

ANNEX III

Sector-Specific Guidance Notes for Investment Business Providers, Investment Funds and Fund Administrators

These sector-specific guidance notes should be read in conjunction with the main guidance notes for AML/ATF regulated financial institutions on anti-money laundering and anti-terrorist financing.

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ANNEX III - SECTOR-SPECIFIC GUIDANCE NOTES FOR INVESTMENT BUSINESS

Introduction

- III.1 This annex sets forth guidance on AML/ATF obligations under the Acts and Regulations of Bermuda that are specific to investment business and applicable to regulated investment business providers, investment funds, fund administrators and non-licensed AML/ATF Regulated Financial Institution (NLPs), as noted under III.2.
- III.2 Under Regulation 2(2)(b), (e) and (h) of the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008 (the Regulations), a person is designated as an anti-money laundering and anti-terrorist financing (AML/ATF) regulated financial institution (RFI) if the person:
- Carries on investment business within the meaning of Section 3 of the Investment Business Act 2003;
 - Carries on the business of a fund administrator within the meaning of Section 2(2) of the Investment Funds Act 2006; or
 - Is the operator of an investment fund within the meaning of Section 2 of the Investment Funds Act 2006;
 - Is a NLP under Section 9 of the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act 2008 (SEA Act 2008).
- III.3 *Left blank intentionally*
- III.4 All RFIs and independent professionals must comply with the Acts and Regulations, and with the main AML/ATF guidance notes issued by the Bermuda Monetary Authority (BMA).
- III.5 For the purposes of these guidance notes, the terms “AML/ATF regulated financial institution” and “RFI” should be understood to include the “independent professionals”. The term “investment business” should be understood to include any and all of the activities described in paragraphs III.2.
- III.6 RFIs conducting investment business should read these sector specific guidance notes in conjunction with the main guidance notes for AML/ATF regulated financial institutions on anti-money laundering and anti-terrorist financing. This annexes supplements, but does not replace the main guidance notes.

- III.7 Portions of this annex summarise or cross-reference relevant information that is contained in detail in the main guidance notes. The detailed information in the main guidance notes remains the authoritative guidance.
- III.8 Portions of this annex include sector-specific information, such as risk indicators that are particular to investment business. This sector-specific information should be considered as supplementary to the main guidance notes.

Status of the guidance

- III.9 Approved by the Minister responsible for Justice, these guidance notes are issued by the BMA under Section 5(2) of the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act 2008 (SEA Act 2008).
- III.10 These guidance notes are of direct relevance to all senior management, inclusive of the Compliance Officer, and to the Reporting Officer. The primary purpose of the notes is to provide guidance to those who set the RFI's risk management policies, procedures and controls for the prevention and detection of money laundering and terrorist financing (ML/TF).
- III.11 The Court, or the Authority, as the case may be, in determining whether a person is in breach of a relevant provision of the Acts or Regulations, is required to consider whether a person has followed any relevant guidance approved by the Minister of Justice and issued by the Authority. These requirements upon the Court are detailed in the provisions of Section 49M of POCA 1997, Regulation 19(2), Section 12(O) of, and paragraph 1(6) of Part I, Schedule I to, ATFA 2004 and the requirements in relation to the Authority are detailed in Section 20(6) of the SEA Act 2008.
- III.12 When a provision of the Acts or Regulations is directly described in the text of the guidance, the guidance notes use the term **“must”** to indicate that the provision is mandatory.
- III.13 In other cases, the guidance uses the term **“should”** to indicate ways in which the requirements of the Acts or Regulations may be satisfied, while allowing for alternative means, provided that those alternatives effectively accomplish the same objectives.
- III.14 Departures from this guidance, and the rationale for so doing, should be documented, and RFIs should stand prepared to justify departures to authorities such as the BMA.

III.15 RFIs should be aware that under Section 16 of the Financial Intelligence Agency Act 2007, the Financial Intelligence Agency (FIA) may, in the course of enquiring into a suspicious transaction or activity relating to money laundering or terrorist financing, serve a notice in writing on any person, requiring the person to provide the Financial Intelligence Agency with such information as it may reasonably require for the purpose of its enquiry.

III.16 Detailed information is set forth in the main guidance notes, beginning with the Preface.

Senior management responsibilities and internal controls

III.17 The AML/ATF responsibilities for senior management of an RFI conducting investment business are governed primarily by POCA 1997, SEA Act 2008, ATFA 2004, and Regulations 16, 17 and 19.

III.18 The AML/ATF internal control requirements for RFIs conducting investment business are governed primarily by Regulations 12, 16 and 18.

III.19 Regulation 19 provides that failure to comply with the requirements of specified Regulations is a criminal offence and carries with it significant penalties. On summary conviction, the penalty is a fine of up to \$50,000. Where conviction occurs on indictment, penalties include a fine of up to \$750,000, imprisonment for a term of two years, or both.

III.20 Section 20 of the SEA Act 2008 empowers the BMA to impose a penalty on an RFI of up to \$500,000 for each failure to comply with specified Regulations. Section 33 of the SEA Act creates a number of criminal offences for breach of certain provisions by non-licensed AML/ATF regulated financial institutions, to include breach of the registration requirement in section 9 of that Act.

III.21 Under the Acts and Regulations of Bermuda, senior management in all RFIs must:

- Ensure compliance with the Acts and Regulations;
- Identify, assess and effectively mitigate the ML/TF risks the RFI faces amongst its customers, products, services, transactions, delivery channels, outsourcing arrangements and geographic connections;
- Ensure that risk assessments are kept up to date;
- Appoint a Compliance Officer at the managerial level to oversee the establishment, maintenance and effectiveness of the RFI's AML/ATF policies, procedures and controls;
- Appoint a Reporting Officer;

- Ensure that procedures for identification and reporting of suspicious transactions are established and adhered to;
- Screen employees against high standards;
- Ensure that adequate resources are devoted to the RFI's AML/ATF policies, procedures and controls;
- At least once per calendar year, audit and periodically test the RFI's AML/ATF policies, procedures and controls for effectiveness; and
- Recognise potential personal liability if legal obligations are not met.

III.22 RFIs must establish and maintain detailed policies, procedures and controls that are adequate and appropriate to forestall and prevent operations related to ML/TF.

III.23 Where a Bermuda RFI conducting investment business has branches, subsidiaries or representative offices located in a country or territory other than Bermuda, it must communicate its AML/ATF policies and procedures to all such entities and must ensure that all such entities apply AML/ATF measures at least equivalent to those set out in the Acts and Regulations.

III.24 Attempts to launder money through investment business products or services may be carried out in any one or several of three ways:

- Internally, by a director, manager or employee, either individually or in collusion with others inside and/or outside of the RFI conducting investment business;
- Externally, by an investor seeking to place, layer or integrate illicit funds with an RFI for subsequent recovery; and
- Indirectly, by a third party service provider or by an RFI, independent professional or other intermediary facilitating transactions involving illicit funds or assets on behalf of either an investor or a third party or intermediary itself.

III.25 The majority of this annex addresses attempted money laundering by investors. Money laundering risks involving intermediaries and third party service providers are addressed in paragraphs III.34 through II.37 and III.87 through III.103. Money laundering risks involving internal directors, managers or employees, are addressed in paragraphs III.38 through III.41.

III.26 Specific requirements for an RFI's detailed policies, procedures and controls are set forth in chapters 2 through 11 of the main guidance notes.

III.27 Additional details are set forth in *Chapter 1: Senior Management Responsibilities and Internal Controls* of the main guidance notes.

Links between investment business practices and AML/ATF policies, procedures and controls

III.28 Persons carrying on investment business may be subject to Acts and Regulations that achieve some of Bermuda's AML/ATF objectives. These Acts and Regulations include, but are not limited to:

- The Investment Business Act 2003;
- The Investment Business Regulations 2004;
- The Investment Business (Client Money) Regulations 2004;
- Investment Business (Reporting Accountants) (Facts and Matters of Material Significance) Regulations 2006; and
- The Investment Funds Act 2006.

III.29 The requirements of the Acts and Regulations described in paragraph III.28 provide a suitable foundation for the AML/ATF policies, procedures and controls that Bermuda RFIs are required to adopt and implement. An RFI should not presume, however, that its existing processes are sufficient. Each RFI must ensure that it meets each of its AML/ATF obligations under the Bermuda Acts, Regulations and these guidance notes, whether as part of its existing business processes or through separate processes.

III.30 Criminals seeking to launder money via investment business are attracted primarily by:

- Investment transactions that take place at high speeds;
- Investment products and services that are complicated in nature;
- Investment products and services that permit cross-border transfers of value;
- Investment products and services that permit the use of a client money account for transactions unrelated to investment activity; and
- A perception that RFIs conducting investment business may presume that other persons have conducted or will conduct customer due diligence (CDD), and therefore that the RFI may be less likely to conduct CDD itself.

III.31 *Left intentionally blank*

Links between investment business, insurance business and trust business

III.32 An RFI's investment business may involve insurance business or trust business, including, but not limited to:

- Life insurance policies and both fixed and variable annuities that are investment-linked;
- A customer that is an insurance company, agent, broker, manager or other insurance intermediary;
- Unit trusts; and
- A customer that is a trust, trustee or other person associated with a trust, including a beneficiary.

