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(ALCO)**

**Non-Profit Association**

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**Report of the work group nr 3  
Money laundering prevention in the framework of the Transfer Agent of a UCIT  
administered in Luxembourg.**

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## **I. Aims.**

The aims of the Work Group are to bring about a new thinking on the means of prevention used in the framework of Money laundering prevention, given the complexity and diversity of transactions on the one hand, and the international context of the Undertaking for collective Investments (UCITS) on the other hand.

The range of reflection has been defined as the analysis of the various cases likely to be encountered in the distribution of a UCIT subject to Luxembourg's administration or when the depositary bank is tributary to Luxembourg's laws, through the following channels:

- Distributors having a distribution contract (nominee), or distributing through specialised channels using "Terms of Business" (TOB).
- Distribution through an "independent Financial Advisor" (IFA).
- Own clients (private investors, institutions, or other UCITS).
- Special cases: Trusts, managed accounts, etc...

For each category the various cases will be treated in reference to the UCIT's distribution network (whether in a FATF country or a non-FATF country).

Concurrently the Work Group will also emit its opinion on the controls and means of prevention to institute:

- Required documentation and its authentication.
- Models of distribution contracts, TOB, subscription forms.
- Detection of suspicious transactions, daily and periodical monitoring.
- Control of the distribution delegate and the clients' identification.

It is important to specify that the action of delegating the authentication of investors to a distributor<sup>1</sup> in the context of a contractual arrangement in no way reduces the responsibility of the central administration which has the obligation to know its clients as well as the origin of their funds.

It is to be noted that the central administration of a UCIT is not under the obligation to carry out itself the identification of an investor the subscription or redemption order of which has been received by a professional of a financial sector subject to identification requirements equivalent to those of the laws of Luxembourg (Circular IML 94/112; article 39, 5 of the law pertaining to the financial sector of April 5<sup>th</sup>, 1993, and its modifications).

This report does not distinguish between in-house UCITs and third party UCITs, but introduces a distinction at the level of distribution between a UCIT distributed within a financial group, and a UCIT distributed via entities extraneous to the Group.

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<sup>1</sup> See definition under « distributor », section 10 of this document.

## 2. Reference documents:

- **The coordinated Law of April 5<sup>th</sup>, 1993** pertaining to the financial sector (articles 38, 39 and 40).
- **IML Circular 94/112** dated 25.11.1994: Prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **Law of 11<sup>th</sup> August 1998** pertaining to the introduction of the incrimination of criminal organisations and laundering offences before the penal code.
- **BCL Circular 98/153** dated 24.11. 1998: addendum to IML Circular 94/112 dated 25.11.1994 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular 00/16** dated 23.08.2000: addendum to IML Circular 94/112 dated 25.11.1994 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular 00/21** dated 11.12.2000: addendum to IML Circular 94/112 and to BCL Circular 98/153 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular 01/31** dated 04.07.2001: addendum to CSSF Circular CSSF 00/16 and IML Circular 94/112 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular 01/37** dated 04.10.2001: addendum to CSSF Circulars 00/16, 01/31, and IML Circular 94/112 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular 01/40** dated 14.11.2001: clarifications on the extent of professional obligations as depicted by part II of the modified Law of 5<sup>th</sup> April 1993 on the financial sector and IML Circular 94/112 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **CSSF Circular Letter** dated 19.12.2001: census of the procedures to be established for the application of circular CSSF 01/40 pertaining to clarifications on the extent of professional obligations as depicted by part II of the modified Law of 5<sup>th</sup> April 1993 on the financial sector and Circular IML 94/112 on the prevention of money laundering and against the utilisation of the financial sector for laundering purposes.
- **ABBL – ALFI – March 2000**: uses and recommendations pertaining on the prevention of the use of UCITs for money laundering purposes.

## 3. Categories of Distributors:

### 3.1. Distributors using distribution contracts and specialised companies:

The following two cases are frequently encountered:

- Distributors using distribution contracts.
- Distribution through companies specialised in the sale of UCIT shares using “Terms of Business” (TOB).

