FIAU

IMPLEMENTING PROCEDURES

PART II

COLLECTIVE INVESTMENT SCHEMES & RELATED SERVICE PROVIDERS

CONSULTATION DOCUMENT

October 2023

CONSULTATION

The Financial Intelligence Analysis Unit ('FIAU') has today issued a Consultation Document on the Implementing Procedures – Part II for CISs ('CISs') and related Service Providers.

The said document sets out how the FIAU envisages that CISs and related Service Providers are to meet their obligations under the Prevention of Money Laundering Act and the Prevention of Money Laundering and Funding of Terrorism Regulations where it is not feasible to refer to the Implementing Procedures – Part I. The proposals seek to provide an answer to a number of questions, including how beneficial ownership requirements are to be applied within the context of CISs and what on-going monitoring obligations CISs and their related Service Providers have. In addition, the document tries to adopt as holistic an approach as possible by also providing some ML/TF risks that are of particular relevance within the context of CISs.

In drafting the Consultation Document, the FIAU took into account the discussions it had with the Malta Asset Servicing Association and input received from the Malta Financial Services Authority, the Malta Business Registry as well as its own internal sections.

Interested parties may submit their feedback via email on consultations@fiaumalta.org by not later than 31 December 2023. Representative bodies are invited to collate their members' feedback and submit the same as a single submission.

25 October 2023

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ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
CDD	Customer Due Diligence
CIS	Collective Investment Scheme
CRA	Customer Risk Assessment
EBA	European Banking Authority
EDD	Enhanced Due Diligence
EEA	European Economic Area
FATF	Financial Action Task Force
FIAU	Financial Intelligence Analysis Unit
FSRB	FATF-Style Regional Body
IMF	International Monetary Fund
MFSA	Malta Financial Services Authority
ML/FT	Money Laundering and the Funding of Terrorism
MLRO	Money Laundering Reporting Officer
NAV	Net Asset Value
OECD	Organisation for Economic Co-operation and Development
PEP	Politically Exposed Person
PMLA	Prevention of Money Laundering Act
PMLFTR	Prevention of Money Laundering and Funding of Terrorism Regulations
SDD	Simplified Due Diligence
STR	Suspicious Transaction Report
VFA	Virtual Financial Asset

INTRODUCTION

CISs are quite particular in their nature. They are, at least within the context of the EEA, subject to AML/CFT obligations even though they are very much a securities product that one can acquire from investment services providers. Though they are established as either legal persons or legal arrangements, their main and, in most cases, only function is that of collecting money from different investors and then contributing all the money collected to fund the acquisition of one or more investments. In so doing, investors benefit from economies of scale, allowing them to access a wider variety of investment opportunities while still benefitting from professional management services. It is due to this particular purpose that CISs present quite a level of flexibility. Their units are somewhat different from any securities usually issued by legal persons or arrangements as they do not have any fixed nominal value and, in most cases, are intended to be easily redeemable.

All of these characteristics give rise to a number of questions as to how CISs and the subject persons who service them are to meet their obligations as they arise from the PMLA, the PMLFTR, the accompanying Implementing Procedures – Part I and other binding documents that may be issued from time to time by the FIAU. The purpose of this document is to set out how this can be done. Part A provides an overview of the main ML/FT risks associated with CISs. Part B and Part C address particular aspects and difficulties faced by CISs and service providers servicing these legal entities and/or legal arrangements respectively in complying with their AML/CFT obligations.

These Implementing Procedures are therefore complementary to the Implementing Procedures – Part I and are to be read together with the same. Where any particular aspect is not dealt with specifically in these Implementing Procedures, reference is to be made to the Implementing Procedures – Part I as they are still applicable to the sector. It is only to the extent that the two documents contradict one another that the Implementing Procedures – Part I are to be disregarded.

These Implementing Procedures are being issued in terms of Regulation 17 of the PMLFTR and are therefore binding at law. They are to come into effect six (6) months from the date of their official publication on the FIAU's website.

25 October 2023

PART A THE ML/FT RISKS ASSOCIATED WITH COLLECTIVE INVESTMENT SCHEMES

This Part sets out what are the main ML/FT risks to which CISs are exposed and/or which CISs present to those subject persons servicing them. It is not an exhaustive list, and subject persons are to also take into account the ML/FT risks highlighted by other authorities and bodies, especially those referred to in the EBA Guidelines on ML/FT Risk Factors, even though such risks need not all be relevant within a Maltese context. However, given that subject persons may also be servicing foreign established CISs, these Implementing Procedures also include risk factors that may arise when interacting with such schemes rather than domestic ones.

The ML/FT risk factors referred to hereunder can find application both within the context of drawing up one's BRA as well as when carrying out the CRA. What is important is to always bear in mind, especially when assessing the ML/FT risk associated with a given business relationship or occasional transaction, that risk should be assessed taking a comprehensive look at the situation and not only on the basis of one or more risk factors in isolation. The only exception to this is when there is a clear obligation at law to consider as high risk a situation that presents one or more characteristics as is the case with having business relationships with, or carrying out occasional transactions on behalf of, PEPs.

In addition, it is important to bear in mind that any one risk factor may manifest itself at different times, be it when considering it within the context of one's own activities as a subject person as well as in the context of a specific business relationship or occasional transaction. Hence, the importance of revising and, where necessary, updating one's risk assessments accordingly.

A1. CUSTOMER RISK

Customer risk is extensively considered in the Implementing Procedures – Part I. However, it is worth remarking that there are aspects of the customer that may be of more relevance in the context of CISs.

A1.1 The Nature of the Customer

A distinction in terms of ML/FT risks has to be drawn on the basis of the nature of the customer, being the investor in the case of a CIS. Generally, a customer that would qualify as a retail investor is likely to pose a lower risk of ML/FT than one that qualifies as a professional investor. A retail investor is more likely to be a small-scale investor than a professional one, with any amounts invested posing a lower risk of ML/FT. Institutional investors may also present a lower ML/FT risk from a customer perspective as these would usually be entities that are subject to market entry requirements and regulatory supervision, including with regards to AML/CFT obligations. As set out further on under Section B3.1 of these Implementing Procedures, the regulatory status of regulated unitholders will also play a role in determining whether the relationship with the same is to be considered as low risk or otherwise. A low risk of ML/FT is also associated with government entities, or government approved entities.

When a subject person intends to establish a business relationship with a CIS or is to otherwise carry out an occasional transaction on behalf of the same, the subject person has to consider the regulatory status of the said scheme. The absence of any market entry requirements and/or the inapplicability of AML/CFT

obligations thereto implies that a CIS presents a higher ML/FT risk than one that is subject to these requirements. Needless to say that the subject person would also need to consider the kind of business carried out by the CIS. While all CIS function on the basis of the same premiss, the actual ML/FT risks posed by any one given CIS will vary depending on the type of underlying investors it is marketed to, the markets the CIS is marketing its units in, the investment strategy adopted, including what type of assets the scheme is to acquire, and the type of subscriptions it accepts.

A1.2 The Behaviour of the Customer

From the perspective of the CIS, customer behaviour can be an indication that a particular relationship presents a higher risk of ML/FT than others. In addition to the high-risk factors referred to in Section 3.5(a)(b) of the Implementing Procedures – Part I, it may be that the customer:

a. Makes investments that are inconsistent with the customer's overall financial situation.

b. Requests the repeated purchase and/or sale of units within a short period of time after the initial investment or before the payout date without a clear strategy or rationale, in particular where this results in financial loss or payment of high transaction fees.

c. Transfers funds in excess of those required for the subscription in the CIS and asks for any surplus amounts to be reimbursed.

d. Uses multiple accounts without previous notification, especially when these accounts are held in multiple jurisdictions or jurisdictions associated with higher ML/FT risk.

e. Suddenly changes the settlement location without rationale.

A1.3 Reputation

Attention has to also be had to any adverse information as referred to under Section 3.5.1(a)(a) of the Implementing Procedures – Part I. Any such information has to also be factored into one's risk assessment.

A2. PRODUCT/TRANSACTION RISK

In terms of the product risk, particular reference here is to be made to the CIS itself. This applies not only with regards to subject persons servicing CISs but, due to its nature as an investment product, also to situations where the scheme is the subject person itself. While comprehending that the product is one, the characteristics of the different CISs need to be factored in as a risk consideration as these may result in a higher or lower ML/TF risk.

Characteristics of a CIS that increase ML/FT risk include:

- The absence of any capping to the amount that can be invested either through a single subscription or multiple subscriptions.
- The absence of any lock-in period for one's subscription.

- The ability to subscribe to units in the CIS in kind.
- Allowing subscriptions to be financed by third parties and/or allowing the proceeds of any redemption to be transferred to third parties.
- The CIS is intended to attract high-value investors, as is the case with what are locally termed as qualified investors, especially where the number is limited.

A CIS presenting characteristics that are the opposite of the above could be considered as presenting a lower risk of ML/FT from a product/transaction point of view.

A3. GEOGRAPHICAL RISK

From the perspective of the CIS, geographical risk is likely to manifest itself in terms of where its customers are resident or otherwise established, where the activities generating the funds that are to be invested are located and from where funds are received/to be sent. By way of example, a higher risk of ML/FT will be present where the customers' or beneficial owners' funds have been generated in jurisdictions associated with higher ML/FT risk, in particular those associated with higher levels of predicate offences to ML. Another example of a higher level of risk is where it is possible for a customer to request that its units be redeemed and proceeds forwarded to an account held with a credit or financial institution located in a jurisdiction associated with higher ML/FT risk.