III.33 Where an RFI's investment business involves an insurance product, service, company, agent, broker, manager or other insurance intermediary or where the investment business involves a trust or any person associated with a trust, the RFI should have due regard to the risks detailed in the main guidance notes and annexes addressing insurance business and trust business.

Intermediaries and third party service providers

III.34 The AML/ATF risks associated with investment business are increased by the involvement of intermediaries, third party service providers and other persons or entities. "Downstream" RFIs with customers that are investors must take appropriate measures to ensure that CDD is applied and that, where required, relevant information is provided to other relevant RFIs. "Upstream" RFIs with customers that are downstream RFIs and that often provide clearing, settlement, omnibus, management, custodial and other services, must take appropriate measures to ensure that their downstream RFI customers are applying CDD effectively to investors and their funds, and that, where appropriate, downstream RFI customers are providing upstream RFIs with relevant information.

III.35 Where an intermediary is not acting directly under the control or supervision of the RFI conducting investment business, there is a heightened inherent risk that the intermediary is unaware or unwilling to conform to required AML/ATF policies, procedures and controls. In turn, there is a heightened inherent risk that the intermediary will fail to apply appropriate due diligence measures on the customer and source of funds and will fail to recognise and report knowledge, suspicion, and reasonable grounds to know or suspect

that funds or assets are the proceeds of crime, or that a person is involved in money laundering or terrorist financing.

- III.36 The use of third party service providers to apply CDD and other measures similarly heightens the inherent risk of an AML/ATF failure.
- III.37 To ensure that intermediaries and third party service providers apply appropriate AML/ATF measures, RFIs conducting investment business must carefully apply appropriate due diligence, reliance and outsourcing measures. See paragraphs III.87 through III.103, and paragraphs 3.23 through 3.24, 5.118 through 5.148 and 5.149 through 5.178 of the main guidance notes.

Ownership, management and employee checks

- III.38 To guard against potential money laundering involving owners, directors, managers and employees, RFIs conducting investment business should screen such persons against high standards in accordance with paragraphs 1.70 through 1.74 of the main guidance notes.
- III.39 RFIs should ensure that screenings are conducted both for the RFI itself and for any intermediary or third party service provider.
- III.40 Where any screening is conducted by a third party, the RFI should have procedures to satisfy itself as to the effectiveness of the screening procedures the third party uses to ensure the competence and probity of each person subject to screening.
- III.41 Working with intermediaries and third party service providers that apply AML/ATF measures at least equivalent to those in Bermuda is likely to reduce the measures a Bermuda RFI conducting investment business will need to undertake in order to meet its screening obligations.

Risk-based approach for RFIs conducting investment business

III.42 RFIs conducting investment business must employ a risk-based approach in determining:

- Appropriate levels of CDD measures;
- Proportionate risk-mitigation measures to prevent the abuse of the RFI's products, services and delivery channels for ML/TF purposes;
- The level of reliance, if any, that can reasonably be placed upon any intermediary;
- The scope and frequency of on-going monitoring; and

- Measures for detecting and reporting suspicious activity.

- III.43 The purpose of an RFI applying a risk-based approach is to balance the cost of AML/ATF compliance resources with a realistic assessment of the risk of the RFI being used in connection with ML/TF. A risk-based approach focuses resources and efforts where they are needed and where they have the greatest impact in preventing and suppressing ML/TF.
- III.44 The higher the ML/TF risk an RFI faces from any particular combination of customer, product, service, transaction, delivery channel or geographic connection, the stronger and/or more numerous the RFI's mitigation measures must be.
- III.45 Although RFIs conducting investment business should target compliance resources toward higher-risk situations, they must also continue to apply risk mitigation measures to any standard- and lower-risk situations, commensurate with the risks identified. The fact that a customer or transaction is assessed as being lower risk does not mean the customer or transaction is not involved in ML/TF.
- III.46 RFIs should document and be in a position to justify the basis on which they have assessed the level of risk associated with each particular combination of customer, product, service, transaction, delivery channel or geographic connection.
- III.47 When designing a new product or service, an RFI conducting investment business must assess the risk of the product or service being used for ML/TF.
- III.48 Detailed information on the requirement that RFIs use a risk-based approach to mitigate the risks of being used in connection with ML/TF is set forth in *Chapter 2: Risk-Based Approach* of the main guidance notes.

ML/TF risks in investment business

- III.49 Using the risk-based approach, each RFI conducting investment business should determine the amount of ML/TF risk it will accept in pursuit of its business goals.
- III.50 Nothing in the Acts or Regulations prevents an RFI from deliberately choosing to accept higher-risk investment business. Each RFI must, however, ensure that it has the capacity and expertise to apply risk mitigation measures that are commensurate with the risks it faces, and that it does in fact apply those measures effectively.

III.51 Generally, the level of risk associated with investment business is highest where:

- Adequate CDD measures are not applied to a customer;
- An investor requests or initiates unusual payment, settlement or delivery transactions; or
- The involvement of intermediaries or third party service providers reduces transparency in a securities custody chain.

III.52 Although the Acts and Regulations create AML/ATF obligations specifically for persons conducting activities within the meaning of “investment business”, ML/TF risks or suspicions may arise with regard to activities falling outside of the meaning of “investment business”. Section 46 of POCA 1997 permits a person to report knowledge or suspicion of money laundering to the FIA.

Securities-related predicate offenses for ML

III.53 RFIs conducting investment business are often in a unique position to identify instances of securities-related predicate offenses for ML.

III.54 An RFI should ensure that its AML/ATF policies, procedures and controls, either independently or in conjunction with the RFI’s other business practices, include appropriate measures to prevent and identify instances of insider trading, market manipulation and fraud.

Transparency in securities custody chains

III.55 The involvement of intermediaries can result in investment managers and custodians being one or more steps removed from the underlying investors and investments. Where CDD is not managed effectively, degrees of removal can reduce upstream or downstream intermediaries’ visibility of the security custody chain, and prevent an RFI from adequately identifying investors and conducting on-going monitoring of the business relationship.

III.56 Any lack of transparency in a securities custody chain may enable or cause an RFI to transact with or on behalf of an investor, intermediary or third party that is committing or seeking to commit an ML/TF offense, or that is a target of international sanctions. Such an act could expose an RFI to prosecution and penalties for failure to meet its AML/ATF and international sanctions obligations under the Acts and Regulations.

III.57 In addition to the requirements of the Acts and Regulations, including but not limited to the Investment Business Act 2003, the Investment Business Regulations 2004, the Investment Business (Client Money) Regulations 2004 and the Investment Funds Act 2006, RFIs conducting investment business should take appropriate measures to prevent the use or provision of any omnibus, pooled account or other arrangement from preventing the effective application of CDD and on-going monitoring throughout the securities custody chain. See paragraphs III.87 through III.103.

III.58 As a general matter, a non-exhaustive list of factors that will affect the level of risk of any investment business relationship or transaction includes:

- The customer and any beneficial owner;
- The product or service to be provided;
- The involvement of any intermediaries or third party service providers;
- The nature of the business relationship formed;
- Geographic connections;
- The methods used to send and receive any payment connected with the product or service; and
- Transactions undertaken following the establishment of the business relationship.

III.59 Information regarding payments related to investment business is set forth in paragraphs III.140 through III.152.

III.60 Additional indicators of higher risk in investment business are discussed in detail in paragraphs III.233 through III.239.

Customer due diligence

III.61 RFIs conducting investment business must carry out CDD.

III.62 Detailed information on CDD is set forth in *Chapters 3, 4 and 5* of the main guidance notes, and paragraphs III.61 through III.170.

III.63 RFIs must know the identities of their investment business customers, their customers' sources of funds and the purpose and intended nature of their customers' activities.

III.64 CDD information assists RFIs in knowing who the customer is, understanding the true source of funds flowing through the investment business relationship or transaction and establishing norms for expected customer profiles and conduct.

III.65 Carrying out CDD also allows RFIs to:

- Guard against impersonation and other fraud by being satisfied that customers are who they say they are;
- Identify any legal barriers (e.g. international sanctions) to providing the investment product or service requested;
- Maintain a sound basis for identifying, limiting and controlling risk exposure;
- Avoid committing offences under POCA and ATFA relating to ML/TF;
- Avoid violating any international sanction that is in effect; and
- Assist law enforcement by providing information on investment customers or activities being investigated.

III.66 CDD measures that must be carried out include:

- Understanding the purpose and intended nature of the customer's business relationship with the RFI;
- Identifying the source of funds associated with the customer;
- Identifying and verifying the identity of each customer;
- Identifying and taking reasonable measures to verify the identity of the beneficial owner(s) of the customer; and
- Updating the CDD information at appropriate times.

III.67 In addition, RFIs should also understand where relevant:

- The investment experience and objectives of each customer;
- Whether the customer is retail or non-retail;
- Whether the customer is acting for his or her own account, or for the account of one or more other persons; and
- Whether the customer seeks a short- or long-term business relationship.

III.68 RFIs should also understand whether, within the meaning of Regulation 1 of the Investment Business (Client Money) Regulations 2004, the customer qualifies, and seeks to be treated, as any of the following:

- A high income private investor;
- A high net worth private investor; or
- A sophisticated private investor.

III.69 High-level principles regarding CDD are set forth in *Chapter 3: Overview of Customer Due Diligence* of the main guidance notes.