### **3.1.1. Distinction.**

The distinction between these two forms of distribution lies in the fact that a company that signs a distribution contract can subscribe for a third party or for its own account, whilst in the case of a TOB, subscriptions are only effected for the account of a third party.

It is worth recalling that CSSF circular 2001/40 states that the Luxembourg professional is duty bound to ask the financial intermediary if he is acting for his account or on behalf of a third party.

The controls pertaining to the status of the distributor are similar in both cases. The distinction is rather at the contractual level.

### **3.1.2. Minimum requirements of a distribution contract.**

A nominee Contract or any other form of distribution contract should, at the very least, contain the following minimum requirements:

- Specify in which capacity the distributor is acting (nominee, financial intermediary,...)
- Provide references of the legal texts equivalent to the Luxembourg standards to which the intermediaries are subjected in the way of money laundering prevention.
- The obligation to verify the identity of the underlying investors.
- The obligation to monitor suspicious or unusual transactions (To be defined by each institution. Please refer to point 7.2).
- Identification documents must be held at the disposition of the administrative agent.
- Specify the length of preservation of the subscription documents.
- The promoter may require the confirmation of the Institution's observance of the concerned laws and regulations at a frequency he may determine, or may decide to carryout an audit of the said observance.

### **3.1.3. Means of identification of intermediaries**

The simplest method to identify the Intermediary is to obtain the proof that he is under the surveillance of a control authority. This may usually be determined by examining the Internet site of the control authority. If the proof that the said Intermediary is subject to a control authority of a FATF country cannot be obtained, the documents required for the identification are:

- A copy of the statutes.
- A copy of its license to operate, of the commercial registry, or their equivalent in the concerned legislation.

The following documents are also required from the Intermediary:

- An account opening form pertaining to a registered account.
- A copy of a distribution agreement.
- A copy of the last audited financials.
- A copy of the list of authorised signatories.
- The name of the control authority.

- Standard payment orders.
- A bank statement.

#### **3.1.4. Recommendations.**

In cases where the distribution itself is delegated, this must be explicitly mentioned in the distribution agreement. The controls relative to the status of the sub-distributor must therefore be the object of the same tests applied to a main distributor.

To secure the application of the money laundering prevention controls, it is recommended that the main distributor requires a yearly confirmation of the company's respect of its contractual obligations relative to the obligation to carry out anti-money laundering controls.

The promoter may appoint as distributors companies not belonging to his group. The controls to apply on the final economical beneficiary are to be instituted by the distributor and are similar to those mentioned in the item above.

Moreover, the transfer agent must in that case set-up internal control procedures in cooperation with his counterparty to ensure he is informed at all times of any and all modifications in the distribution network.

When the identification of Investors is delegated to a branch submitted to legislation equivalent to those of Luxembourg it is recommended to request from the parent bank to confirm the establishment of a group policy on the prevention of money laundering.

### **3.2. Distribution through an "Independent Financial Advisor" (IFA).**

An I.F.A is an intermediary that retains an initial commission on the various subscriptions, as well as a periodical commission on the outstandings of the business contributed. The subscriptions are registered at the Transfer Agent in the client's name. The documentation concerning the client is kept by the IFA, providing the latter is subject to a supervision authority imposing the respect of money laundering prevention regulations. In that case, it is necessary to verify whether the IFA is subject to the control of a monitoring authority that imposes the respect of regulation pertaining to money laundering prevention.

In Germany for instance, the majority of IFAs are not monitored. It is therefore necessary in that case that the Transfer Agent secures the identification.

#### **3.2.1. Method of identification of the I.F.A.**

The documents required for the identifications of the I.F.A. are identical to those required to identify an intermediary. Please refer to point 3.1.3

#### **3.2.2. Recommendations.**

Given that the I.F.A. keeps all the client's identification documents, it is important to ensure that the former is subject to a supervision authority as is the case for example in Great Britain. A document attesting that the IFA is subject to obligation similar to those of Luxembourg should also be secured.

