Alternative Investment Management Association

Joint Committee of the European Supervisory Authorities

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22 January 2016

Dear Sir/Madam,

AIMA's Response to the Joint Consultations on the Joint Guidelines under Article 17 and 18(4) and under Article 48(10) of Directive (EU) 2015/849

The Alternative Investment Management Association[1] (AIMA) welcomes the opportunity to respond to the European Supervisory Authorities' (ESA's) joint consultation papers:

- setting out joint guidelines (the 'Risk Factors Guidelines' or 'RF Guidelines') under Article 17 and 18(4) of Directive (EU) 2015/849 (the 'AML Directive') on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering ('ML') and terrorist financing ('TF') risk associated with individual business relationships and occasional transactions (the 'RF Consultation Paper'); and

- setting out joint guidelines (the 'Risk-Based Supervision Guidelines' or 'RBS Guidelines', together with the RF Guidelines, we refer to these as the 'Guidelines') under Article 48(10) of the AML Directive on the characteristics of a risk-based approach to anti-money laundering ('AML') and counter-terrorist financing ('CTF') supervision and the steps to be taken when conducting supervision on a risk-sensitive basis (the 'RBS Consultation Paper', together with the RF Guidelines we refer to these as the 'Consultation Papers').

[1] Founded in 1990, the Alternative Investment Management Association (AIMA) is the global representative of the hedge fund industry. Our membership is corporate and comprises over 1,600 firms (with over 10,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets.

As the global representative of the hedge fund industry, we set out in this response our comments on the generic parts of the Guidelines and the sector specific part of Title III of the RF Guidelines which relate to the hedge fund industry.

AIMA welcomes the continued work of the EU institutions to bring European Union legislation into line with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation that the Financial Action Task Force (FATF) adopted in 2012. We strongly support the aim of the Consultation Papers to promote the development of a common understanding, by firms and competent authorities across the EU of what the risk-based approach to AML and CTF entails and how it should be applied.

We consider that there should be a close alignment between what firms are expected to assess and how the competent authorities will supervise the monitoring of ML/TF risks. It is imperative that firms are expected to carry out customer due diligence in a manner that is commensurate to the risk posed by a particular client and that firms are aware of what is expected from them and how the adequacy of their processes will be assessed by competent authorities.

Holistic view

AIMA agrees with much that is contained in the RF Guidelines. In particular, we strongly support guideline 17, which states that:

> "Firms should note that the following risk factors are not exhaustive, nor is there an expectation that firms should consider all risk factors in all cases. Firms should take a holistic view of the risk associated with the situation and note that unless required by Directive (EU) 2015/849 or national legislation, the presence of isolated risk factors does not necessarily move a relationship into a higher or lower risk category."

We consider that this is a key statement as whilst the guidelines set out a number of useful risk factors, many of them may not be applicable in every circumstance. Moreover, encouraging firms to take a holistic view and not determine the ML/TF risk based mainly on a few indicators, which may sway the decision in one direction or another, is far more likely to lead to an appropriate risk classification on a case-by-case basis.

Use of Examples

AIMA considers that examples should only be included in the Guidelines where they relate to an issue which would always indicate a higher or lower ML/TF risk and where they are directly related to the guideline to which they attach. For example, the sectoral guidelines for investment managers set out in the RF Guidelines suggest that the involvement of a hedge fund in a transaction may indicate higher risk of money laundering/CTF. We strongly disagree with such implication. The vast majority of funds that use hedging strategies are highly regulated structures. Simply because a fund uses a hedging strategy, should in no way mean it poses a higher risk of money laundering/CTF. For example, a growing portion of UCITS and U.S. funds regulated under the Investment Company Act 1940 are being managed as "liquid alternatives," which are registered and highly regulated funds managed using hedge strategies. We therefore consider that the reference should be removed.

High-Risk Jurisdictions

In certain instances, the Guidelines refer to "offshore jurisdictions" to try to indicate a country may pose a higher risk of ML. We consider that these references should be amended to refer to a specific standard, and hence make the Guidelines clearer for firms. "Offshore" is a term that can mean very different things to different people and using terms like these in guidance is likely to

lead to confusion in firms[2]. For example, on page 18 of the RF Consultation Paper reference is made to jurisdictions which are "a known tax haven, secrecy haven or offshore jurisdiction". This description is extremely vague and subjective. AIMA considers that these types of references should be changed to make reference to jurisdictions which are on the FATF list of high-risk and non-cooperative jurisdictions as this would provide firms with greater certainty in assessing the risk posed by a client from a certain jurisdiction. For example, the AIFMD makes reference to this list in Article 36 and Article 42 in order to provide a standard with which it is possible to comply.