Purpose and intended nature of the customer's business relationship with the RFI

III.70 An RFI must understand the purpose and intended nature of each proposed business relationship or transaction. In some instances the purpose and intended nature of a proposed business relationship may appear self-evident. Nonetheless, an RFI must obtain information that enables it to document and categorise the nature, purpose, size and complexity of the business relationship, such that it can be effectively monitored.

III.71 To obtain an understanding sufficient to monitor an investment business relationship or transaction, an RFI should collect information, including, but not limited to:

- The nature and intended purpose of the investment business relationship or transaction;
- The source of wealth and source of funds to be used in the investment business relationship or transaction;
- The anticipated type, volume, value, frequency, duration and nature of the activity that is likely to be undertaken through the investment business relationship or transaction;
- The geographic connections of the customer, beneficial owner, administrator, advisor, operator, employee, manager, director or other person who is able to exercise significant power over the investment business relationship or occasional transaction;
- The means of payment (cash, wire transfer, other means of payment);
- Whether there is any bearer arrangement, and if so, the reasons for and details of the arrangement;
- Whether the investment product, service, any underlying assets or related transaction are to be used as collateral; and
- Whether any payments are to be made to or by third parties, and if so, the reasons for and details of the request.

Source of wealth and source of funds

III.72 Enquiries regarding the source of wealth and source of funds are among the most useful sources of information leading to knowledge, suspicion or reasonable grounds to know or suspect that funds or assets are the proceeds of crime, or that a person is involved in money laundering or terrorist financing.

III.73 RFIs should make enquiries as to how a customer has acquired the wealth, whether in currency, securities or any other assets, to be used with regard to the investment business relationship or transaction.

III.74 The extent of such enquiries should be made using a risk-based approach.

III.75 RFIs should also ensure that they understand the source of funds and specific means of payment, including the details of any account, which a customer proposes to use. See paragraphs III.72 through III.76.

III.76 Additional information on source of funds and source of wealth is set forth in paragraphs 5.110 through 5.113 of the main guidance notes.

Definition of customer in an investment business context

III.77 An RFI's customer is generally a private individual, legal person, trust or other legal arrangement with and for whom a business relationship is established, or with or for whom an occasional transaction is carried out. A given investment business relationship or transaction may have more than one person who is a customer, whether directly as an investor or as another person involved in advising on or managing an investment, or otherwise involved in a securities custody chain.

III.78 For the purposes of these guidance notes, a customer includes each of the following:

- Any private individual, legal person, trust or other legal arrangement that is an **investor** seeking an investment business product or service;
- Any **beneficial owner** of an investor; and
- Any **intermediary** or other person acting with regard to an investor or an investment, whether on an advisory, discretionary, administrative, controlling, operative or custodial basis.

III.79 In line with the main guidance notes, RFIs must obtain and verify identification information for each person who is a customer in the investment business context.

III.80 Full information on the meaning of customer, business relationship and occasional transaction, and on identifying and verifying individuals, legal persons, trusts and other legal arrangements is set forth in *Chapter 4: Standard Customer Due Diligence Measures* of the main guidance notes.

Obtaining and verifying investor identification information

III.81 A person who is an investor in the investment business context may be a private individual, legal person, trust or other legal arrangement. For each type of investor that is

a customer, an RFI should follow the identification and verification requirements in *Chapter 4: Standard Customer Due Diligence Measures* of the main guidance notes.

III.82 Verification of identity must be completed for each investor and any third party or other person sending or receiving any payment, prior to the payment's initiation.

Obtaining and verifying an investor's beneficial owner information

III.83 In addition, and in line with the guidance for private individuals, legal persons, trusts and other legal arrangements, RFIs must obtain identification information for the beneficial owners of any investor and verification information where necessary following a risk based assessment.

III.84 Where an RFI's customer is an investor, for example where the RFI is an introducing broker or other person that accepts or has accepted instructions directly from an investor, and the investor is a legal person, trust or other legal arrangement, the RFI should:

- Understand the ownership and control structure of the investor;
- Obtain and verify the identity of each private individual owning or acting on behalf of the legal person, trust or other legal arrangement, as per paragraph 4.87 of the main guidance notes; and
- Ascertain whether each private individual owning or acting on behalf of the investor is appropriately authorised.

III.85 Information on the identification and verification of beneficial owners is set forth in Regulation 3 of the Regulations and *Chapter 4: Standard Customer Due Diligence Measures* of the main guidance notes.

III.86 Additional information specific to the beneficial ownership of trusts is set forth in Regulation 3(3) of the Regulations and paragraphs I.78 through I.87 of Annex I.

Obtaining and verifying intermediary information

III.87 For the purposes of these guidance notes, a customer that is an intermediary includes, but is not limited to:

- A fund authorised under section 13 of the Investment Funds Act 2006, an excluded fund as set forth in section 6(2) of the Investment Funds Act 2006, and an exempted fund as set forth in sections 6A and 7 of the Investment Funds Act;
- An intermediary within the meaning of section 2 of the Investment Business (Client Money) Regulations 2004;

- A fund administrator within the meaning of section 2(2) of the Investment Funds Act 2006;
- An operator within the meaning of section 2 of the Investment Funds Act 2006;
- A controller within the meaning of section 2A of the Investment Funds Act 2006;
- The non-Bermudian equivalent of any of the persons named above; and
- Any person that is transacting on behalf of one or more underlying customers rather than on its own behalf.

III.88 In general, an intermediary is not an underlying investor. An RFI with a customer that is an intermediary accepts instructions from the intermediary, and not from any underlying investor.

III.89 Where an RFI's customer is an intermediary, the RFI should follow the identification and verification requirements for individuals, legal persons, trusts and other legal arrangements in *Chapter 4: Standard Customer Due Diligence Measures* of the main guidance notes.

III.90 An RFI must make a determination concerning the appropriateness of establishing a business relationship with any intermediary. Because intermediaries generally act on behalf of underlying investors or downstream intermediaries, there is a risk that an intermediary, in failing to apply appropriate policies, procedures and controls, may expose an upstream RFI to liability for violations of the Acts and Regulations pertaining to AML/ATF and international sanctions.

III.91 Where an RFI is a fund administrator within the meaning of section 2(2) of the Investment Funds Act 2006 or an operator of an investment fund within the meaning of section 2 of the Investment Funds Act 2006, the RFI must:

- Undertake due diligence on the fund, its underlying customers and any other parties appointed to the fund; and
- Conduct on-going monitoring of the fund's transactions and arrangements to ensure that all obligations under the Acts and Regulations are being met.

III.92 RFIs must take appropriate measures to determine whether an intermediary with which a business relationship has been proposed applies adequate AML/ATF and international sanctions measures to its business, the intermediary's underlying investors and any downstream intermediaries. To do so, an RFI should establish:

- Whether the intermediary is a Bermuda RFI, or a wholly-owned subsidiary of a Bermuda RFI;

- Whether the intermediary is a non-Bermuda person or entity that is regulated and applies AML/ATF and international sanctions measures at least equivalent to those in Bermuda, or whether the intermediary is a wholly-owned subsidiary of such a person or entity;
- The geographic locations where the intermediary transacts business, and the location of the parent company, if the intermediary is a wholly owned subsidiary;
- Whether the intermediary establishes or maintains correspondent accounts for non-Bermuda financial institutions;
- Whether the intermediary establishes or maintains private banking accounts;
- Whether the intermediary is a shell entity;
- Whether any of the intermediary’s customers, employees, managers, beneficial owners or directors is a politically exposed person (PEP);
- Whether the intermediary facilitates activities, for example dealing in thinly traded securities, that are recognised as being vulnerable to ML/TF, corruption, insider trading, market manipulation, fraud or the evasion of sanctions;
- The customer base of the intermediary;
- The business of the intermediary, including the products, services and geographic connections of persons, including any intermediaries of the intermediary, that are linked with the investment business the intermediary seeks to conduct with the RFI;
- The professional reputation of the intermediary;
- The ownership and management structure of the intermediary and any upstream or downstream intermediaries appointed to or working with or on behalf of the intermediary; and
- The adequacy of the intermediary’s AML/ATF and international sanctions policies, procedures and controls.

III.93 *Left intentionally blank*

III.94 Where an RFI’s customer is an intermediary, the RFI and intermediary should ensure that a division of contractual responsibility for compliance with AML/ATF and international sanctions obligations is set forth clearly. The RFI should bear in mind that, although it may not contract out its AML/ATF obligations, it may contract with another party to assist the RFI in meeting its AML/ATF obligations.

III.95 Using a risk-based approach, RFIs should consider including in the agreement described in paragraph III.94 the following rights and obligations:

- The RFI will communicate its AML/ATF and international sanctions standards and other requirements to the intermediary;
- The intermediary will comply with those standards and requirements;
- Where the intermediary has customers who themselves engage in investment business with customers further downstream, the intermediary will ensure that the customers further downstream are subject to the legal and regulatory standards and requirements of the jurisdictions, including Bermuda, in which persons taking part in the securities custody chain are located, or in which they are subject to regulation;
- The intermediary will conduct investment business with or through the RFI on behalf of the intermediary's underlying customers only where the underlying customers and their beneficial owners have been subjected to satisfactory due diligence;
- The RFI is entitled to obtain from the intermediary, and the intermediary will provide, information concerning the intermediary's underlying customers where the RFI requires such information in order to meet its AML/ATF and international sanctions obligations; and
- The RFI is entitled to verify with the intermediary, or through the engagement of an independent third party, whether the RFI's AML/ATF and international sanctions obligations have been met.