From the service providers' point of view there are other aspects of geographical risk that need to be taken into account. These would include having regard to the jurisdiction where the CIS is established and, where applicable, subject to regulatory oversight, where it is being marketed and where it is investing its funds.

A4. INTERFACE RISK

A CIS is unlikely to deal with its customers directly. This may at times happen within the context of self-managed schemes but, more often than not, a CIS will have a distribution network in place through which its units are marketed and subscribed to. The said network may comprise distributors and sub-distributors, with the associated risk increasing as the network becomes more extensive and its layers increase. In addition, these distributors may carry out the initial CDD measures mandated by the CIS. Thus, there will be a dependence on the quality of the implementation of these measures by the CIS' distributors and sub-distributors.

To the extent that the distributor is itself a regulated entity subject to equivalent AML/CFT obligations as the CIS, the ML/FT risk from an interface point of view will be less than in situations where, to the extent that this may be possible, the said distributor does not meet either or both of the said criteria.

A5. OUTSOURCING RISK

Outsourcing is especially important from a risk perspective when it comes to CISs. It is highly probable that a scheme outsources all of its main functions, including the carrying out of the policies, measures, controls and procedures adopted to meet its AML/CFT obligations, to different service providers. There will therefore be a dependence on these other service providers for the conduct of the scheme's affairs

on a daily basis which, notwithstanding all the efforts made, will always entail a limitation and an additional obstacle in maintaining the correct flow of data, information and documentation to ensure effective AML/CFT measures.

In addition, a CIS may simply adopt the same policies, measures, controls and procedures that are implemented by the outsourced service provider to meet its own obligations. The scheme has to ascertain that these policies, measures, controls and procedures effectively address the ML/TF risks it is exposed to, which may not be the same being faced by the outsourced service provider, and consider whether the mitigating measures to be implemented do mitigate the said risks. This aspect is considered in further detail under Section B.9 hereunder.

PART B – THE COLLECTIVE INVESTMENT SCHEME

This part of the document is addressed at CISs authorised under the Investment Services Act[1] and subsidiary legislation thereunder. It therefore sets out how a CIS can meet its obligations as a subject person.

B1. THE COLLECTIVE INVESTMENT SCHEME AS A SUBJECT PERSON

The PMLFTR set out that anyone carrying out relevant activity or relevant financial business is to be considered a subject person and is therefore bound to abide by the provisions of the PMLA and of the PMLFTR as well as by the requirements of the Implementing Procedures and any other binding orders, instructions, guidance or directives issued by the FIAU. Amongst the activities included under the definition of 'relevant financial business', one finds that there is included that of 'a CIS marketing its units or shares, licensed, recognised or notified, or required to be licensed, recognised or notified, under the provisions of the Investment Services Act'. CISs are therefore also considered to be subject persons in their own right and any one scheme is equally bound by all of the obligations arising from the above-mentioned legal instruments.

However, this is not an unqualified categorisation. A legal person or legal arrangement is considered to be carrying out relevant financial business as a CIS only where:

i. It is marketing its units or shares; and
ii. It is licensed, recognised or notified, or required to be licensed, recognised or notified, under the provisions of the Investment Services Act.

These two criteria are further elaborated upon hereunder:

Criterion (i) This criterion makes reference to the marketing by a CIS of its units or shares. This should not be construed as being limited to direct marketing carried out by the scheme itself, but includes also any marketing carried out by any of its service providers, or by any distributors or intermediaries engaged by the scheme or by one of its service providers. In addition, the reference to 'marketing' does not only cover situations where marketing material is produced to attract possible investors but also situations where units are placed privately by approaching potential investors, be it individually or collectively, to see if they are interested to invest in the particular scheme.

Criterion (ii) For a body corporate or a legal arrangement to act as a CIS it needs to have some form of authorisation by the MFSA, which authorisation can take the form of a licence, recognition notice or notification in terms of the Investment Services Act or subsidiary legislation issued thereunder.

[1] Cap 370 of the Laws of Malta.

Thus, it follows that legal persons or legal arrangements which carry out an activity similar to that of a CIS but are not authorised as such in terms of law are not to be considered as subject persons on the basis of paragraph (h) of the definition of relevant financial business. By way of example, a retirement scheme licensed in terms of article 4 of the Retirement Pensions Act[2] or a securitisation vehicle notified in terms of article 18 of the Securitisation Act[3] do not qualify as CISs in terms of law and are not therefore considered as subject persons under the PMLFTR on the basis of the said paragraph.

The situation is different with respect to those legal persons or legal arrangements that meet all the conditions under the Investment Services Act to be considered as CISs but have not sought to be so authorised. Notwithstanding the illegality of such an activity, the legal person or the legal arrangement would still be considered as carrying out relevant financial business and as therefore having to comply with all AML/CFT obligations.

For clarity's sake it is being set out that a CIS that is exempt from licensing under the Investment Services Act in terms of the Investment Services Act (Exemption) Regulations is not considered a subject person in terms of the PMLFTR.

Once both conditions are met, the CIS is considered to be a subject person for the purposes of the PMLFTR. For the avoidance of any doubt, it is being clarified that a CIS will be considered to be a subject person up until such moment in time as, depending on its regulatory status, its licence or recognition certificate is either surrendered or withdrawn or its notification struck off. Thus, until any of the said events materialises, the CIS remains bound to abide by its AML/CFT obligations.

The same applies with regards to close-ended CISs. In this instance, there will usually be a one-time offer of the scheme's units for subscription. Anyone interested in acquiring a holding in any such scheme following this initial offering would therefore need to buy the units or shares from an existing investor. Given that: (a) the close-ended scheme will still be licensed; and (b) it will still be exposed to the risks of ML/FT from any new investor who manages to acquire any of its existing units, the CIS will still be considered as a subject person even though it is no longer offering units or shares for investment and will still be bound to comply with the AML/CFT obligations as they result from the PMLFTR, the Implementing Procedures and any other binding document issued by the FIAU.

B1.1 Sub-Funds and Cell Companies

Questions may arise as to how CISs that are not stand-alone funds are to be treated, i.e. whether in such circumstances it is still the scheme that is to be considered as a subject person, or whether even the compartments established thereunder have some standing under the PMLFTR as subject persons in their own right.

A CIS can be established as an umbrella scheme, i.e. the CIS would still be constituted as a single entity but its units would be divided to form different sub-funds, each presenting a different investment

[2] Cap 514 of the Laws of Malta.
[3] Cap 484 of the Laws of Malta.

proposition and having its own pool of assets and liabilities attributable to it. In such cases, the subject person is still considered to be the umbrella scheme and not the different sub-funds, reason being that these sub-funds do not enjoy legal personality.

On the other hand, there are situations where local laws allow for the constitution of incorporated cells as sub-funds. This can be done for example under the Companies Act (SICAV Incorporated Cell Companies) Regulations[4]. Given that any cell created under a scheme established under these regulations does not only represent a separate patrimony but also a separate and distinct legal person requiring licensing or notification in terms of the Investment Services Act, both the scheme and the individual sub-funds are to be considered as subject persons.

Incorporated cells can also be established under the Companies Act (Recognised Incorporated Cell Companies) Regulations[5]. In this case, considering also paragraph (g) of the definition of 'relevant financial business', it would only be the cells that are to be considered as subject persons and not the company providing administrative services and support to the same. This is also set out under Section 2.1 of the Implementing Procedures – Part I

A CIS is therefore considered to be a subject person from the moment it is issued with a licence, a recognition certificate or otherwise has the relevant notification accepted by the MFSA. Up until such time as it remains so licenced, recognised or notified, it is for the scheme, its directors, officers and, where applicable, its employees to ensure that (i) they have an understanding of the ML/FT risks to which the scheme is exposed; (ii) they adopt and ensure the implementation of corresponding mitigating AML/CFT measures; and (iii) they monitor and ensure that these measures are effectively being implemented correctly and are addressing the risks to which the CIS is exposed to. This applies also in those instances where any function is outsourced by the scheme to one or more third party.

B2. THE CUSTOMER RISK ASSESSMENT

One of the main AML/CFT obligations arising from Regulation 5(5)(a) of the PMLFTR and further elaborated upon in Chapter 3 of the Implementing Procedures – Part I is that of carrying out a CRA whenever a new business relationship is being established or an occasional transaction is to be carried out. As already stated, the different risk factors referred to in Chapter 3 of the Implementing Procedures – Part I are complemented by Part A of these Implementing Procedures which provides further detail as to how ML/FT can manifest itself in the context of a CIS under the different risk pillars.

One question which often arises is whether there is still an obligation on the part of a CIS to carry out a CRA when the scheme is itself the creation of another subject person and the CIS' customers are very likely to also be customers of the subject person who would have created the scheme. The subject person would already have carried out a CRA on the said customers and, it could be argued, the scheme could therefore very well rely on the risk assessment process of the subject person and on the risk rating resulting therefrom. However, adopting such an approach would not reflect the risk-based approach.

[4] S.L. 386.14.
[5] S.L. 386.15.