All of the significant non-EU fund jurisdictions are members of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes and have passed the Phase 2 peer review process rated as largely compliant (the same rating as the UK and the US). They have enacted domestic legislation and entered into intergovernmental agreements with the US to implement FATCA and are members of the "early adopters" group of jurisdictions which are implementing the Common Reporting Standard (CRS). Accordingly, funds established in these jurisdictions are now required to collect specified information on investors who are US citizens or who are residents of jurisdictions which have adopted the CRS and report this to the tax authorities for automatic exchange with the relevant jurisdictions. The popular perception that these non-EU fund jurisdictions are "tax havens" is incorrect and the term should be replaced in the Guidelines to avoid confusion and incorrect application."

AIMA also considers that a more objective test, such as referring to the FATF list of high-risk and non-cooperative jurisdictions, should be used in the Guidelines to determine the risk posed by different jurisdictions as this would leave less room for competent authorities to bring political factors into their decisions as to whether a firm should have deemed a client from a certain jurisdiction to be high risk or not.

For example, in 2014 the UK Financial Conduct Authority (FCA) published its own list of countries it considered to pose great ML/TF risk. This list included, amongst others, two EU Member States (Bulgaria and Latvia) and four jurisdictions which were identified in a separate list published by the European Commission as having regimes equivalent to EU standards (Brazil, India, Mexico and South Africa). The FCA explained that the list of higher risk jurisdictions would be one factor to be taken into account when the FCA is assessing firms' AML systems and controls during supervisory visits. After petition by certain jurisdictions who had been placed on the list, the list had to be subsequently withdrawn by the FCA as it could not support its conclusion that these countries all posed higher ML/TF risk.[3] This exercise was confusing for firms who had to assess clients' ML/TF risk from jurisdictions who were on the FCA list but not on other lists and had not been previously assessed as high risk jurisdictions by international organisations.

Suspicious Activity Reports

The RF Guidelines pose the question as to whether the firm knows if the customer or beneficial owner has been subject to a suspicious activity report ('SAR') in the past.[4] In practice, the RF Guidelines, once finalised, are likely to be incorporated by firms into their routine checklists of matters they should consider when carrying out customer due diligence. AIMA considers that this guideline could be difficult to implement in practice as there are often multiple people at a firm which will be involved in the AML procedures and most would not know if a customer had been subject to a SAR without breaching certain rules, such as 'tipping-off' rules in the UK.[5] If the customer or beneficial owner is being reviewed as part of an ongoing review (i.e., existing relationship), then the firm conducting the review would know if the customer/beneficial owner has

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[2] For example, the Investopedia definition of "offshore" includes "Dublin" as an offshore financial center. Taken quite literally, "offshore" could be any country which is not the country of origin. This would mean all other EU Member States would be "offshore" for the purposes of the Guidelines.

[3] See further: http://www.caymanfinances.com/fca-withdraws-high-risk-country-list/.

[4] See Guideline 20 of the RF Guidelines on page 16 of the RF Consultation Paper.

[5] In the UK, a person commits an offence under section 333 of the Proceeds of Crime Act 2002 (POCA) if they make a disclosure that a customer has been subject to a SAR and that disclosure is likely to prejudice a money laundering investigation.

been subject to an internal suspicious activity report during the period of the relationship, as the SAR would have been submitted by the firm's Nominated Officer to the Financial Intelligence Unit. However, due to 'tipping-off' requirements, the raising of the SAR would require the Nominated Officer to maintain an internal register that is limited only to relevant people that should have access to it. AIMA would therefore request that further guidance be provided as to how this can be implemented in any but the smallest organisations without breaching any other legislated requirements, such as 'tipping off' rules.

If the customer or beneficial owner is a new customer to be on-boarded by the firm (i.e., no existing relationship), due-diligence would never be able to ascertain if a SAR has been raised against a customer or beneficial owner. The only agency that could confirm if a SAR has been raised against such parties are the domestic Financial Intelligence Units e.g. the UK National Crimes Agency, and this information would not be disclosed. AIMA would therefore request that further guidance be provided as to the context of this question and how this can be implemented without breaching 'tipping-off' legislated requirements.

Yours faithfully,

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The Alternative Investment Management Association Limited (AIMA)