III.96 RFIs should periodically assess their customers who are intermediaries to determine the appropriateness of maintaining a business relationship with the intermediary, and the adequacy of the agreement(s) governing the respective AML/ATF and international sanctions obligations of the RFI and the intermediary.

III.97 Using a risk-based approach, an RFI may require an intermediary to provide identification and/or verification information for the intermediary's underlying customers, as a condition for commencing or maintaining a business relationship.

III.98 An intermediary may provide an RFI with the names of the intermediary's underlying customers, either by providing the information directly, or through the use of segregated accounts that include the underlying customer's name in the name of the accountholder. An intermediary's request for a segregated account held in a name such as "ABC Investment Company Ltd of John Smith" may assist an RFI in meeting its AML/ATF and international sanctions obligations, but does not necessarily create a customer relationship between the RFI and the intermediary's underlying customer.

III.99 Similarly, where a life insurance company is the legal and beneficial owner of the funds or other investments held in an RFI, and the policyholder has not been led to believe that he or she has no rights over the account with the RFI, the life company, and not the policyholder, is the RFI's customer.

III.100 Where an RFI with an intermediary customer holds some limited information about an intermediary's underlying customer, the RFI may nonetheless treat the intermediary as its customer for CDD purposes, provided that the following circumstances are met:

- The omnibus account or other business relationship is established by or on behalf of an intermediary for the purpose of executing transactions that will clear or settle at another financial institution, or the intermediary making use of the RFI's services provides limited information to the RFI for the purpose of delivering assets to the custody account of the beneficial owner at another financial institution;
- The limited information given to the RFI about any underlying customers is used primarily to assist the intermediary with recordkeeping, or to establish sub-accounts that hold positions for a limited duration to facilitate the transfer of assets to another financial institution, or for the purposes of ensuring that appropriate AML/ATF measures are applied;
- All transactions in the omnibus account or sub-accounts at the RFI are initiated by the intermediary; and
- The underlying customer has no direct control over the omnibus account or sub-accounts at the RFI.

III.101 *Left intentionally blank*

III.102 Information concerning the applicability of simplified due diligence to investment business is set forth in paragraphs III.153 through III.161.

III.103 Information concerning an RFI's application of enhanced due diligence to investment business is set forth in paragraphs III.162 through III.170.

Timing of customer due diligence

III.104 An RFI must apply CDD measures when it:

- Establishes a business relationship;
- Carries out an occasional transaction with a value of \$15,000 or more, whether the transaction is carried out in a single operation or several operations which appear to be linked, (see *Chapter 8: Wire Transfers* of the main guidance notes);

- Suspects money laundering or terrorist financing; or
- Doubts the veracity or adequacy of documents, data or information previously obtained for the purposes of identification or verification.

III.105 RFIs conducting investment business must identify the following before entering into any business relationship or conducting any occasional transaction:

- The customer and any beneficial owners of the customer;
- The purpose and intended nature of the business relationship; and
- The source of funds.

III.106 Before concluding any transaction, RFIs must also verify the identity of the customer and any beneficial owners of the customer, as per paragraphs 3.13 and 3.20 of the main guidance notes.

III.107 In addition, each time a customer makes an unusually large transaction, as per Paragraph 7(2)(b) of the Regulations, into a client money account, or otherwise contributes significant value to an investment business relationship or occasional transaction, an RFI should obtain and verify the source of the funds or source of wealth and the objectives of the customer.

III.108 Verification of identity should also take place, or be confirmed:

- Before any payment is made to, from the account of, or on behalf of the customer, other than routine fees paid to the RFI;
- Before any manager, beneficial owner, director or similar person associated with an intermediary is permitted to act on behalf of the intermediary or its underlying customers;
- Subsequently when there is any change in information previously provided; and
- When otherwise deemed necessary due to information obtained through risk-assessment or on-going monitoring.

III.109 Where a particular investment business relationship presents higher ML/TF risks, for example, where a PEP or a target of international sanctions is involved, RFIs should apply enhanced due diligence (see *Chapter 5 Non-Standard Customer Due Diligence Measures* of the main guidance notes).

III.110 In order to keep aging identity information accurate and up-to-date, RFIs should take advantage of opportunities to obtain updated documentation. Such opportunities include, but are not limited to:

- A change in the address of a customer;
- The expiration of a document establishing identity;
- A receipt of payment from, or a request for payment to, a previously unknown account; and
- The appointment of a new employee, manager, beneficial owner, director or similar person to act on behalf of an intermediary.

III.111 Using a risk-based approach, an RFI may consider the appropriateness of opening an investor account and accepting a subscription payment upon receipt of a valid application form, provided that the RFI withholds payment and transfer of redemptions, dividends and all other funds and assets until full AML/ATF documentation and information has been received and evaluated as sufficient.

III.112 Detailed information on the timing of CDD measures is set forth in *Chapter 3: Overview of Customer Due Diligence* of the main guidance notes.

Reliance on intermediaries

III.113 As set forth in paragraphs III.34 through III.37, the significant involvement of intermediaries in investment business requires RFIs to carefully implement reliance controls.

III.114 An RFI may choose to rely upon another person to apply certain CDD measures, provided that both the person being relied upon and the nature of the reliance meet certain criteria. In any reliance situation, however, the relying RFI retains responsibility for any failure to comply with a requirement of the Regulations, as this responsibility cannot be delegated.

III.115 The CDD measures that an RFI may rely upon a person to apply are:

- Identifying and verifying the identity of an investor and any beneficial owners;
- Identifying and verifying the identity of an intermediary and any beneficial owners, administrators, operators and other persons associated with the intermediary's upstream and downstream investment business relationships;
- Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship, including an investor's source of wealth, source of funds, investment experience and investment objectives, and an intermediary's business structure and reputation as set forth in paragraph III.92.

III.116 In any reliance situation, the following duties remain with the relying RFI and cannot be delegated:

- Conducting on-going monitoring to scrutinise transactions undertaken throughout the course of the relationship to ensure that the transactions are consistent with the RFI's knowledge of the customer, beneficial owner, purpose and intended nature of the business relationship and, where necessary, the source of funds or wealth; and
- Reporting knowledge or suspicion of money laundering or terrorist financing.

III.117 However, within the limitations established by Act, Regulations and these guidance notes, intermediaries being relied upon may support an RFI in carrying out the duties described in paragraph II.116 of Annex II.

III.118 RFIs may rely upon a person who is:

For Bermuda persons

- An AML/ATF regulated financial institution under Section 2(2) of the Regulations; or
- A specified business under Section 3 of the Anti-Terrorism (Financial and Other Measures) (Business in Regulated Sector) Order 2008; or
- An independent professional as defined at Section (2)(1) of the Regulations; and
- Regulated, supervised or monitored for, and has measures in place for compliance with the AML/ATF Regulations of Bermuda.

For non-Bermuda persons

- An institution that carries on business corresponding to the business of an AML/ATF regulated financial institution or independent professional; and
- Regulated, supervised or monitored for, and has measures in place for compliance with AML/ATF regulations equivalent to those in Bermuda.

III.119 Where an RFI seeks to rely upon or outsource to a non-Bermuda person, and the RFI seeks to determine whether the non-Bermuda person is subject to AML/ATF regulations equivalent to those of Bermuda, the RFI should consider not only the degree to which the non-Bermuda jurisdiction regulates financial institutions for AML/ATF compliance, but also the degree to which the non-Bermuda jurisdiction regulates the specific type of entity with which the RFI seeks an AML/ATF reliance or outsourcing relationship. For example, where the non-Bermuda person is an attorney, accountant or investment company, the RFI should consider whether the non-Bermuda jurisdiction regulates,

supervises or monitors attorneys, accountants or investment companies, respectively, for compliance with AML/ATF regulations equivalent to those in Bermuda.

III.120 An RFI may rely upon another person or institution to carry out CDD measures only where:

- The RFI utilises a risk-based approach to determine the level of reliance it can reasonably place on an intermediary and the verification work the intermediary has carried out, and as a consequence, the amount of evidence that should be obtained directly from the customer.
- The intermediary being relied upon consents to being relied upon;
- The intermediary being relied upon confirms in writing that it has applied the CDD measures itself; and
- The intermediary being relied upon has carried out at least the standard level of customer verification.

III.121 Relying RFIs must satisfy themselves that copies of documents, data and other information used by the intermediary for verification of identity, purpose and intended nature of the business relationship, and the sources of wealth and funds will be made available by the intermediary upon request, without delay, for at least five years after the account is closed.

III.122 Periodically, and on a risk-sensitive basis, relying RFIs should test the willingness and ability of relied upon intermediaries to actually make available requested evidence of verification. This is particularly relevant when a customer is assessed as being higher risk, when the intermediary is situated in, or a transaction involves, a higher-risk jurisdiction, or when knowledge or suspicion of money laundering or terrorism financing is present.

III.123 In addition to using a risk-based approach to determine the level of reliance an RFI can place on an intermediary; RFIs should consider whether to introduce AML/ATF standards and related training as a condition of accepting or maintaining business from an intermediary.