Though termed a 'Customer Risk Assessment', the risk assessment looks at elements that go well beyond the customer and takes into account a number of other risk factors. While there may be similarities with how the customer risk factor is taken into account by the scheme and by the subject person who would have created it, there is one risk factor that is especially different, i.e. the product/service/transaction risk factor. By way of example, cases are encountered where banks launch their own schemes with the bulk of investors being also bank customers. A CRA would already have been carried out on the investor by the bank and therefore a case is often made for the CIS to rely on the bank's own CRA and resulting risk rating. However, banking services and CIS itself can present different levels of ML/FT risks and therefore they may ultimately result in different risk ratings being attributed to the business relationship, even though the customer is the same one. In addition, it may be that certain elements of customer risk are assigned different weightings within the CRA process adopted by the two institutions as what may be especially relevant for one need not be equally relevant for the other.

What is important to note is that in any such instances, it is possible for the CIS to obtain and make use of the information collected by the subject person for the purpose of drawing up the customer's risk and business profile. However, even in this context it would be important for the scheme to evaluate whether it needs to supplement the information provided to it by the subject person to be able to effectively risk assess the particular business relationship. In this regard, reference is to be made to Regulation 12 of the PMLFTR and Section 4.10 of the Implementing Procedures – Part I on reliance arrangements.

Another scenario in which a similar question can arise is that involving Master – Feeder Funds structures. In such instances, the structure would usually comprise a number of schemes, with all except one being established in different jurisdictions to attract investors and collect monies from the jurisdiction in which they are established. These different schemes would then transfer or 'feed' these monies to a master fund that is to make the actual investments. These structures are therefore pre-conceived to function in this manner and it is not just by chance or due to any form of investment strategy that the feeder funds end up investing in the master fund.

Given that the structure is designed to function in this manner, it may be argued that the feeder funds are ultimately just an expression of the master fund and there should therefore be no need to carry out a CRA on the said feeder funds by the master fund. However, this is not the case. The feeder funds may be part of a pre-designed structure but they remain at all times separate and distinct entities from the master fund. Thus, even in such circumstances, the obligation to carry out a CRA still holds good and the master fund would have to risk assess its customers, i.e. the feeder funds.

B3. THE CUSTOMER OF THE COLLECTIVE INVESTMENT SCHEME

The customer in the case of the CIS is the registered holder of its units, independently of how the said holder would have acquired the units in question. Thus, the CIS has to identify and verify the identity of the same, including any beneficial owner thereof, in line with what is required under Section 4.3 of the Implementing Procedures – Part I. In on-boarding a customer, the scheme enters into a business relationship with the registered holder as it is quite unusual for a unit holder to transfer, redeem or otherwise dispose of the units subscribed to within a short period of time, especially where the scheme happens to be a close-ended one or, though being open-ended, dealing is done either on the realisation

of a particular event or is otherwise quite infrequent. Thus, a CIS is not considered as ever carrying out occasional transactions but only enters into business relationships.

B3.1 Regulated Entities as Customers

The customers of a CIS may very well include customers that carry out relevant financial business or an equivalent activity in a third country, including an EEA Member State ('Regulated Entities'). This particular segment of customers merits a more detailed consideration than others due to a number of factors, not least because they are usually associated with scenarios where SDD is applied by schemes and they may also hold units in their own name but on behalf of underlying investors.

Assessing Risk for Regulated Entities

SDD is only applicable in the case of a business relationship or an occasional transaction that presents a low risk of ML/FT. The extent to which CDD measures can be varied due to the low level of ML/FT risk is set out in Section 4.8 of the Implementing Procedures – Part I. How is this to be determined by the CIS? Independently of whether the Regulated Entity is holding the units on its own behalf or on behalf of underlying investors, there are a number of factors that need to be taken into consideration:

a. The Regulated Entity is authorised to carry out relevant financial business in Malta or an equivalent activity in a third country, be it within the EEA or otherwise. This can be ascertained by consulting public registries and websites maintained by licensing authorities, requesting information and supporting documentation directly from the customer, or by checking with another office, subsidiary, or branch of the subject person operating in the same country as the nominee.

b. The Regulated Entity is subject to AML/CFT obligations in a reputable jurisdiction equivalent to those arising from Directive (EU) 2015/849 and it should be effectively subject to supervision to ensure that it is compliant with the said obligation. In this context reports issued by bodies like the FATF, IMF, EBA, OECD, FSRBs like MONEYVAL etc. can provide valuable insights into the matter.

c. The Regulated Entity is effectively implementing risk-sensitive AML/CFT measures. In this case, it would not be sufficient to obtain information on the nature of the measures it applies but also consider whether there were any supervisory and/or enforcement measures taken with regards to the Regulated Entity in the area of AML/CFT.

d. The business activities of the Regulated Entity, including the services and products it provides, the markets it is active in and the nature of customers, including whether there will be any PEPs, customers active within high risk sectors etc. Where the Regulated Entity is acting on behalf of third parties, there would be the need to consider not the kind of customers the Regulated Entity is willing to engage with in general but which customers it is willing to provide its services as a nominee to.

e. Any adverse information available on the Regulated Entity.

In so far as (c) and (e) are concerned, the CIS is to consider the same in light of what is set out in Section 3.5.1(a)(a) of the Implementing Procedures – Part I. When it comes to supervisory and/or enforcement measures, one has to take into account the nature of the breach(es) that led to the taking of any such measures, both on their own and within the context of the Regulated Entity's business. By way of example, the failure to submit a regulatory return is not to be considered as carrying the same weight as AML/CFT breaches related to beneficial ownership. Even within the area of beneficial ownership there can be a difference drawn, i.e. the failure to verify the residential address of an individual is different from not having carried out any identification or verification measures with respect to the same or, worse still, not having determined who the beneficial owner actually is. One also has to consider the time elapsed since the supervisory and/or enforcement measures were taken, and any remedial action that may have been undertaken to address the said breach(es). Information in this regard may be publicly available but, if not, the subject person can very well request updates from the nominee itself.

In so far as any adverse information is concerned, one needs to take into account a number of factors. CISs are expected to consider how reliable these reports are on the basis of the quality and independence of their source/s, and how persistent these reports are. The impact of adverse information is also dependent on how remote in time it is. The longer the passage of time from the date of the media item (or the date of the adverse activity reported on in the media item), the less likely it is that the facts reported on will have an ML/FT impact. Equally important is to consider whether following any adverse media reports, there were reports which showed that the earlier information was groundless or otherwise downsized the gravity and severity of any such earlier information. Where the information derived from adverse media gives rise to suspicion of ML/FT, CISs are reminded of their obligation to report to the FIAU.

Should it result that the business relationship with the Regulated Entity can be classified as low risk, the Scheme is entitled to exercise SDD in relation to that particular business relationship. However, it has to be borne in mind that the application of SDD does not entail not carrying out any CDD measures but that there is a certain leeway as to the extent and timing of the CDD measures that are applicable. In particular, it has to be borne in mind that a CIS that applies SDD has at all times to carry out:

a. The identification and verification of the customer;
b. The identification of the beneficial owner/s of the customer; and
c. The carrying out of a degree of on-going monitoring to ensure that the business relationship continues to be a low risk one.

In all other instances, i.e. where the business relationship with the Regulated Entity is assessed to present a level of ML/FT risk that is not low, the CIS has to carry out the full range of CDD measures and intensify the same in those situations where the business relationship is assessed to present a high risk of ML/FT.

Nominee Arrangements or Omnibus Accounts

When it comes to CIS, it is quite common for units nowadays to be held either within an omnibus account or otherwise under nominee. In these situations, the units would be registered in the name of a service

provider who for all intents and purposes would be considered as the scheme's customer. It is with the said service provider that the CIS would interact with regards to the units registered in its name and it would therefore have no contact with the underlying investors on whose behalf the service provider would be actually holding and administering the units in the scheme. More often than not, the nominee will also be a Regulated Entity as already described above.

Given what has been stated above, the question will arise whether there is still the need to identify the beneficial owners of the Regulated Entity acting as nominee. Applying CDD measures with regards to the beneficial owners of a nominee would not be of any particular benefit from an AML/CFT perspective. One has to bear in mind that the funds invested in the CIS would not be originating from the nominee or its beneficial owners, but from the underlying investors. CDD measures are therefore to be carried out with regards to the underlying investors, depending always on the level of ML/FT risk presented by the business relationship held with the nominee.

While in all circumstances, there would still be the obligation to identify and verify the customer and to carry out on-going monitoring, the level of ML/FT risk inherent to the business relationship held with the nominee will dictate the CDD measures applicable with regards to the underlying investors as set out in the table hereunder:

Table 1 – CDD Measures applicable to Underlying Investors

Level of ML/FT Risk	AML/CFT Measures
Low Risk	The CIS has to: (a) obtain a declaration from the nominee that it has carried out CDD with regards to all the underlying investors; (b) determine whether any one individual holds through the nominee, directly or indirectly, 25% or more of the NAV and/or of the voting rights in the Scheme; (c) identify any such individuals.
Moderate Risk	The CIS has to: (a) obtain a declaration from the nominee that it has carried out CDD with regards to all the underlying investors; (b) determine whether any one individual holds through the nominee, directly or indirectly, 10% or more of the NAV and/or of the voting rights in the Scheme; (c) identify any such individuals.
High Risk	The CIS has to: (a) obtain a declaration from the nominee that it has carried out CDD with regards to all the underlying investors; (b) identify all the underlying investors; and (c) identify the beneficial owners of any such investors.