#### **4. Direct Clients.**

Are considered « direct » clients those who send their subscription orders directly to the central administration. In that case the onus of identification is incumbent upon the central administration. The orders of a direct client are received either by mail, or at the counter, or through an unofficial nominee (without distribution contract).

##### **4.1. Private Clients.**

###### **4.1.1. Means for the identification of private clients.**

Identification documents required to identify a client vary from country to country. Generally, a private client will be identified by his passport and photograph, or his national I.D. card. At the time of subscription a copy of his I.D. certified true to original will be maintained on file. This certification is however not necessary if the orderer's bank can be clearly identified and resides in a FATF country. (See item 6.3)

Any other type of identification documents will be examined on a case-by-case basis, according to the client's country of residence. Particular care will be taken on the nationality and residence of the investor, in order to identify "sensitive clients".

###### **4.1.2. Recommendations.**

When the subscription order is effected through a non-FATF bank, the client will be classified in the "sensitive clients" category.

##### **4.2. Institutional clients.**

An institutional client can be a financial or a commercial company, another UCIT, a pension fund, an insurance company, etc. (Please refer to the CSSF note relative to the application of the law of 19<sup>th</sup> July 1991 pertaining to UCITS the shares of which are not destined to public placings).

###### **4.2.1. Method for the identification of institutional clients.**

Please refer to the attached table displaying the different identification documents, by country. The identification documents must be certified true to original. A certified document will not be required in the following cases:

- Institutional clients known in the market, and whose shares are listed on an official exchange.
- By definition, company documents such as extracts from the commercial registry, acts of constitution, statutes, are public documents. It is therefore not necessary to obtain a copy certified true to original if the documents have been obtained directly from an officially recognised organism. (For instance the commercial registry)

In the case of a subscription received from a pension fund or another UCIT, a copy of the prospectus will be required. Moreover it will be necessary to verify the underlying investors if all the following conditions are met:

- The custodian (depository bank) of the UCIT is located in a non-FATF country and not subject to obligations equivalent to those in force in Luxembourg. (CSSF circular 94/112)
- The central administration of the UCIT's orderer is an entity located in a non-FATF country and not subject to obligations equivalent to those in force in Luxembourg. (CSSF circular 94/112)
- The orderer's bank is located in a non-FATF country and not subject to obligations equivalent to those in force in Luxembourg (circular CSSF 94/112)

#### **4.2.2. Recommendations.**

Effect a deeper control on the fund's origin when the subscription payment is effected through a non-FATF bank.

For subscriptions received from a pension fund or another UCIT, it would be useful to request a confirmation that none of the shareholders is on one of the black lists communicated by the authorities of UCIT's country or the pension fund's domiciliation, as is the case for all investors.

#### **5. Subscriptions through clearing organisms.**

Clearing organisms such as Euroclear (Fundsettle) and Clearstream (Vestima) only identify their own client. Their distribution contracts have a clause specifying that the onus of identifying the beneficial owner rests on the client (which implies the central administration in the case of a UCIT). Subscription through a clearing agent is similar to a subscription through a financial intermediary where the identification of the investor can be delegated if the Clearing organism's client who has received the subscription or redemption order is a professional of the financial sector subject to an identification requirement equivalent to the requirement of the Law of Luxembourg (Circular 94/112).

#### **6. Identification documents.**

##### **6.1. Type of identification documents.**

For physical persons, the identification is made by means of a passport or of a valid identity card. For companies, please refer to the attached table reviewing the different types of documents for each country.

##### **6.2. Validity of the documents.**

The documents validity dates are usually mentioned on the clients' identification documents (Passport, ID card, etc.) It is recommended to update expired identification documents. This can be effected at the next redemption or subscription.

### **6.3. Documents' certification .**

#### **6.3.1. Direct order of an investor.**

The Law of Luxembourg on money laundering is not sufficiently explicit on the notion of ID certification. The 94/112 Circular is specific on private individuals (for instance embassy, consulate, notary, police officer). In the case where the orderer's bank is located in a FATF country, it is not necessarily required to certify the identification documents. By the "orderer's bank" it is meant the investor's bank and not one of the players intervening in the transfer of funds process.