III.124 Where an RFI has reason to believe that an intermediary is subject to insufficient or no legislation, regulation or guidance in respect of AML/ATF, or simply as a matter of good practice, the RFI should introduce measures to ensure that the intermediary has in place adequate policies, procedures and controls. These measures may include, but are not limited to:

- Requiring sight of the intermediary's AML/ATF policies, procedures and controls;
- Requesting and reviewing a copy of the relevant section of the last inspection report undertaken by the intermediary's regulator;
- Devising a standard set of customer due diligence procedures and requiring an undertaking from the intermediary that procedures to the same standard will be applied;
- Requiring the right to physically audit the introducer's AML/ATF policies, procedures and controls, and periodically testing those policies, procedures and controls; and/or
- Obtaining any of the information set forth in paragraph III.92.

III.125 Any use of a pro-forma certificate should not unthinkingly be accepted as an adequate performance of CDD. Pro-forma certificates may reduce duplication of effort and documentation only where the RFI determines after careful assessment that the pro-forma certificate in combination with the RFI's and intermediary's AML/ATF policies, procedures and controls meets all of the requirements of the relevant Bermuda Acts, Regulations and guidance notes.

III.126 Paragraphs 5.118 through 5.148 of the main guidance notes set forth the circumstances in which reliance on an intermediary or other person is permissible. Paragraphs 3.22 through 3.24 of the main guidance notes provide additional relevant guidance. In any reliance situation, however, the relying RFI retains responsibility for any failure to comply with a requirement of the Regulations, as this responsibility cannot be delegated.

III.127 Where an RFI determines that the information it has received is adequate, and all other criteria for relying upon an intermediary or other third party have been met, the RFI may determine that it has satisfied its CDD obligations.

III.128 Where, however, an RFI determines that relevant documentation is not available, or is inadequate, the RFI will need to obtain additional documentation, by ensuring that either:

- The relied upon intermediary obtains the information in accordance with the relevant Bermuda Acts, Regulations and guidance notes; or
- The relying RFI obtains the information itself.

Outsourcing

III.129 An outsourcing arrangement occurs where an RFI uses a service provider to perform an activity, such as applying CDD measures that would normally be carried out by the RFI. Irrespective of whether the service provider is in Bermuda or overseas, and irrespective of whether the service provider is within or independent of any financial sector group of

which the RFI may be a member, any outsourcing arrangement is subject to the Regulations and these Guidance Notes.

III.130 Outsourced activities should be carried out in accordance with the RFI's procedures and the RFI should have effective control over the service provider's implementation of those procedures. An RFI's board or similarly empowered body or individual, such as the Compliance Officer, should establish clear accountability for all outsourced activities, as if the activities were performed in-house according to the RFI's own standards of internal control and oversight.

III.131 RFIs considering an outsourcing arrangement should carry out due diligence as to the service provider under consideration. The purpose of the due diligence is to determine whether the service provider has the ability, capacity and any required authorisation to perform the outsourced activities reliably, professionally and in accordance with the Acts, Regulations and all applicable guidance notes. RFIs should establish a written policy concerning the scope and frequency of initial and on-going due diligence carried out as to such service providers.

III.132 Where an RFI outsources any functions, the RFI retains the ultimate responsibility to ensure that the activities or work carried out on its behalf are completed in accordance with Regulation 14 of the Regulations, the relevant Bermuda Acts, Regulations and guidance notes.

III.133 In any outsourcing arrangement, an RFI cannot contract out of its statutory and regulatory responsibilities to prevent and detect ML/TF.

III.134 When considering an outsourcing arrangement, RFIs should have regard to paragraph III.119.

III.135 Paragraphs 5.149 through 5.178 of the main guidance notes set forth the circumstances in which an outsourcing arrangement is permissible.

Refusing or terminating investment business

III.136 If for any reason an RFI is unable to apply required CDD measures in relation to a customer, Regulation 9 establishes that the RFI must:

- In the case of a proposed business relationship or transaction, not establish that business relationship and not carry out that occasional transaction with or on behalf of the customer;

- In the case of an existing business relationship, terminate that business relationship with the customer; and
- Consider making a report to the FIA, in accordance with its obligations under POCA and the ATFA.

III.137 Where an RFI declines or terminates business that it knows is, or suspects might be, criminal in intent or origin, the RFI must refrain from referring such declined business to another person.

III.138 Where an RFI requests information from an outsourced entity or a relied-upon intermediary, and the request is not met, the RFI will need to take account of that fact in its assessment of the intermediary in question, and of the risks associated with relying upon, or maintaining a business relationship with, the intermediary in the future. In addition, the RFI should review its application of CDD in respect of any underlying customers of the intermediary.

III.139 Each outsourcing agreement should include a termination and exit management clause that, in the event that an RFI discontinues its outsourcing arrangement with the service provider, allows the outsourced activities and any related data to be transferred to another service provider or to be reincorporated into the outsourcing RFI. Care should be taken to ensure that any termination of an outsourcing arrangement is carried out without detriment to the continuity and quality of the provision of services to customers.

Receiving and sending payments

III.140 The ML/TF risks associated with an investor receiving and sending payments, including subscriptions, other capital contributions, redemptions, dividends, interest and any other payments, other than fees paid to the RFI, are lowest where:

- No cash deposits, withdrawals or payments are permitted;
- No third parties are permitted to send or receive payments, other than a personal representative named on the death or disablement of the investor;
- The RFI ensures that payments are received from, and made to, an account held in the name of the investor at an RFI subject to the Regulations, or at an institution that is situated in a country or territory other than Bermuda that imposes requirements equivalent to those in Bermuda, that effectively implements those requirements, and that is supervised for effective compliance with those requirements; and
- The RFI permits no changes to its payment policies, procedures and controls concerning the above.

- III.141 No investor payments, including but not limited to redemptions and distributions, should be made until appropriate due diligence has been completed.
- III.142 An RFI should establish how any initial, recurring or one-off payment to the RFI, intermediary or third party service provider is to be made, from where and by whom.
- III.143 *Left intentionally blank*
- III.144 Where payment is to be made from an account other than in the name of the customer, the reasons for this must be understood, assessed and recorded. Where considered necessary, evidence of identity of the account holder should be obtained.
- III.145 The RFI should take on-going measures to satisfy itself that each payment received was actually made from the anticipated account.
- III.146 Where funds are being remitted from several accounts, an RFI must understand the reasons for this and be appropriate in each case.
- III.147 Where an RFI is sending a payment to an investor, whether as a redemption, dividend, interest or other payment, the RFI should ensure that payment is sent only to an account in the name of the authorised recipient.
- III.148 Where there is a request for payment to be made to more than one account, the reasons for this should be understood and recorded. Where considered necessary evidence of identity of the account holder(s) must be obtained.
- III.149 Where there is a request for any payment to be made by cheque, the reasons for this should be understood, assessed and recorded. Where an RFI approves the issuance of payment by cheque, any cheque should be marked “account payee only”.
- III.150 In circumstances where payment is made in cash or bearer negotiable instruments, an RFI should be prepared to demonstrate that it has determined and applied appropriate risk-mitigation measures, and documented relevant policies, procedures and controls. An RFI’s Reporting Officer should review any investment business cash or bearer instrument transaction that may present a higher risk.
- III.151 Paragraph 7.14 of the main guidance notes states that each RFI should establish norms for cash transactions and procedures for the identification of unusual cash transactions or proposed cash transactions.

III.152 Paragraphs 4.97 through 4.101 of the main guidance notes provide additional guidance on the use of bearer instruments.

Applicability of simplified due diligence to investment business

III.153 Simplified due diligence involves the application of reduced or simplified CDD measures in specified circumstances.

III.154 RFIs may consider applying reduced or simplified due diligence measures only where the risk assessment process results in a finding of lower than standard risk.

III.155 Regulation 10 and paragraph 1 of the Schedule to the Regulations authorise RFIs to apply simplified due diligence measures for investment business customers provided the following criteria are met:

- The product is a pension, superannuation or similar scheme which provides retirement benefits to employees, where contributions are made by an employer or by way of deduction from an employee's wages and the scheme rules do not permit the assignment of a member's interest under the scheme;
- In the case of insurance policies or savings products or a similar nature, the product has an annual premium of no more than \$1,000 or a single premium of no more than \$2,500;
- In the case of products which are related to the financing of physical assets where the legal and beneficial title of the assets is not transferred to the customer until the termination of the contractual relationship, the product has annual payments not exceeding \$15,000;
- In all other cases, the product has a maximum threshold of \$15,000;

and

- The product has a written contractual base;
- Any related transactions are carried out through an account of the customer with an RFI subject to the Regulations, or with a banking institution that is situated in a country or territory other than Bermuda that imposes requirements equivalent to those in Bermuda, that effectively implements those requirements, and that is supervised for effective compliance with those requirements;
- The product or related transaction is not anonymous and its nature is such that it allows for the timely application of CDD measures where there is a suspicion of ML/TF;

- The benefits of the product and any related transactions cannot be realised for the benefit of third parties, except in the case of death, disablement, survival to a predetermined advanced age, or similar events;
- The benefits of the product and any related transactions are only realisable in the long term;
- The product and any related transactions cannot be used as collateral; and
- During the contractual relationship, no accelerated payments are made, no surrender clauses are used and no early termination takes place.