The said information is to be obtained from the nominee once the first NAV has been calculated. A declaration is to be obtained from the nominee and is to set out:

a. Who are the individuals that meet the said conditions or, in the case of a high-risk business relationship, who are the underlying investors and, where applicable, the investors' beneficial owners.
b. What percentage of the NAV each such individual holds.
c. The identification details of the said individuals in line with what is set out under Section 4.3 of the Implementing Procedures – Part I

The CIS is to request updates of the said information from the nominee at least:

a. Whenever there is a significant change in the units held under nominee that may point at a possible change in the information originally provided by the nominee;
b. Upon the launch of a new sub-fund, where this may be applicable; and
c. On an annual basis.

The check on an annual basis should be carried out even if there has been no change in the units held as there may have been internal transfers on the nominee's books resulting in a change in beneficial ownership.

It is important that when the nominee is requested the said information, the exercise takes into account its different nominee holdings in all the sub-funds that there may be within the scheme. Documentation on any individuals identified need not be provided but there has to be a documented arrangement in place obliging the nominee to provide the necessary verification documentation upon request and without undue delay.

B3.2 Nominees and Trading Platforms

There are instances in which a nominee makes use of an established trading platform to carry out its deals involving CISs' units, i.e. the said platform would be acting on behalf of a nominee who would itself be acting on behalf of underlying investors. In such an instance, it is important to point out that it is the nominee that is to be considered as the customer and not the trading platform. As such, the risk assessment and corresponding mitigating measures are to be carried out with respect of the nominee and not the trading platform.

B3.3 Unregulated Nominees

Situations may arise where a customer subscribes to units within a CIS through a Regulated Entity but the said service provider does not hold the units under nominee itself. Instead, it may have an entity within its group that is tasked with the said function, which itself may not be subject to any form of regulatory requirements. In such cases, the above-mentioned procedures may still be made use thereof without the need to necessarily apply a complete look-through to the underlying investors. This is subject to:

a. The Regulated Entity meeting the conditions stipulated in Section B3.1 above;
b. Obtaining evidence that the nominee forms part of the same group as the Regulated Entity; and
c. Being provided with an undertaking to provide information to the CIS being signed by both the Regulated Entity and the nominee itself.

Where the aforementioned criteria are not met, the CIS would have to look through to the underlying investors, independently of the actual risks associated with the said business relationship.

B4. PURPOSE AND INTENDED NATURE OF THE BUSINESS RELATIONSHIP

In line with what is set out in Section 4.4 of the Implementing Procedures - Part I, a subject person has to establish the purpose and intended nature of the business relationship. This entails understanding why a customer is requesting a particular service or product. Within the context of CISs, the purpose can be easily assumed to be capital accumulation/accretion. There would therefore be no need to request any further information in this regard from the customer.

B5. BUSINESS AND RISK PROFILE

The aforementioned section of the Implementing Procedures also requires the subject person to collect information on the business and risk profile of its customer. This entails that the subject person has to understand:

a. What is the source of wealth of the customer;
b. What is the expected source of the funds to be used throughout the business relationship; and
c. The anticipated level of activity.

This information is intended not only to allow the subject person to risk assess the business relationship but to also set the expectations of the subject person as to the volume and value of activity that it will be processing in the course of the business relationship.

Absent the subscription to savings plans made available by some schemes, investment activity in CISs is rarely characterised by frequent repeated investments by the same individuals. In most cases, any subsequent investment in a CIS will be dictated by the performance of the CIS and the investor's access to capital. Thus, in this context, the business and risk profile of the customer can be established on the basis of the source of wealth of the customer as long as:

a. The CIS also establishes what is the source of funds for each individual subscription made throughout the business relationship where this is different from the customer's own declared source of wealth; and
b. The CIS considers each subsequent investment to the original subscription as a triggering event to review the information and documentation it may hold as to the source of wealth of the customer and establish whether it is still current. Where this is not the case, the CIS is to update the same.

As can be seen, establishing what is the customer's source of wealth is a key CDD measure. Source of wealth consists in establishing how the customer has generated his current wealth, i.e. what activities has the customer carried out to allow him to have at his disposal his current patrimony. Information of this kind is to be collected independently of the risk posed by the customer and this should be as detailed as possible. On the other hand, the level of documentation to be obtained will vary on the basis of the overall ML/FT risk inherent to the business relationship.

The following are some examples of documentation that can be obtained to substantiate the information provided by the customer:

a. Retail investor whose source of wealth is an average salaried job and whose subscription is one that any such employee would afford, with an overall low risk rating – payslip, FS3 or equivalent substantiating the individual's source of wealth description.

b. Regulated Entity investing on its own behalf with an overall low risk rating – copy of its most recent audited financial statements to attest to its financial resources and the ability to invest.

c. Retail investor whose source of funds comprises different sources of income, including rental income and investments' portfolio, and who is investing copious amounts, with an overall high risk rating – copies of property deeds, rental agreements and investment portfolio statements.

As already highlighted, what is also important in the context of an initial subscription is the source of funds used to finance the units' subscription. Reference is not being made to the expected source of funds but to the actual source from which the funds used for the subscription have been generated. As is the case with source of wealth, this information is to be requested in all cases and it may have to be supplemented with documentation where the source of the financing is different from the declared source of wealth. The most basic example would be an average salaried customer who invests an amount well beyond his means but who is able to justify the same on the basis of a legacy received upon a relative passing away. In such a case, a copy of the will would have to be acquired to substantiate the source of funds of this particular transaction.

It is therefore key at the point of an initial subscription and of any subsequent investment to ascertain that there is a reasonable explanation, supported by the necessary information and documentation, whenever the amounts invested do not reflect a customer's source of wealth or involve funds that are derived from sources other than those comprised within one's source of wealth.

In the case of nominee holdings, a CIS is not expected to have source of wealth and source of funds information relative to the underlying investors. However, it will have available a description of the kind of customers that it is acting as nominee for. In addition, a Regulated Entity is most likely to have carried out some form of assessment as to whether there is a business case to marketing and/or distributing units in a particular CIS. This entails that the Regulated Entity may have very well assessed what volume and value of investments in the CIS it can expect from its customers. That information should be requested

by the CIS as it would be a useful measure to assess not only the ML/TF risk but also as a means to further carry out on-going monitoring.

Another aspect to consider under this heading is any instance where the subscription is not paid for by the customer but by a third party. In such cases, the CIS has to understand what is the relationship between the two and what may have been the reasons that led the third party to disburse own funds on behalf of the unit holder. Where there is a reasonable explanation (e.g. the two individuals are married or the subscription is the result of a donation from a parent to a child) and the amounts involved are not significant, the CIS need not request supporting documentation. On the other hand, where this is not the case, the CIS is to obtain documentation supporting the explanations provided and consider whether there are grounds to submit a report to the FIAU.

B5.1 Subscriptions in Kind

Subscriptions need not be made using money but, to the extent that the CIS allows it, they may also be made in kind. These kind of subscriptions present higher ML/FT risks, especially where the assets involved are highly illiquid and/or have characteristics that essentially render them untraceable. The development of the relative markets for these assets thus presents an issue from an AML/CFT perspective.

The illiquid nature of the assets entails that they are not easy to valuate, raising the risk that what is being transferred to the scheme does not in actual fact correspond to the true value of the units issued in return. By way of example, the process to set a value to securities is more transparent and robust than that for valuating fine wines or collectibles. Securities may be listed on a regulated market but even where this is not the case, the rules to actually assess what is their real value is quite well-established through different standards. On the other hand, when it comes to fine wines, art or other collectibles, there will always be a degree of reliance put on the technical expert engaged to assess the asset's value and the opaqueness of the relative markets allows for significant discretion in this area. Hence there is a need to take measures to establish the expert's good-standing and expertise in the area.

A CIS should also ascertain that the investor has title over the asset to be transferred to it and that the investor could reasonably be expected to have acquired the said asset. Establishing title over the asset may in itself present some difficulties. Where the assets require registration, such as immovable property, listed securities etc, title can be easily established through for example a copy of the deed providing for the transfer of ownership to the customer, a statement of one's holdings etc. However, there may be assets that may have been acquired by the investor at a time when no registration requirements were in place. In such a situation, the Scheme would need to corroborate the explanation of how the investor acquired the asset through other means such as public records, media information etc.

The CISs examination is not to stop there as it has to also consider whether the prospective customer actually had the means to acquire such assets or, where not, whether there is a reasonable explanation as to how he came in possession of the same. Thus, it is not enough for the prospective customer to show that he has a legitimate title to the asset but the CIS has to consider whether, given what it knows about the customer, and especially the customer's source of wealth, it can be reasonably understood how he acquired the said asset. By way of example, if the prospective customer who so happens to be an average

salaried employee is proposing to transfer an immovable property to the Scheme valued at EUR500,000 in return for its units, the CIS has to question how the prospective customer came to be in possession of the said immovable property. Is it the case that the immovable property was acquired at a time when prices in the area where much lower and accessible? Is it the case that the prospective customer inherited the said property? In such cases, there would be the need for the customer to substantiate the explanations provided with documentation, including on his source of wealth.

