower risk for a fund would be where the trading in the fund is relatively illiquid e.g. it only deals on a weekly basis, or the underlying assets in the fund prevent rapid removal of proceeds (such as a restricted property fund where sale of the underlying property is needed for redemptions).

Paragraph 205 – item (i) should only indicate higher risk if there is no clear, legitimate, understandable rationale for this behaviour.

Paragraph 209 – why is there no equivalent paragraph stating that investors' funds being generated in a low risk jurisdiction, in particular those associated with lower levels of predicate offences to money laundering, would be a factor indicating lower risk (as in Chapters 2 and 6)?

Paragraph 210 – it is not clear what is meant by 'the Internet' in the first bullet point.

Paragraph 211 – it would be useful if the Guidelines could be clear on whether the phrase 'source of funds' used here has the same meaning as when it is used elsewhere and defined in paragraph 8, or whether this is a different concept limited to the where the funds were previously held, e.g. an EEA bank. If it is meant in this different, more limited, sense, this should be made clear.

Paragraph 215 – the paragraph should make it clear that the full CDD or EDD is to be applied to the intermediary / platform, not the underlying investors, or beneficial owners of the fund.

Q c: The guidelines in Title III of this consultation paper are organised by types of business. Respondents to this consultation paper are invited to express their views on whether such an approach gives sufficient clarity on the scope of application of the AMLD to the various entities subject to its requirements or whether it would be preferable to follow a legally-driven classification of the various sectors; for example, for the asset management sector, this would mean referring to entities covered by Directive 2009/65/EC and Directive 2011/61/EU and for the individual portfolio management or investment advice activities, or entities providing other investment services or activities, to entities covered by Directive 2014/65/EU.

We prefer the proposed approach in Title III, and would not wish to see a legally-driven classification of the various sectors. The aim should be for the guidelines to focus on the activity, which may only be a part of a legal entity's business, making a legally-driven classification problematic and difficult to implement.