III.156 In addition, customers for which it may be appropriate to reduce or simplify the application of CDD measures include:

- AML/ATF regulated financial institutions transacting solely on their own behalf (see paragraph 5.147);
- Companies listed on an appointed stock exchange (see paragraphs 4.95 through 4.96);
- Employee pension schemes (see paragraphs 4.136 through 4.141); and
- Bermuda public authorities.

III.157 Where the customer is an independent professional (or similar professional) and the product is an account into which monies of underlying customers are pooled, Regulation 10(4) permits simplified due diligence on the independent professional (or similar professional) only where the following conditions are met:

- The pooled account is held in Bermuda by an independent professional subject to, and supervised for compliance with, Bermuda's AML/ATF Acts and Regulations; and
- The RFI holding the pooled account has confirmed in writing, and confirms, via periodic testing, that it will receive, upon request, information on the identity of the underlying customers whose monies are pooled in the account.

or

- The pooled account is held by an independent professional (or similar professional) in a country or territory other than Bermuda that imposes equivalent AML/ATF requirements; and
- The independent professional (or similar professional) is supervised for compliance with that jurisdiction's AML/ATF requirements; and
- The institution holding the pooled account has confirmed in writing, and confirms, via periodic testing, that it will receive, upon request, information on the identity of the underlying customers whose monies are pooled in the account.

III.158 An RFI must discontinue the application of any reduced or simplified CDD measures and apply either standard or enhanced due diligence measures where:

- A customer exercises a right to cancel or effectuate an early redemption;
- Any other provision of paragraphs III.154 through III.157 is no longer met; or
- The RFI has reason to doubt that the risks associated with any business relationship or occasional transaction is anything other than lower risk.

III.159 Notwithstanding the Regulations' provisions for applying reduced or simplified CDD measures, an RFI may consider it appropriate or necessary to apply standard or enhanced CDD where none is required by the Regulations. An RFI may consider it appropriate or necessary to apply CDD for practical business reasons, for the purpose of screening customers for international sanctions targets, or for any other reason.

III.160 Where reduced or simplified due diligence is appropriate for only one party to an investment business relationship or occasional transaction, RFIs must adhere to the guidance notes in identifying and verifying other parties to the relationship or transaction.

III.161 Detailed information on the applicability of simplified due diligence is set forth in paragraphs 3.14 and 5.1 through 5.14 of the main guidance notes.

Enhanced due diligence for investment business

III.162 Enhanced due diligence is the application of additional CDD measures where necessary to ensure that the AML/ATF measures in place are commensurate with higher ML/TF risks.

III.163 Regulation 11 of the Regulations requires RFIs to apply enhanced due diligence in all situations where a customer or the products, services, delivery channels or geographic connections with which the customer engages present a higher risk of ML/TF.

III.164 In addition, enhanced due diligence must be applied in each of the following circumstances:

- The business relationship or occasional transaction has a connection with a country or territory that represents a higher risk of money laundering, corruption, terrorist financing or being subject to international sanctions (see paragraphs 5.19 through 5.20 of the main guidance notes);
- The customer or beneficial owner has not been physically present for identification purposes (see paragraph 5.26 through 5.30 of the main guidance notes);

- The business relationship or transaction involves the use of one or more bearer instruments (see paragraphs 4.97 through 4.101 of the main guidance notes);
- The business relationship or occasional transaction involves a PEP (see paragraphs 5.97 through 5.117 and Annex IV of the main guidance notes).

III.165 An RFI must have in place procedures to apply CDD measures in respect of identifying whether any of the following is a PEP:

- A customer;
- A beneficial owner of a customer;
- A settlor or trustee of a trust whose trustee is a customer;
- A beneficiary of a trust whose trustee is a customer; and
- Any administrator, advisor, operator, employee, manager, director or other person associated with an investment, investor or intermediary who is able to exercise significant power over the investment business relationship or occasional transaction.

III.166 Where an RFI determines that enhanced due diligence measures are necessary, it must apply specific and adequate measures to compensate for the higher risk of ML/TF.

III.167 In selecting the appropriate additional measures to be applied, RFIs should consider obtaining additional information and approvals, including one or more of the following:

- Additional information on the customer, such as occupation, volume of assets and information available through public databases;
- Additional information on the nature and purpose of the business relationship (see paragraphs 4.1 through 4.4 of the main guidance notes and III.67 through III.68);
- Additional information on the source of wealth and source of funds of the customer (see paragraphs 5.110 through 5.113 of the main guidance notes);
- Additional information on the reasons for planned or completed transactions;
- Approval of senior management to commence or continue the business relationship (see paragraph 5.109 of the main guidance notes); and
- The information set forth in paragraph III.92.

III.168 In addition, RFIs should consider applying additional measures, such as:

- Apply appropriate risk mitigation methods when accepting cash payments;
- Limiting or precluding early redemption;
- Updating more frequently the identification and verification data for a customer, beneficial owner, trustee, trust beneficiary, administrator, advisor, operator, employee,

manager, director or other person who is able to exercise significant power over the investment business relationship or occasional transaction;

- Conducting enhanced monitoring of the business relationship by increasing the number and frequency of controls applied and by identifying patterns of conduct requiring further examination; and
- Ensuring that payments are carried out through an account in the customer's name through an RFI subject to the Regulations, or through an institution that is situated in a country or territory other than Bermuda that imposes requirements equivalent to those in Bermuda, that effectively implements those requirements and that is supervised for effective compliance with those requirements.

III.169 Detailed information on enhanced due diligence is set forth in *Chapter 5: Non-Standard Customer Due Diligence Measures* of the main guidance notes.

III.170 Specific indicators of higher risk in investment business are discussed in greater detail in paragraphs III.233 through III.239.

International sanctions

III.171 RFIs conducting investment business should implement a sanctions compliance programme in line with the Acts, Regulations and guidance notes.

III.172 RFIs should determine whether any persons or activities connected with investment business, and the individuals behind any such persons that are legal persons, trusts or other legal arrangements, are sanctions targets.

III.173 RFIs conducting investment business should scrutinise all investment instruments to ensure that they do not represent obligations of, or ownership interests in, entities owned or controlled by sanctions targets. RFIs should have particular regard to sovereign debt securities, oil and gas futures contracts and other investment vehicles and securities that may involve a sanctions target in an upstream or downstream portion of a securities custody chain.

III.174 Where an RFI conducting investment business identifies an investment asset that is subject to freezing under a sanction in effect in Bermuda, the RFI should ensure that the asset is not redeemed, paid, withdrawn, endorsed, guaranteed, subject to a book transfer or dealt with in any other way in violation of the Acts and Regulations.

III.175 RFIs must be aware that, in contrast to AML/ATF measures, which permit firms some flexibility in setting their own timetables for verifying and updating CDD information, an

RFI risks breaching a sanctions obligation as soon as a person, entity or good is listed under a sanctions regime in effect in Bermuda. In addition, whereas an RFI may choose to transact with a higher-risk individual or entity, it may not transact with any individual or entity subject to the Bermuda sanctions regime without first applying for and obtaining an appropriate license.

III.176 RFIs should note that the application of reduced or simplified CDD measures, and delays in identifying or verifying the identity of a beneficiary may prevent an RFI from effectively identifying a sanctions target, in turn causing the RFI to breach a sanctions regime in effect in Bermuda.

III.177 Detailed information is set forth in *Chapter 6: International Sanctions* of the main guidance notes.

On-going monitoring for investment business

III.178 Regulations 7, 11(4)(c), 13(4), 16 and 18 of the Regulations require RFIs to conduct on-going monitoring of the business relationship with their customers.

III.179 On-going monitoring in the context of investment business supports several objectives:

- Maintaining a proper understanding of an investor's activities;
- Assessing the appropriateness of maintaining a business relationship with an intermediary, and the adequacy of the agreement(s) governing the respective AML/ATF and international sanctions obligations of the RFI and the intermediary;
- Ensuring that CDD documents and other records are accurate and up-to-date;
- Providing accurate inputs for the RFI's risk assessment processes;
- Testing the outcomes of the RFI's risk assessment processes; and
- Detecting and scrutinising unusual or suspicious conduct.

III.180 Failure to adequately monitor a customer's business relationship could expose an RFI to abuse by criminals and may call into question the adequacy of the RFI's AML/ATF policies, procedures and controls and the competence and probity of the RFI's management.

III.181 On-going monitoring of a business relationship includes:

- Scrutinising transactions undertaken throughout the course of the relationship (including, where necessary, the source of wealth, source of funds, investor experience and objectives and any prospectus) to ensure that the transactions are consistent with

the RFI's knowledge of the customer and any underlying investors;

- Investigating the background and purpose of all complex or unusually large transactions, and unusual patterns of transactions that have no apparent economic or lawful purpose and recording in writing the findings of the investigation; and
- Reviewing existing documents, data and information to ensure that they are accurate, up-to-date, adequate and relevant for the purpose of applying CDD measures to investment business.

III.182 On-going monitoring also includes an RFI maintaining up-to-date information on the reliability of any intermediaries the RFI is relying upon for AML/ATF purposes, and taking any needed corrective actions.

III.183 On-going monitoring must be carried out on a risk-sensitive basis. Higher-risk customers, whether investors or intermediaries, must be subjected to enhanced due diligence and more frequent and/or intensive on-going monitoring.

III.184 Bearing in mind that some criminal activity may be so widespread as to appear to be the norm, RFIs should establish norms for lawful transactions and conduct in relation to customers. See paragraphs 7.11 through 7.14 of the main guidance notes.