CISs may also be willing to accept subscriptions paid for in VFAs. In any such case, the Scheme has to make reference to the Implementing Procedures – Part II addressed to the VFA Sector. Particular reference has to be made to Section 2.2.3 thereof as the said section sets out the mitigating measures to be applied in the case of payments effected using VFAs. These measures would be equally applicable in this case.

B6. TIMING

Regulation 7(5) of the PMLFTR requires that CDD measures be applied whenever a subject person is entering into a business relationship with a customer. In terms of Regulation 8(1) of the PMLFTR, no business relationship is to be carried out until such time as the identity of the customer has been verified. There is therefore a general obligation to meet CDD obligations prior to the actual on-boarding of the customer. However, carrying out all CDD measures prior to the establishment of the business relationship may not always be easily achievable within the context of CISs due to the frequency with which dealing in units may be set to take place.

In most cases, the CISs allowing for frequent dealing in their units (e.g. daily or weekly) will be active in the retail space. As set out in Part A above, this may be indicative that most customers will be small-scale investors, lowering the overall ML/FT risk of the business relationship. One possible solution to therefore address any possible issues in terms of the timing of the initial CDD measures is for the scheme:

a. To create an average profile of those customers that it would consider as presenting different levels of ML/FT risk. In terms of the Implementing Procedures – Part I there is the possibility of considering groups of customers or business relationships that share similar characteristics as presenting the same level of risk as long as the subject person can demonstrate that the groupings are logical and specific enough to reflect the reality of the subject person's business. This exercise would create a pre-defined set of 'buckets' within which to group customers on the basis that the scheme has a sufficiently wide customer basis to justify the creation of such 'buckets'

b. Include within the subscription form the basic information required to carry out an initial assessment as to whether a customer falls within any of these pre-defined 'buckets' which would allow for easy categorisation of any applications for subscriptions received. The subscription form should also list basic documentation that may be required by the scheme to verify the information provided by the customer.

c. In all cases proceed with the issue and allotment of the units but, in those cases where the information obtained suggests that either further information is required to assess the actual risk of the customer or documentation is required due to the higher risks that the customer presents,

ensure that it is possible for the scheme to block the units until such time as the customer provides the additional information or documentation required.

d. In the event that the customer does not provide the necessary information and/or documentation, the scheme is to proceed with termination of the business relationship as per Regulation 8(5) of the PMLFTR and in line with Section 4.7 of the Implementing Procedures. It should therefore be possible for the CIS concerned to forcefully redeem the units initially acquired by the customer concerned and remit the resulting funds back to the customer in line with what is set out in the afore-mentioned section of the Implementing Procedures – Part I.

The above is not to mean that when a CIS receives an application for subscription before the dealing day and it is possible for it to start assessing the same, it is to refrain from doing so until the actual dealing date. In such circumstances, the scheme is to start the process of assessing the application and reaching out to the (prospective) customer for any additional information and/or documentation it may require as early as possible.

In addition, in a more sophisticated context where subscriptions may be actually negotiated, it would be advisable to ensure that any such negotiations also include AML/CFT aspects, especially with regards to source of wealth and source of funds aspects, to avoid any situations where it proves impossible for the CIS to complete its CDD process.

B7. ON-GOING MONITORING

As set out in Regulation 7(1)(d) and in Regulation 7(2), the on-going monitoring obligation has two limbs, i.e. (i) the review and, where necessary, update of the data, information and documentation collected to ensure compliance with one's AML/CFT obligations; and (ii) the monitoring and scrutiny of transactions. What this entail is then set out in further detail in Chapter 4 of the Implementing Procedures – Part I.

B7.1 Review and Update CDD Data, Information and Documentation

Reference has already been made under Section B2.1 to the need to review and, if necessary, update the beneficial ownership information obtained from nominees. Related to nominees, it is also important to review and, where necessary, update the information used to risk assess the relationship held with the same. There may be changes that may impact the scheme's assessment of the said relationship, resulting in a revision of the risk classification thereof and therefore a need for the CIS to step-up the measures taken with regards to that particular relationship.

Possible changes may include the results of the mutual evaluation of the jurisdiction where the nominee is established. It may either be the case that the said jurisdiction can no longer be considered as reputable or, even if the same has not been grey or blacklisted, it may result that there were still serious deficiencies in its AML/CFT system impacting also the level and quality of AML/CFT obligations implemented by the nominee. Another possible event that has to trigger a review of the said relationship would be where the relative AML/CFT supervisor has taken action against the nominee for serious AML/CFT breaches, especially where these relate to beneficial ownership and/or transaction monitoring. The listing of

jurisdictions for AML/CFT failures would need to be factored in as soon as it is made public, given that it is a process that takes place at regular intervals and does receive a degree of publicity. The same applies with regards to information on serious AML/CFT breaches that receive wide-spread publicity. As regards other information, there should be a process in place to ensure that any nominee relationship is reviewed on a regular basis and any developments are factored in.

A review of the information held on a Regulated Entity acting as nominee may be brought about as a result of a trigger event. A case in point may be where a nominee with whom the CIS already has a relationship in relation to one of its sub-funds, and the said nominee seeks to widen the said relationship to include additional sub-funds. Otherwise, where no trigger events materialise themselves, the CIS has to seek an update on a risk-sensitive basis, i.e. seek to revise and, where necessary, update its assessment of the nominee relationship on the basis of the ML/TF risk it presents. It is relevant to point out that this obligation is separate and distinct from the obligation to review any information collected on the underlying investors which has to be carried out as set out under Section B2.1 above.

Within a more retail context, involving small-scale investors who may not be that active or who may have sought only a one-time investment, the focus relative to on-going monitoring should be more on ensuring that any identification and verification of identity data, information and documentation is kept up-to-date. As set out in the Implementing Procedures – Part I this can be done on a risk sensitive basis and there would not be the need to actually seek fresh copies of identification documents the moment that the previous ones expire.

With regards to the information obtained on one's source of wealth and source of funds, there would be no need to refresh the same absent a triggering event such as a subsequent investment. The customer is to be requested to confirm whether the information held on the source of wealth is still current and what is the source of funds of this additional subscription. Where the customer provides information that this has changed, the CIS has to obtain updated information and supporting documentation, as well as consider what effect any such new information is to have on the customer's risk profile.

B7.2 Transaction Monitoring and Scrutiny

The nature of transaction scrutiny in the case of a CIS will be somewhat different from that carried out by other subject persons and especially other financial institutions as the nature of the business relationships they hold with customers is not characterised by frequent transactions. Indeed, a high volume of trading may in itself be a red flag. Regular trading may in itself not even be possible due to the applicable dealing dates, absent recourse to the transfer of units from existing unitholders.

In this context, the main form of transaction scrutiny that a scheme is to undertake is to compare investments made into the scheme against what the CIS knows about a customer's source of wealth and source of funds to ensure that the amounts so invested are actually in line with its knowledge and understanding of the customer. While it is true that for each transaction the CIS is to collect information thereon, the CIS is to also consider the transactions taking place over a given period of time by the same investor to assess whether, when taken into account all together, they do tally with the information provided as to the customers' source of wealth and source of funds.

With regards to investments made by nominees, there will be no source of wealth against which to compare new unit acquisitions as the funds invested would anyway not pertain to the nominee but to the underlying investors. This does not mean that no transaction monitoring is to be carried out. In the context of nominee holdings:

a. A nominee would have provided information on the expected volume and value of investments that its customers are likely to make into the CIS. In this context, there would therefore also be the ability and possibility for the CIS to compare investments being received with this expected level of activity and question any major variation there may be between the two.

b. It is possible to compare investments made over a given period of time to identify outlier transactions which may represent an increase in funds transferred to the CIS compared to the rest. Where one or more such transactions are identified, the CIS has to ask the nominee whether there is a reason for the increase in activity. It may be the case that the nominee has increased its efforts to have additional investors attracted to the CIS and the said results would have paid off. However, it may also be the case that the nominee is active in new markets, with the CIS having to consider what could be the implications for its assessment of the said relationship and if it still can be considered as presenting the level of risk attributed to it originally. In addition, any increase in subscriptions held under nominee which may lead the CIS to suspect that there may have also been a change in beneficial ownership should also be queried from this aspect.

A question which may arise in the context of high risk nominee relationships is what more can be done by way of transaction monitoring and scrutiny. In such instances, the higher risk levels justify a more intrusive approach and where any unusual transactions are noted, the CIS is to go beyond questioning what is the reason for this increase and also obtain source of wealth and source of funds information on the underlying investors involved.

Attention should be made to situations where the frequency with which subscriptions, redemptions and transfers are carried out as there may be instances where the frequency itself may not be something that can be somehow associated with any form of investment strategy. In particular, this may be especially relevant within the context of umbrella schemes where there may be repeated and unexplained exists from one sub-fund only for the resulting proceeds to be reinvested in another.

Transfers are also to be monitored, especially with regards to schemes that allow dealing on quite a regular frequency. A transfer may be justified where there is a close-ended scheme or an open-ended scheme that does not allow dealing to take place with any regular frequency. Any existing investor who would be in need of liquidity would be restricted as to how to realise his holding other than by seeking an interested investor to replace him. In such cases the scheme is still obliged to carry out CDD on the incoming unit holder, including obtaining source of wealth information to assess whether the amount paid for the transfer is one that could be legitimately afforded by the same and ascertaining that the funds have actually been paid to the transferee.