As far as companies are concerned, the constitution of a company being effected before a public notary, a copy certified true to original by a FATF financial intermediary or by the investor's banker is sufficient. Extracts of the commercial registry and statutes are by definition public documents that can be obtained directly at the registrar or from a professional chamber, and need not therefore be certified. (see point 4.2.1).

Authorities competent in certifying documents vary from country to country. The central administration will institute procedures defining competent authorities.

#### **6.3.2. Orders taken by an approved distributor.**

An approved distributor to whom a UCIT has delegate the obligation of identification of the investor can certify the identification documents if he is a professional of the financial sector subject to requirements identification requirements equivalent to those demanded by the Luxembourg Law.

#### **6.3.3. Subscription taken by a financial institution having effected the client's identification.**

The circular 94/112 specifies that the central administration of a Luxembourg UCIT is not required to proceed with the identification itself of an investor of whom the order of subscription or redemption has been received from a professional of the financial sector subject to an obligation of identification equivalent to that of Luxembourg. In that particular case the issue of certification does not arise, since in that case the UCIT is dispensed from the obligation of identification.

### **6.4. Period of conservation of Identification Documents**

Identification documents must be kept for a period of at least five years after the final redemption by the investor.

## **7. Controls and means of prevention to institute.**

### **7.1. Controls.**

Internal control procedures and the set-up of automated monitoring tools rest on the fundamental principle "The Transfer Agent must know his client", i.e. the final beneficial owner.

The UCIT's distributor network is determined by the Promoter (CSSF circular 91/75, chapter D, point III). The administrative agent gathering the UCIT's investment orders must therefore know, at the inception of the relationship, the distribution network and its legal entities, as well as the quality of the latter (nominee, distributor), the countries of distribution, the clients targeted, the marketing strategy of every distributor, the modalities by which investment orders not transiting through the usual channels are accepted or turned down, etc. This information is indispensable to rule on whether it is possible or not to delegate the identification of investors (CSSF circular 94/112 point B). A transfer agent is indeed entitled to demand from the distributor any information on the beneficial owner's identity he deems necessary, or to take the decision to delegate or not the identification process. Moreover the transfer agent must be informed of changes concerning the distribution network.

## **7.2. Laundering clues.**

The following list is indicative and by no means exhaustive. An array of converging items could constitute clues to a laundering operation.

- Recurring redemption or subscription orders below the level of €10,000.
- Origin or destination of a fund transfer unrelated with the client's residence.
- Unusual names used for the fund transfers.
- Subscriptions followed immediately by redemptions.
- Share transfers between clients.
- Transfer of investments to seemingly unconnected third parties
- Disproportionate transactions in reference to usual transactions.
- Subscriptions and redemptions of investors of whom the ordering bank is located in a non-FATF country
- Difficulties in obtaining identification documents.
- The client providing insufficient information, or vague or suspect information, or fails to provide them within a reasonable delay.
- Company or Trust that takes an undue amount of time in providing company documentation or accounts.
- Contradicting or inconsistent information provided by the client.
- Payment by a cheque issued by a third party or through a fund transfer in which the account owner, the signatories, and the client are different persons.
- Numerous transfers requested in a relatively short period: transfer operations are submitted to the same rules as subscriptions.
- Excessive inflation of the account.
- The frenetic activation of a "dormant account".
- The abnormal growth of the account, not in consistence with the activities of the client.
- Payment of a redemption effected to a third party account, unconnected to the account.
- Payment order with incorrect data on the orderer.

- Several transfers from different individuals landing on the same account.
- Frequent and large transfers arriving from different countries.
- Bearer securities with physical delivery.
- Cash operations or transactions unconnected to the client's activities.
- Operations apparently devoid of any commercial purpose.
- The settlement of a transaction through several fund transfers or by means of several cheques.
- Settlement of a transaction by means of equity redemption without apparent reason.