III.185 Once an RFI has established norms for lawful transactions and conduct, it must monitor the business relationship, including transactions, patterns of transactions and conduct by customers and any underlying investors to identify transactions and conduct falling outside of the norm.

III.186 The determination of norms for a category of customers should be based initially upon the information obtained in order to understand the purpose and intended nature of the business relationship with the RFI. See paragraphs III.67 through III.76.

III.187 An RFI's or intermediary's knowledge of its customers should be sufficiently detailed to enable it to assess any investment event properly and should allow it to evaluate the consistency of the event with the customer's profile.

III.188 Where an RFI becomes aware at any time that it lacks sufficient information about an existing customer, it should take steps to ensure that all relevant information is obtained as soon as is reasonably practicable. See paragraph III.128.

III.189 Monitoring may take place in real time and/or after the event, and it may be manual or automated. Irrespective, any system of monitoring should ensure at its core that:

- Transactions and conduct are flagged in exception reports for further examination;
- The exception reports are reviewed promptly by the appropriate person(s); and
- Appropriate and proportionate action is taken to reduce the possibility of ML/TF occurring without detection.

III.190 Where an RFI accepts higher-risk investment business, it must ensure that it has the capacity and expertise to effectively conduct on-going monitoring of the business relationship (see paragraph III.50).

Trigger events

III.191 In investment business, various transactions or conduct taking place after initial CDD measures are applied may require the application of additional CDD as part of an RFI's on-going monitoring. These trigger events include, but are not limited to:

- Early redemptions of long-term investments;
- Changes in the type of investment product;
- Changes of address;
- Changes of payment method;
- Requests for payment to a third party;
- Subsequently discovered information about an investor or intermediary; and
- Information received from a competent authority.

III.192 Where an RFI is monitoring the reliability of an intermediary upon which it relies for AML/ATF purposes, additional trigger events include, but are not limited to:

- Changes in the volume of business through the intermediary;
- Changes in fee amounts the intermediary charges customers; and
- Changes to the AML/ATF regulatory status of the intermediary or of the country or territory in which the intermediary is regulated.

III.193 The background and purpose of each trigger event should, as far as possible, be examined in order to determine whether the risk ratings assigned to the business relationship require modification and whether any additional risk-mitigation measures need to be put in place. The findings of the examination should be recorded and maintained in accordance with the record-keeping obligations set forth in **Chapter 11: Record-Keeping** of the main guidance notes and paragraphs III.227 through III.232.

- III.194 Where an investor takes up any right to decline to proceed with an investment or to exercise an early redemption, the circumstances surrounding the request should be examined.
- III.195 Where a payment is made to an investor due to the exercise of a cancellation or early redemption, the payment should be made to the ceding account from which the funds were originally sent. See paragraphs III.140 through III.152.
- III.196 RFIs should exercise caution with regard to any investment business that involves the use of bearer instruments. Because bearer instruments can be exchanged easily from person to person without notifying the RFI of the resulting changes in ownership and control, bearer instruments limit an RFI's ability to conduct CDD that meets the requirements of the Acts, Regulations and these guidance notes.
- III.197 Paragraphs 4.97 through 4.101 of the main guidance notes set forth additional guidance concerning bearer instruments.
- III.198 Where the client is of higher risk, they must undertake an additional or subsequent transaction, for example, an additional investment, must be examined to consider whether the information held at that time is sufficient to indicate that the additional transaction would be reasonable. Where an RFI considers that additional information is required, it should obtain that information as soon as is reasonably practicable.
- III.199 Paragraphs 5.110 through 5.113 of the main guidance notes and III.72 through III.76 set forth additional guidance on sources of wealth and funds.
- III.200 Detailed information on on-going monitoring is set forth in *Chapter 7: On-Going Monitoring* of the main guidance notes.

Suspicious activity reporting

- III.201 The suspicious activity reporting requirements for RFIs are governed primarily by Sections 43 through 48 of POCA 1997, Paragraphs 1 and 2 of Schedule 1 of ATFA 2004 and Regulations 16 and 17 of the Regulations.
- III.202 RFIs conducting investment business must put in place appropriate policies and procedures to ensure that knowledge, suspicion and reasonable grounds to know or suspect that funds or assets are the proceeds of crime, or that a person is involved in money laundering or terrorist financing, are identified, enquired into, documented and reported.

- III.203 The definitions of knowledge, suspicion and reasonable grounds to know or suspect are set forth in paragraphs 9.6 through 9.10 of the main guidance notes.
- III.204 Many customers may, for perfectly good reasons, have an erratic pattern of transactions or account activity. A transaction or activity that is identified as unusual, therefore, should not be automatically considered suspicious, but should cause the RFI to conduct further, objective enquiries to determine whether or not the transaction or conduct is indeed suspicious.
- III.205 Enquiries into unusual transactions should be in the form of additional CDD measures to ensure an adequate, gap-free understanding of the relationship, including the purpose and nature of the transaction and/or conduct in question.
- III.206 All employees, regardless of whether they have a compliance function, are obliged to report to the Reporting Officer within the RFI each instance in which they have knowledge, suspicion or reasonable grounds to know or suspect that funds or assets are the proceeds of crime or that a person is involved in money laundering or terrorist financing.
- III.207 An RFI's Reporting Officer must consider each report, in light of all available information.
- III.208 Where, after evaluating an internal suspicious activity report, the Reporting Officer determines that there is knowledge, suspicion or reasonable grounds to know or suspect that funds or assets are the proceeds of crime or that a person is involved in money laundering or terrorist financing, the Reporting Officer must file an external suspicious activity report with the Financial Intelligence Agency (FIA).
- III.209 As of October 2011, the FIA no longer accepts any manually submitted suspicious activity reports (including those faxed or emailed). The FIA accepts only those suspicious activity reports that are submitted electronically via the goAML system, which is available at www.fia.bm.
- III.210 Where a Reporting Officer considers that an external report should be made urgently, initial notification to the Financial Intelligence Agency may be made by telephone, but must be followed up by a full suspicious activity report as soon as is reasonably practicable.

III.211 The FIA is located at 6th Floor, Strata 'G' Building, 30A Church Street, Hamilton HM11 and it can be contacted during office hours on telephone number (441)-292-3422, on fax number (441)-296-3422, or by email at info@fia.bm

III.212 RFIs should ensure that any intermediaries that are customers or are being relied upon have appropriate policies, procedures and controls to identify, enquire into, document and report knowledge, suspicion or reasonable grounds to know or suspect that funds or assets are the proceeds of crime or that a person is involved in money laundering or terrorist financing.

III.213 Because some securities products and services are highly complex, RFIs should ensure that suspicious activity reports adequately describe and explain the products, services, transactions and conduct connected with each report.

Failure to report and tipping-off offenses

III.214 Where an employee fails to comply with the obligations under Section 46 of POCA 1997 or Schedule 1 of ATFA 2004 to make disclosures to a Reporting Officer and/or to the FIA as soon as is reasonably practicable after information giving rise to knowledge or suspicion comes to the attention of the employee, the employee is liable to criminal prosecution.

III.215 The criminal sanction, under POCA 1997 and ATFA 2004, for failure to report, is a prison term of up to three years on summary conviction or ten years on conviction in indictment, a fine up to an unlimited amount, or both.

III.216 Section 47 of POCA 1997 and Section 10 of ATFA 2004 contain tipping-off offences.

III.217 It is a tipping-off offence under Section 47 of POCA 1997 and Section 10 of ATFA 2004 if a person knows or suspects that an internal or external report has been made to the Reporting Officer or to the Financial Intelligence Agency and the person discloses to any other person:

- Knowledge or suspicion that a report has been made; and/or
- Any information or other matter likely to prejudice any investigation that might be conducted following such a disclosure.

III.218 It is also a tipping-off offence if a person knows or suspects that a police officer is acting, or proposing to act, in connection with an actual or proposed investigation of money

laundering or terrorist financing and the person discloses to any other person any information or other matter likely to prejudice the actual or proposed investigation.

III.219 Any approach to the customer, intermediary or parent corporation should be made with due regard to the risk of committing a tipping-off offense. See paragraphs 9.83 through 9.84 of the main guidance notes.

III.220 RFIs and intermediaries should also have due regard to paragraphs 9.85 through 9.86 of the main guidance notes.

III.221 Detailed information on suspicious activity reporting is set forth in ***Chapter 9: Suspicious Activity Reporting*** of the main guidance notes.

Employee training and awareness

III.222 The responsibilities of RFIs to ensure appropriate employee training and awareness are governed primarily by Regulations 16 and 18 of the Regulations.

III.223 RFIs must take appropriate measures to ensure that relevant employees, including employees of relied upon intermediaries:

- Are aware of the Acts and Regulations and guidance notes relating to ML/TF;
- Undergo training on how to identify transactions which may be related to ML/TF; and
- Know how to properly report suspicions regarding transactions that may be related to ML/TF.

III.224 Each RFI must also ensure that relevant employees, including employees of relied upon intermediaries receive appropriate training on its AML/ATF policies and procedures relating to:

- Customer due diligence measures;
- On-going monitoring;
- Record-keeping;
- Internal controls; and
- Risk assessment and management.