On the other hand, it may be worth looking into the reasons behind a transfer when the CIS allows dealing in its units to take place on regular basis and frequently. In such cases, anyone seeking to realise his investment may be expected to redeem the units rather than transfer the same. The same applies with regards to situations where it is the incoming investor that seeks to acquire units in the Scheme in this manner. While this should be done on a risk-sensitive basis and therefore focusing more on transfers of NAV that are substantial in value, it is important that regard be had to the transfers taking place within the different sub-funds of a Scheme involving the same parties or otherwise taking place at the same time.

Akin to transfers, some CISs allow investors to switch from one sub-fund to another whereby units in one sub-fund are exchanged for units in another sub-fund of the same CIS. While this allows customers to more easily access better performing investment propositions, it is also true that frequent switches may be cause of concern as they offer a means for obfuscating the trail. Thus, where the CIS notices frequent switches, and especially if they do not have any economic rationale, it should ask the customer to provide it with an explanation as to why this is taking place.

Another aspect to consider is who is actually financing the subscription, entailing that even here there would be the need to apply the measures referred to under Section B4 with regards to similar situations encountered at initial subscription stage.

B8. The Compliance and Reporting Functions

B8.1 The Role of the Board of Directors or Equivalent Body

Regulation 5(6) of the PMLFTR requires subject persons to appoint a member of their Board as responsible for overseeing the overall AML/CFT framework of the subject person concerned. While the regulation provides some leeway in this regard, it is also true that the EBA Guidelines on the Role of AML/CFT Compliance Officers dictate that every credit or financial institution must in all instances appoint such an officer. The reference to credit or financial institutions is to be read as a reference to every subject person carrying out relevant financial business. Thus, CISs are to designate one of their directors or, where it does not have a board, a corresponding officer to be in charge of the said function and oversee the overall implementation of the AML/CFT framework. Subject to what is set out hereunder, this role is to be considered as separate and distinct from that of the MLRO and of the Day-to-Day Monitoring Officer.

It is relevant to point out that this role carries considerable importance in the context of CISs. As repeatedly held, schemes are very likely to outsource most of their functions. This also extends to the AML/CFT domain and therefore any director so designated would be key to actually ensure that the scheme is provided with the necessary data, information and documentation to allow it to assess the level and quality of the actions being taken by its service providers in implementing its own AML/CFT policies, measures, procedures and controls.

It has to be clarified that the designation of any such director does not necessarily exonerate the other members of the Board from their collective responsibility to ensure that the CIS is adhering to its obligations at law. It is rather intended as a means to ensure that there is Board involvement within the area of AML/CFT.

The above-stated is without prejudice to any other obligations and duties to which Board members may be subject to under primary or secondary legislation, or in terms of regulatory requirements or codes of conduct that are equally binding on the said directors.

B8.2 Outsourcing the Compliance and Reporting Function

In line with Chapter 5 of the Implementing Procedures – Part I, subject persons have to appoint an officer that is to be responsible for the day-to-day monitoring of AML/CFT obligations as well as for the functions carried out by the said 'MLRO'. CISs, being also subject persons, are also bound by this obligation and, subject to the contents of this Section, are to abide the requirements of the said Chapter.

However, CISs are rarely established as self-managed schemes and their business model does not foresee having any employees or officers of their own. Indeed, the most likely set-up in Malta will only comprise a Board composed of non-executive directors, with all other functions are outsourced to the different service providers referred to in Part B of this document. Thus, in this context, the only option is to effectively allow for the outsourcing of the compliance and reporting functions. This is also a possibility recognised in the EBA's own Guidelines on the role of AML/CFT Compliance Officers[6].

For a CIS that is subject to the PMLFTR it is therefore possible to outsource its compliance and reporting functions to its administrator as long as the scheme meets all three of the following criteria:

a. It does not have a physical operational set-up in Malta other than a registered address and a board of directors;
b. It does not engage any employees;
c. It is not involved in the acceptance and processing of subscriptions and the collection of funds from investors.

The above outsourcing arrangement may only be entered into where:

a. The administrator is recognised under the Investment Services Act[7]; or
b. The administrator is subject to authorisation, licensing or recognition in an EEA Member State or in third country other than a non-reputable jurisdiction, is subject to AML/CFT obligations consistent with the PMLFTR, especially in relation to reporting and reporting procedures, and is supervised for compliance with these obligations.

When a CIS decides to outsource these functions, the officers within the administrator who can be appointed as the compliance and reporting officers are:

[6] *71. Where the credit or financial institution does not have any officers or employees of its own other than a management body, it may outsource the AML/CFT compliance function to a service provider. In such instances the AML/CFT compliance officer should be the AML/CFT compliance officer of one of the service providers who has experience or knowledge on the type of activity or transactions carried out by the credit or financial institution.*
[7] Cap 370 of the Laws of Malta.

a. The officers that are already acting as compliance and reporting officers for the administrator; or
b. Officers within the administrator's own AML/CFT team/section who possess the necessary skills, experience and qualifications to take on the said functions and the associated responsibilities.

For clarity's sake, any obligation that the compliance and reporting officer has towards the Board are to be here interpreted as being towards the Board of the CIS and not towards the Board of the Administrator as they are separate and distinct roles.

Given that in both instances the said officer may take on this role for two or more CISs, consideration is to be given to the appointment of a designated employee to assist the MLRO. The designated employee is to be an officer of the fund administrator, answerable to the officer appointed as the scheme's compliance and/or reporting officer who has to exercise oversight over the activities of the designated employee.

B8.3 Multiple Administrators

Situations may arise where a CIS comprising two or more sub-funds appoints different administrators for different sub-funds. This is not to be interpreted as meaning that there may be different compliance and reporting officers appointed for the different sub-funds. It has to be borne in mind that it is the CIS that is the subject person and that each subject person can have only one (1) compliance officer and only one (1) reporting officer. In addition, having multiple officers will entail that none of them will have a complete oversight of what is happening within the Scheme as a whole and the FIAU will find itself with multiple different points of contact to dialogue with.

In such a situation, it is for the scheme to decide which of the different administrators it is to outsource its compliance and reporting function to and the other administrators have to make sufficient information and documentation available to it so as to allow it to carry out its functions effectively, including any periodical reporting required by the FIAU. To this end, the other administrators are to appoint a contact point to whom any questions and requests can be directed while the scheme's own policies and procedures are to include pre-agreed timeframes for replies thereto, bearing in mind the timeframes applicable with regards to examinations, replying to requests for information from the FIAU, submission of STRs etc. In addition, there should be common timeframes agreed with regards to the review of records etc.

In the event that the said officer is not finding the necessary cooperation, the Board is to be informed promptly so as to take the necessary actions to address the issue.

B8.4 Close-Ended Collective Investment Schemes

A close-ended CIS is one that does not issue any further units for subscription following its initial offering or placement. This limits the possibility of new unitholders being admitted into the scheme unless there is either a transfer of units from an existing shareholder or the transmission to a new shareholder due to the decease of an existing one. Given this limited exposure to new shareholders, there may be the impression that no MLRO or Monitoring Function is needed. While one can appreciate that the AML/CFT

obligations that need to be adhered to in such a case are quite limited in nature, it does not follow that there are none as:

a. CDD data, information and documentation will still need to be reviewed and, where necessary, updated.

b. CDD measures have to be applied with regards to any new investor admitted into the CIS by way of unit transfer or unit transmission. In the case of units acquired through transmission, i.e. via inheritance, there would be no source of wealth and source of funds checks to be carried out as the new investor would not have transferred any funds or assets to the CIS in return for the units held. In the case of unit transfers, the CIS, even though it would not have itself received any funds for the transferee to acquire the units, also has to establish whether the consideration has actually been paid and whether this is in line with the transferee's source of wealth.

c. The CIS in question may still have to file STRs with the FIAU and reply to requests for information on one or more of its investors.

Should the director identified in terms of Section B7.1 above be willing to take on the role of meeting these obligations, the scheme can refrain from actually appointed a dedicated MLRO or Monitoring Function and assign to the said director the role of meeting the indicated obligations on behalf of the close-ended scheme as long the director is able to carry out the said function effectively and efficiently, taking into account the time commitment involved and avoiding possible conflicts of interest.

B9. Outsourcing

Any outsourcing by a CIS has to be aligned with the requirements set out in Chapter 6 of the Implementing Procedures – Part I. This usually involves outsourcing the performance of AML/CFT obligations to the fund administrator of the particular CIS to whom the scheme, may or may not, also outsource the MLRO and Monitoring functions.

It has to be borne in mind that the subject person being addressed here is the CIS and therefore, even though the fund administrator may be the one drafting the scheme's AML/CFT policies and procedures, it is ultimately the responsibility of the CIS to determine if the said policies and procedures address the particular ML/FT risks to which it is exposed. Standardised policies and procedures may be adopted by the scheme as long as these are adequate and commensurate to the risk profile of the CIS – it is no justification for the CIS to argue that the policies and procedures were provided to it by the fund administrator or that these are the same ones implemented by the fund administrator to meet its own AML/CFT obligations.