#### 8. Miscellaneous.

The ABBL and ALFI have issued to their members recommendations in a document titled "uses and recommendations aimed at the prevention of the use of UCITs for money laundering" dated March 2000. The ALCO would nevertheless like to bring some clarifications to this document, subsequent to various misinterpretations made by some institutions on certain terms used in this document.

The intermediary mentioned in point 2 of the ABBL / ALFI document is of course the organism that has received the client's subscription, and not the correspondent through whom the bank transfer has transited.

The determinant factor in establishing identification is the financial intermediary's country of residence (FATF or non-FATF), and not that of the subscriber.

A third point that needs to be clarified is that the identification must be made at the subscription with the possibility of accepting the subscription on the basis of the due diligence effected on a subscription bulletin, providing the identification procedure has been initiated. In case of redemption, the transfer agent reserves the right to suspend payment in case of money laundering suspicions.

*It is important to note that a draft law is being drawn, with a view of adopting the European anti-laundering second directive. The new dispositions will be have to be taken into account as soon as this directive will be translated into Luxemburg Law.*

#### 9. Points to be handled in a future work group.

- Role of the custodian bank when it is not transfer agent and registry holder.
- UCIT under foreign law, i.e. when the Luxembourg financial institution is not the custodian.

#### 10. Definitions / Glossary.

**Distributor:** the "*distributor*" is an intermediary in the distribution network set-up by the UCIT's promoters, whether directly intervening in the marketing of the UCIT's shares, or whether he is designated in the prospectus as authorised to receive subscription and redemption orders for and on behalf of the UCIT's account (circular 91/75 chapter D III 2.2.1).

**Economic owner:** see final economic beneficiary.

**Final economic beneficiary:** ultimate shareholder of a structure putting forward aliases acting on behalf of the real beneficiary of the operation.

**I.F.A (Independent Financial Advisor):** the "IFA" is an intermediary contractually linked to a distributor, a sub-distributor or an institutional investor for whom he sells UCITS shares.

**Institutional:** "The institutional Investor" is an intermediary that can intervene for his own account or on behalf of final subscribers. If he acts for the account of his clients we consider that the account he may have at the UCIT or the central administration an "Omnibus Account". If he acts on his own behalf, he may be a market maker.

**Intermediary:** a financial agent or holder of a Power of Attorney nominated by the UCIT for the placing or the redemption of its shares. The intermediary can be a Luxembourg national or an alien. They are empowered to accept subscription or redemption orders of the UCIT's shares. They can intervene in the operations of placing or repurchase either as distributors, or nominees, or market makers.<sup>2</sup>

"The Intermediary" is a generic term covering all the participants taking part in the marketing of the UCIT's shares and intercede between the central administration and the final subscriber.

**Market makers:** Intermediaries who intervene for their own account, at their sole risk, in operations of subscription or redemption of UCIT.<sup>3</sup>

**Nominee:** Intermediaries interceding between investors and UCITS of their choice. Consequently they are registered as shareholders or participants of the UCIT. The conditions relative to the nominee's statutes are defined in Chapter D, Section III 22.2 of the IML circular 91/75.

When the nominee is not an integral part of the distribution network, he may have a contractual relation with the client only. In the contrary case, an agreement specifying the respective obligations of the nominee and the UCIT is required.

**Promoter:** The person who is at the origin of the UCIT, that give the first impulse, creates the UCIT, determines the orientation of its activities and eventually benefits from it.<sup>4</sup>

## **11. Appendix.**

### **11.1. List of professionals of FATF countries aimed at by the anti money laundering legislation.**

Please refer to the file "AML\_Professionnels\_par\_pays\_Dec2002.pdf".

### **11.2. Liste of identification documents used in various countries.**

Please refer to the file "Country\_Chart\_ALCO.pdf".

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<sup>2</sup> Reference : IML circular 91/75 of 21st January 1991 – Chapter D, Section III 2.1.

<sup>3</sup> Reference: IML circular 91/75 of the 21<sup>st</sup> January 1991 – Chapter D, Section III 2.2.3.

<sup>4</sup> IML Note of 20th May 1998 pertaining to the elements managing a Luxembourg undertaking for collective investments ( UCIT).