III.225 In an investment business context, training should, at a minimum, enable employees to:

- Readily identify investment products, services and transactions that may be abused for ML/TF purposes;

- Effectively vet investors, intermediaries and their beneficial owners;
- Assess the risks associated with an investment business relationship or occasional transaction and related transactions to and from an investor's account; and
- Conduct on-going monitoring of the investment business relationship with the RFI.

III.226 Detailed information on employee training and awareness is set forth in Chapter 10: Employee Training and Awareness.

Record-keeping

III.227 The record-keeping obligations of RFIs are governed primarily by Regulations 15 and 16 of the Regulations.

III.228 RFIs must keep specified records for a period of at least five years following the date on which the business relationship ends, or, in the case of an occasional transaction, following the date on which the transaction, or the last in a series of transactions, is completed.

III.229 RFIs conducting investment business should ensure that adequate procedures are in place to allow the RFI, in combination with any intermediaries to access:

- Initial documentation including, but not limited to, records of beneficial ownership, structure and control, copies of regulatory documentation and copies of documentation supporting verification;
- All confirmation notes, account statements and correspondence pertaining to the operation of the business relationship;
- Payment transaction details sufficient to identify and, where applicable, verify the proposed and actual sources and recipients of funds and assets.

III.230 Where records are maintained by intermediaries or third party service providers, RFIs should ensure that any records are stored securely and are capable of being retrieved upon request and without delay.

III.231 RFIs must not rely upon, outsource to or accept as a customer any person where access to required records without delay is likely to be impeded by confidentiality, secrecy, privacy or data protection restrictions.

III.232 Detailed information on the records that must be kept is set forth in *Chapter 11: Record-Keeping* of the main guidance notes.

Risk factors for investment business

III.233 In addition to the non-exhaustive list of risk factors set forth in paragraphs 2.35 of the main guidance notes and III.58, RFIs conducting investment business should consider sector-specific risk factors, including those in paragraphs III.234 through III.239 below, in order to fully assess the ML/TF risks associated with a particular investment business relationship or transaction. The non-exhaustive list of sector-specific risk factors addresses customers, products and services, transactions, delivery channels, intermediaries and third party service providers and geographic connections.

III.234 Customer risk factors include, but are not limited to:

- Situations in which it is difficult to identify a customer's individual beneficial owners, administrators, advisors, operators, employees, managers, directors or other persons able to exercise significant power over the investment business relationship or occasional transaction. This includes situations where identification is hindered because a person is a legal person, trust or other type of legal arrangement;
- Unjustified delays in the production of identity documents or other requested information;
- A customer is unwilling or unable to provide satisfactory CDD information, including source of wealth and source of funds;
- Inconsistencies between the information provided by a customer and information the RFI obtains elsewhere;
- A customer who represented that he is acting on his own behalf appears to be acting on behalf of one or more other persons;
- A customer acting through one or more intermediaries or other persons in order to avoid the application of CDD measures;
- A customer seeking products or services that appear unusual given the customer's investment experience and objectives;
- A customer who is unwilling to invest in more appropriate securities, where the purchase of the securities would require the application of additional CDD measures;
- The involvement of a PEP in the investment business relationship;
- The unexplained and illogical use of corporate structures, intermediaries, express trusts, nominee shares or the use of bearer negotiable instruments;
- Any business relationship or transaction involving apparently unnecessary complexity;
- Any change in the nature or value of an investment product or service that is inconsistent with a customer's sources of wealth and funds as recorded in the customer's profile;
- Levels of funds, assets or transactions exceeding what a reasonable person would expect of a customer with a similar profile;

- Sudden and unexplained deposits, withdrawals, subscriptions, redemptions, transfers or lifestyle changes;
- Lack of concern by an investor over charges or losses due to early redemption of a long-term product;
- An investor appearing indifferent to the profit or loss generated by investment business activities;
- An investor seeking multiple accounts with an RFI or intermediary for no apparent reason;
- An investor showing undue interest in client money account operations;
- A investor seeking to borrow heavily against assets, soon after obtaining or investing them;
- The unexplained use of a power of attorney or other third party mandate;
- Apparent collusion between an investor and an intermediary or RFI employee;
- A customer accepting highly unfavourable terms in exchange for access to a client money account;
- A customer offering to pay extraordinary fees for unusual services, or for services that would not ordinarily warrant such a fee; and
- Requests for no correspondence to go to the investor.

III.235 Products and services risk factors include, but are not limited to:

- Client money accounts that permit payments to or from third parties;
- Investment products that can be used as collateral;
- Investment-linked insurance policies;
- Single premium life insurance policies that store value; and
- Investment products or services that allow a transfer of value without the knowledge of the RFI.

III.236 Transaction risk factors include, but are not limited to:

- An investment business relationship that, once established, receives cash payments, or payments from multiple sources;
- A client money account with several signatories, any of which appears to have no relationship with the other signatories;
- Cash or bearer instrument transactions in circumstances where such a transaction would normally be made by cheque, banker's draft or wire transfer;
- The purchase or sale of a security where no purpose for the transaction is discernible, or where the circumstances otherwise appear unusual;

- The subscription, redemption, exchange or transfer of funds or assets with values that fall consistently just below threshold and reporting levels;
- A dormant account receiving one or more subscriptions in close succession, followed by daily withdrawals that continue until the account balance has been fully, or nearly fully, drawn down;
- The placement of funds into a client money account, followed by withdrawal, where little or no investment of the funds takes place;
- The purchase of valuable assets followed by instant redemption;
- A customer appearing indifferent to the profit or loss generated by investment business activities;
- Requests for early redemption or cancellation of a long-term investment product or service, that would result in a payment being made to the customer, particularly where such requests result in economic penalty to the customer;
- A customer seeking to transfer value between a personal portfolio and a corporate portfolio over which the customer has control;
- A customer transferring assets via journaling or book transfer with no apparent business purpose;
- A customer requesting that certain payments be routed through a correspondent account held by the RFI, rather than through the customer's own account;
- Transactions for unregistered or unregulated investment vehicles;
- Payment by a means which allows for anonymity of the transaction;
- Payment of a subscription in one currency, followed by a request for repayment in a different currency;
- Requests for payments to accounts that are not in the name of the investor;
- Payments received from an account that is not in the name of the investor;
- Unusual requests to borrow against an investment;
- A customer engaging in an investment activity, for example dealing in thinly traded securities or the use of bearer instruments, that is recognised as being vulnerable to ML/TF, corruption, insider trading, market manipulation, fraud or the evasion of sanctions, particularly where the RFI has information suggesting the customer's interest in the activity is due to limited regulation of the activity;
- Investment business customers requesting payments to or from overseas locations with instructions for payment to be made in cash;
- Transactions within an investment business relationship, or within a client money account, that have no apparent legitimate business, tax or legal purpose;
- Transfers of funds or assets to a third party to which CDD has not been satisfactorily applied;

- Transactions of a size or volume that exceeds what a reasonable person would expect of a customer with a similar profile, or given the nature and stated purpose of the investment business relationship; and
- Transactions that the RFI cannot fully explain and document.

III.237 Delivery channel risk factors include, but are not limited to:

- Non face-to-face relationships with investment business customers;
- Any request to carry out significant transactions using cash, or using any payment or value transfer method such as a bearer instrument that obscures the identity of any of the parties to the transaction;
- The involvement of intermediaries or third party service providers that do not apply AML/ATF measures at least equivalent to those in Bermuda;
- Apparent collusion between a customer and any director, manager or employee of an intermediary;
- An intermediary accepting extraordinary fees for unusual services, or for services that would not ordinarily warrant such a fee; and
- A sudden change in the volume of business connected with an intermediary.

III.238 Intermediary and third party risk factors include, but are not limited to:

- The involvement of any person in carrying out any AML/ATF function in relation to investment business, including reliance upon, outsourcing to or accepting as a customer, any intermediary or other person that has not been sufficiently reviewed for compliance with paragraphs 5.118 through 5.178 and III.92;
- Any unexplained relationship between an investor and any intermediary, third party, administrator, advisor, operator, employee, manager, director or other person who is able to exercise significant power over the investment business relationship or occasional transaction;
- Any intermediary that categorically refuses to provide the RFI or any upstream intermediary with reasonably requested information concerning any underlying customer of the intermediary; and
- The involvement of a recently established intermediary in an investment business relationship, particularly where the background of the intermediary does not appear to be particularly transparent.

III.239 Geographic risk factors include, but are not limited to:

- An investment business relationship established with funds originating from foreign banks in high-risk jurisdictions;

- A customer, beneficial owner, administrator, advisor, operator, employee, manager, director or other person who is able to exercise significant power over the investment business relationship or occasional transaction who is a resident in, or citizen of, a high-risk jurisdiction;
- An investment business transaction to or from a high-risk jurisdiction;
- An investment business transaction linked to business in or through a high-risk jurisdiction;
- The involvement of an intermediary that is regulated in a jurisdiction where banking transactions are not high-risk, but transactions involving the intermediary's type of entity are high-risk, due to the jurisdiction's insufficient application of AML/ATF measures to that type of entity;
- Investment business involving persons or transactions with a material connection to a jurisdiction, entity, person or activity that is a target of an applicable international sanction; and
- An investment business relationship or transaction for which an RFI's ability to conduct full CDD may be impeded by a jurisdiction's confidentiality, secrecy, privacy or data protection restrictions.