A scheme may decide to engage different service providers to carry out different aspects of its AML/CFT obligations. In so doing, the CIS has to ensure that its MLRO and Monitoring Functions are able to effectively carry out their functions and meet the obligations imposed on the scheme in an efficient, exhaustive and timely manner. Hence, the scheme has to ensure that the outsourcing arrangement does not impede the flow of data, information and documentation, and that alerts and reports that need to be

escalated to the MLRO do so in a manner that does not prejudice the assessment that the MLRO needs to carry out to determine whether to submit an STR and the information he is to submit with the same.

An umbrella scheme may also determine that it is to appoint different fund administrators for its sub-funds. In such a situation, if the scheme is also to outsource the performance of its AML/CFT obligations to these different administrators, it has to ensure that the different processes adopted are consistent one with the other. While it is appreciated that there may be differences between the different sub-funds that may lead to different results when carrying out a CRA and different measures having to be applied to address the different ML/TF risks presented by each sub-funds, it is also true that the same underlying principles should apply with regards to the different policies, procedures, measures and controls implemented by the different administrators.

Situations involving a change in the fund administrator servicing a CIS may present particular challenges where the CIS has outsourced both the carrying out of its AML/CFT obligations as well as its MLRO as set out under Chapter 6 and Section 5.1.2 respectively of the Implementing Procedures – Part I. More often than not, these will be functions which the CIS will have delegated to its administrator.

Therefore, with a change in fund administrator there might also be a change in the outsourced service provider as well as a change in MLRO. In this scenario, the fund administrator may not only have to transfer the documentation collected for CDD purposes on the CIS itself, being the fund administrator's outgoing customer, but also any other original documentation on the investors in the CIS collected in fulfilling the scheme's own AML/CFT obligations.

This may not always prove to be possible as, where there are one or more common investors having multiple holdings in two or more CISs serviced by the same fund administrator, it is very likely that the fund administrator will have collected a common set of documentation for CDD purposes. Requiring the transfer of this documentation could potentially result in the other CISs being in breach of their AML/CFT obligations with respect to documentation bearing certification in original or documentation that had otherwise been collected in original.

In these circumstances, the outgoing fund administrator is to provide to the incoming fund administrator on behalf of the CIS a copy, electronic or otherwise, of the documentation collected on the investors affected by any such change. However, in any such circumstances, the outgoing fund administrator would also have to provide a declaration addressed to the CIS, outlining why the documentation in original cannot be made available and a declaration confirming that the documents provided are true copies of the originals held on file.

Thus, to the extent that the said declaration is retained on file by the CIS or by the incoming fund administrator on its behalf, it will be equally deemed that the CIS has met its record keeping obligations with respect to its investors. This would be without prejudice to the scheme's on-going monitoring obligations to ensure that any data, information or documentation is kept up-to-date as and when necessary. Sufficient time should be allowed for the transfer of records to ensure that the incoming fund administrator is in possession of these records by the time it starts to carry out any outsourced AML/CFT requirements.

The above would be equally applicable in situations where the CIS is engaging a third party service provider that is not a fund administrator to carry out its AML/CFT obligations on its behalf.

A change in the service provider to whom the scheme outsources the carrying out of its AML/CFT obligations should be considered as a trigger event for the scheme to assess whether the outgoing service provider was effectively implemented the agreed to policies, controls, procedures and measures. Where it identifies any shortcomings or lacunae, it should ensure that the incoming service provider is informed of as much. A remediation plan should be undertaken to address any issue identified, bearing in mind that it always the scheme's responsibility to demonstrate that it was and is compliant with its AML/CFT obligations.

PART C: SUBJECT PERSONS SERVICING COLLECTIVE INVESTMENT SCHEMES

A CIS will require the services of credit institutions, auditors and other subject persons just as is the case with any other legal person or arrangement. However, in addition to such subject persons, there are specific service providers the main business of which is to service CISs. Reference here is being made to the investment manager, the custodian and the fund administrator. The activities of all three are considered to constitute relevant financial business in terms of the PMLFTR. Being that their client-based will be composed completely, or close thereto, of CISs, there may arise practical difficulties in ensuring compliance with their AML/CFT obligations. This part of the Implementing Procedures – Part II seeks to address said difficulties and also difficulties which may be encountered by other subject persons when servicing CISs.

C1. THE CUSTOMER

Given the nature of CISs, the question may arise as to who is to be considered as the customer for any subject person dealing with the same. Simply stated, the customer is the CIS as services are rendered to the same: there is no relationship whatsoever with the underlying investors other than what may come to exist in so far as any such investor may also be a customer of the subject person in relation to services and products other than those offered to the CIS.

As already referred to, a CIS may be established as an umbrella scheme with a number of sub-funds. Independently, of whether the service provider may be servicing all of the said sub-funds, one of the said sub-funds or some of them, the customer remains the CIS as sub-funds do not possess legal capacity. What needs to be borne in mind is that when carrying out the CRA, the subject person needs to consider the ML/FT risks associated with the sub-funds for which its services have been engaged. A subject person has to therefore refrain from considering sub-funds it has no exposure to in servicing the CIS as otherwise this will result in an erroneous assessment of the ML/FT risks one is actually exposed to.

A further distinction has to be drawn in the case of incorporated cells. In such circumstances, each individual cell represents not only a segregated patrimony but it constitutes a separate and distinct legal person from the mother company and from the other cells created thereunder. Thus, in such instances the customer would be considered to be the incorporated cell and therefore a CRA would have to be drawn limitedly to the incorporated cell in question. Even if the service provider has a relationship with multiple cells, the subject person is not to draw up a single CRA but has to have specific CRA for each such cell it establishes a business relationship with or otherwise carries out an occasional transaction for.

C2. Determining Who is the Beneficial Owner

One of the key obligations whenever onboarding a legal entity or arrangement as a customer is that of determining who are the individual(s) to be considered as beneficial owner(s) and carry out the necessary CDD measures with regards to the same. Even in situations determined to present a low risk of ML/FT, there is still an obligation to at least determine who is the beneficial owner and obtain sufficient data on the same to identify him. How to determine who is to be considered as a beneficial owner is set out in the

definition of the term 'beneficial owner' under Regulation 2(1) of the PMLFTR. Given the particular nature of CISs, subject persons may be faced with specific challenges as to how to make such a determination.

While one's interest in a CIS may be represented by units or shares, those same units or shares will not denote any particular holding in the said scheme. The actual measure of one's interest in a CIS is more accurately represented by how much of the scheme's NAV is attributable to the unit or shareholder and this aligned with what under the definition of a beneficial ownership is described as "ownership interest". This concept encompasses both control rights and rights that are significant in terms of receiving a benefit, as is a right to a share of profits or other internal resources or liquidation balance. The NAV represents one's holding in the scheme and, in the event of a redemption, it represents what one may expect to receive in return for the redeemed units. Thus, for the purposes of determining beneficial ownership on the basis of the first tier criteria, regard has to be made to ownership interest and to the other element of voting rights.

C2.1 CISs established as Limited Liability Companies

A CIS may be established as a limited liability company, entailing that the said scheme will be issuing investors units in the form of shares. In such cases, it is usual for the CIS to issue (a) founder shares, i.e. shares issued to the promoters of the CIS before it actually opens subscriptions for investors; and (b) investor shares, i.e. shares issued to investors following the initial offering, subscription period or placement, and, depending on the nature of the CIS, on subsequent dealing days thereafter. While founder shares may have a fixed value, investor shares are most likely to have their value determined on the basis of the most recent NAV.

These shares will also have voting rights associated therewith. However, it is not a given that all shares will have the same voting rights associated with them as only the holders of one category of shares may have the prerogative to vote on certain matters.

In applying the initial test to determine beneficial ownership, i.e. whether one holds more than 25% of the ownership interest or of the voting rights, regard should be had (i) to the totality of the founder and investor shares to determine if there is any one individual holding directly or indirectly a sufficient percentage of the NAV to be considered as beneficial owner; and (ii) separately and distinct from the consideration of the totality of the NAV, to the totality of the voting rights held so as to determine whether any one individual holds, directly or indirectly, more than 25% of the said voting rights. Investor shares are still a representation of ownership and they may still have voting rights associated therewith. It is therefore important that when determining beneficial ownership, account is taken of both founder and investor shares and not only of founder ones.

Example A

Founder 'Z'
holds 100 Founder Shares

Founder 'Y'
holds 50 Founder Shares

CIS 'A' SICAV p.l.c. has just been licensed and has yet to offer any units to the public. It has two Founder Shareholders, Mr 'Z' and Mr 'Y', each holding the only shares issued by the CIS so far, 100 Founder Shares and 50 Founder Share respectively. Each share has a nominal value of EUR1 and has voting rights associated with it.

The Beneficial Owners in this case would be Mr 'Z' as he holds 66.66% of the Founder Shares and Mr 'Y' as he holds the remaining 33.33% of the Founder Shares.

Example B

Founder 'Z'
holds
100 Founder Shares

Founder 'Y'
holds
50 Founder Shares

Investor 'P'
holds
400 Investor Shares

Investor 'Q'
holds
600 Investor Shares

CIS 'A' SICAV p.l.c. has issued its first Investor Shares and has subsequently determined its first Net Asset Value, standing at EUR 3.45 per Investor Share. Unlike Founder Shares, Investor Shares do not carry any voting rights.

In this case, the following would be considered as beneficial owners:

- *Mr 'P' and Mr 'Q' as they hold respectively 40% and 60% of the NAV of the SICAV;*
- *Mr 'Z' and Mr 'Y' as they can exercise 66.67% and 33.33% of the voting rights in the SICAV.*

Thus, it is possible for (i) both founders and investors may be determined to be beneficial owners; (ii) one or more individuals is determined to be the beneficial owners due to holding directly or indirectly a sufficient percentage of the NAV; (iii) completely different individuals are determined to be beneficial owners on the basis of the voting rights they can exercise.

The absence of any one individual meeting these thresholds does not automatically entail that there is no beneficial owner and that one is entitled to consider the scheme's senior managing officials as beneficial owners. Situations may develop where one or more individuals that are exercising control over the CIS through means other than the shares they individually hold in the same or the voting rights they are individually entitled to exercise are identified. These individuals are to be considered as beneficial owners on the basis that they are exercising control through other means.

It is only where no individual is identified as beneficial owner on the basis of the afore-stated and there are no questions as to possible instances of ML/FT that one should move on to consider the scheme's senior managing officials as its beneficial owners. In any such case, the senior managing officials would comprise the members of the Board of Directors of the CIS and, where applicable, the members of its Investments Committee.

C2.2 CISs set up as Partnerships

A CIS may also be established as a partnership, which may or may not have its capital divided into shares with voting rights. In a partnership, it is usual for the general partner to be responsible for the management of the partnership, including the exercise of powers similar to those arising from voting rights, whereas the limited partners are the ones receiving the benefits from the partnership's activities. Based on the above definition both general and limited partners, if themselves individuals, could fall to be consider as beneficial owners depending on whether the voting rights or the percentage of the NAV attributable to them exceeds the 25% threshold or otherwise. If either one of them happens to be a body corporate or a legal arrangement, then one would have to consider whether any one of the individuals behind the body corporate or the legal arrangement can be said to hold indirectly voting rights or NAV in excess of the 25% threshold.

C2.3 CISs set up as Trusts

A CIS may also be established as a legal arrangement, in particular as a trust. In such a context, beneficial ownership is to be determined by applying the definition of beneficial ownership for legal arrangements found in Regulation 2(1)(b) of the PMLFTR. Thus, anyone holding a position within the CIS equivalent to any of the positions referred to under paragraph (b) of the definition of beneficial owner is to be considered as a beneficial owner. Where any such position happens to be a legal person or arrangement,

the subject person has to look through to identify any one individual who would fall to be considered as a beneficial owner in terms of the definition provided under Regulation 2(1) of the PMLFTR.

A question that may arise in this regard is whether all those unit-holders falling within the beneficiaries' category have to be considered as beneficial owners. The definition itself does not make any reference to percentages as it does under paragraph (a) thereof. However, it is also recognised that from a proportionality point of view it would not make sense to include all unit holders as beneficial owners given the minimal amounts they may have invested. Thus, it is possible to consider only those investors who individually represent more than 25% of the NAV as beneficiaries and as therefore having to be subject to the CDD measures applicable with regards to beneficial owners.

C2.4 CISs and the Listing Exemption

The definition of beneficial ownership set out under Regulation 2(1) of the PMLFTR provides that there is no obligation to identify and verify the beneficial ownership of a legal entity that is listed on a regulated market and is subject to transparency requirements. There are instances where CISs have their units listed on a regulated market, but the said listing does not involve any actual trading of the scheme's units. This is not the scenario contemplated by law and subject persons remain bound to determine who is the beneficial owner even in these cases.

On the other hand, there are so-called 'Exchange Traded Funds' that are actively traded on regulated markets. To the extent that these CISs are subject to transparency requirements, a subject person servicing the same can rely on the exemption provided for by law and refrain from identifying anyone as the beneficial owner of such schemes. Thus, apart from determining the status of the market on which the units are listed and the level of disclosure applicable, a subject person has to determine whether any units are actually traded on the regulated market and not take the listing at face value as an indication that this is the case.

C2.5 Reviewing and Updating Beneficial Ownership Information

Having outlined who is to be considered as the beneficial owner in the case of CISs, questions may still arise in relation to how to determine the same on an on-going basis to ensure that the information on beneficial ownership is correct and up-to-date. An initial determination on the basis of the information provided by the CIS should be made at on-boarding stage. However, there is a need to check at regular intervals whether the said information is still current and factually correct, or otherwise. To this end, the subject person is to query the CIS it is servicing at least:

a. On an annual basis;
b. Whenever the subject person notices a significant influx of funds or assets indicative of a significant volume of new subscriptions being made; and
c. Whenever a new sub-fund, if applicable, is launched.

Subject persons may also consider entering into contractual undertakings whereby the CIS undertakes to inform the subject person of any change in its beneficial ownership. However, this does not entail that

responsibility for compliance with the obligation to ensure that beneficial ownership information is at all times correct shifts from the subject person to the CIS. Whilst recognising that there will be a dependence on the CIS to obtain correct and updated information, the subject person remains at all times obliged to question the scheme as to whether there may have been any changes in its beneficial ownership as set out hereabove and, where possible, to question any information provided which the subject person may consider to be erroneous.

C3. BUSINESS AND RISK PROFILE

C3.1 Anticipated Level of Activity

The anticipated level of activity consists in an estimate of the volume and value of transactions that are to be processed within the context of a particular business relationship. The said information is intended to assist subject persons not only within the context of their CRA but also as part of their on-going monitoring obligations to detect any unusual spikes in activity.

When it comes to schemes, there are a number of elements that can be indicative of anticipated level of activity which may vary depending on the particular subject person servicing the same. The anticipated volume of subscriptions and/or the projected value of assets under management are both useful data points when it comes to establishing the anticipated level of activity which can be obtained by subject persons. It is also the FIAU's understanding that certain service providers would actually base their fee structure on the basis of the volume of activity/business that the CIS would be transacting as this would also influence the use of the subject person's services.

C3.2 Source of Wealth and Expected Source of Funds

The source of wealth of a CIS would be its activities as a CIS, i.e. receiving income in the form of subscriptions from investors and from the assets it invests in. In this context, the offering document of the particular scheme would be particularly useful as it usually provides a description of all of the above. In addition, if one is on-boarding a CIS that has just been established, this is as far as the information available will be. In other circumstances, the financial statements of the CIS, especially where these are accompanied by a portfolio statement, would be particularly relevant.

C4. On-Going Monitoring

There are two forms of on-going monitoring that are to be taken into account for AML/CFT purposes. The first is that of reviewing and, where necessary, updating any data, information or documentation collected for CDD purposes. The relevant sections in the Implementing Procedures – Part I would equally find application in this context.

The other relates to transaction monitoring. While for most subject persons servicing CISs these will be mostly the same as set out in the Implementing Procedures – Part I, it is important to bear in mind that some of the same subject persons carry out activities and services that are very particular to the collective investment services sector and are therefore being specifically being dealt with here:

C4.1 The Investment Manager

An investment manager carries out transactions on behalf of its customers but within its own discretion. In such cases it is not expected that the subject person monitors the transactions it is carrying out itself. In these cases, the subject person would have received a mandate from the customer to invest funds and manage assets as the subject person wishes as long as particular parameters are adhered to; the carrying out of individual transactions are not directed or dictated by the customer but by the subject person itself. In these cases, the activities subject to monitoring would be:

(a) any increase in the funds or assets entrusted to the subject person for investment purposes, and especially whether any such addition can be justified on the basis of the economic capabilities of the customer; and

(b) any request from the customer to have any funds or assets entrusted to the subject person released back to it, especially where this may harm the performance of the customer's portfolio or result in significant penalties or fees being charged by the subject person.

C4.2 The Custodian

The Custodian's main function is to safeguard the assets of the CIS. This entails that either it will be physically holding the asset or that it will otherwise have control over the assets though the asset being held or registered in the Custodian's name. This would include oversight over the funds and/or assets collected for subscription purposes.

Thus, the nature and level of on-going monitoring that would need to be carried out by the same would be quite limited and, not unlike the investment manager, it would have to question scenarios as the ones in which the investment manager too would have to consider the reasons for the particular situation. In brief, the Custodian has to consider what may be the reasons for:

a. Any unexpected increase in the funds or assets held under custody, and especially whether any such addition can be justified on the basis of the economic capabilities of the customer; and

b. Any request to have any funds or assets held under custody released, especially where this may harm the performance of the customer's portfolio or result in significant penalties or fees being charged by the investment manager.

In addition, where the Custodian detects instances where investment restrictions are breached, it has to consider whether the said breaches give rise to suspected instances of ML/TF. In such cases, reporting should not be limited to any regulatory disclosures to the prudential regulator but also lead to an STR being filed with the FIAU.

C4.3 The Fund Administrator

The Fund Administrator carries out a number of back-office functions necessary for the CIS to keep an orderly record and account of its funds and of its unit holders. In particular, it usually acts as the scheme's transfer agent, processing requests for subscriptions, redemptions and transfers. Thus, it has quite a privileged position to understand what is happening with regards to the particular scheme serviced.

In terms of transaction monitoring and scrutiny, its main obligation would be limited to detect spikes in the level of subscriptions and to seek clarifications as to the reasons for their occurrence. It may be that there was a renewed effort by the CIS or its service providers to attract new customers but it could also be that this is not the case. In addition, the administrator should equally detect any transactions that are not in line with the scheme's limitations and restrictions. While these may be of more relevance from a regulatory point of view, they should also be questioned from an ML/FT perspective.