

Dietz, Andrea

Research Report

Anti-money laundering and counter-terrorist financing in the Luxembourg investment fund market

EIKV-Schriftenreihe zum Wissens- und Wertemanagement, No. 21

Provided in Cooperation with:

European Institute for Knowledge & Value Management (EIKV), Hostert (Luxembourg)

Suggested Citation: Dietz, Andrea (2017) : Anti-money laundering and counter-terrorist financing in the Luxembourg investment fund market, EIKV-Schriftenreihe zum Wissens- und Wertemanagement, No. 21, European Institute for Knowledge & Value Management (EIKV), Rameldange

This Version is available at:

<https://hdl.handle.net/10419/162698>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

EIKV-Schriftenreihe zum
Wissens- und Wertemanagement

Anti-Money Laundering and Counter-Terrorist Financing
in the Luxembourg Investment Fund Market

Andrea Dietz

IMPRESSUM

EIKV-Schriftenreihe zum Wissens- und Wertemanagement

Herausgeber: André Reuter, Heiko Hansjosten, Thomas Gergen

© EIKV Luxemburg, 2016, 2017

European Institute for Knowledge & Value Management (EIKV)

c/o M. André REUTER - 27d, rue du Scheid

L-6996 Rameldange - GD de Luxembourg

info@eikv.org

www.eikv.org

Anti-Money Laundering and Counter-Terrorist
Financing in the Luxembourg Investment Fund
Market

Andrea Dietz

Table of Content

Table of Content	II
List of Figures	IV
List of Tables	IV
List of Abbreviations	V
Abstract	VII
1. Preface	1
1.1. Motivation for the Topic	1
1.2. Objective	3
1.3. Methodology	3
1.4. Structure	5
2. Money Laundering & Terrorist Financing - a general Overview	6
2.1. Money Laundering – Definition, Origin, Figures & legal Background	6
2.2. Terrorist Financing – Definition, Origin, Figures & legal Background	11
3. Money Laundering & Terrorist Financing - Activities & Processes	17
3.1. Differences & Similarities between Money Laundering & Terrorist Financing	17
3.2. The Money Laundering Cycle	21
3.3. Methods of Terrorist used for Financing & financial Transactions	25
3.4. Threats & Harms posed by Money Laundering & Financing Terrorism	30
4. The current European & Luxembourg Anti-Money Laundering & Counter-Terrorist Financing legal Framework	31
4.1. The legal Definitions of Money Laundering & Terrorist Financing in the European Union	33
4.2. The legal Definitions of Money Laundering & Terrorist Financing in Luxembourg	35
4.3. Legal Obligations in the Fight against Money Laundering & Terrorist Financing in Luxembourg	37
5. The Luxembourg Fund Market & local Investment Fund Vehicles	43
5.1. The Luxembourg Fund Market	43

5.2. Investment Funds in general.....	46
5.3. The Luxembourg Fund Vehicles	48
5.3.1. UCITS.....	53
5.3.2. Alternative Investment Funds/Non-UCITS-Funds	57
5.4. Parties within a Fund Structure & their Duties.....	61
6. Empirical Analysis	67
6.1. Interview Development.....	67
6.2. Interview Partners	68
6.2.1. Interview Partner I	68
6.2.2. Interview Partner II	68
6.2.3. Interview Partner III	69
6.3. Interview Results	69
7. Establishment of an Investment Fund’s Risk Assessment.....	74
7.1. Identification of the inherent Risk	74
7.2. Risk Assessment of an Investment Fund.....	77
8. Conclusion	83
Annex I: Threats & Harms posed by Money Laundering & Terrorist Financing	VIII
Annex II: Laws amending the Law of 04 November 2004	XI
Annex III: Risk Factors according to European Supervisory Authorities Risk Factor Guidelines	XIII
Annex IV – Interviews.....	XXVIII
Interview I	XXVIII
Interview II	XXXII
Interview III	XL
Bibliography.....	LI
Internet Sources	LIV

List of Figures

Figure 1: Structure of this Thesis.....	5
Figure 2: Estimated Distribution of Funds within the al- Qaida Terrorist Network...	16
Figure 3: Money Laundering & Terrorist Financing Cash Flows	20
Figure 4: The three Stages of Money Laundering	22
Figure 5: Net Asset Distribution of European Investment Funds by Country & Funds Type	44
Figure 6: Main Cash Flows within a Fund Structure.....	48
Figure 7: Fund Regimes in Luxembourg	49
Figure 8: Breakdown of Net Assets according to Investment Policy	55
Figure 9: Number and Net Assets of Alternative Investment Funds according to the Law under which the funds are incorporated as of December 31 st , 2015.	58
Figure 10: Common organizational Setups of UICs	62
Figure 11: Components of Investment Funds presenting a potential Risk Exposure to Money Laundering and/or Terrorist Financing	78

List of Tables

Table 1: Historically estimated Figures on the Amount of Money laundered globally	10
Table 2: Overview of estimated operational Costs for Terrorist Attacks	15
Table 3: Differences & Similarities between Terrorist Financing & Money Laundering.....	19
Table 4: Possible Sources for financing Terrorism.....	26
Table 5: Examples of predicate Offences of Money Laundering in Luxembourg....	36
Table 6: UICs according to Key Characteristics	47
Table 7: Corporate Entity Structures under the different Fund Laws	51
Table 8: Overview of Corporate Entity Setup Requirements.....	52

List of Abbreviations

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Manager Directive
AML	Anti-Money Laundering
AML/CTF	Anti-Money and Counter-Terrorist Financing
CDD	Customer Due Diligence
CSSF	Commission de Surveillance du Secteur Financier
CRF	Cellule de Renseignement financier
CTF	Counter-Terrorist Financing (also known as Anti-Terrorist Financing (ATF))
EEA	European Economic Area
EDD	Enhanced Due Diligence
ESA	European Supervisory Authorities
ETF	Exchange Traded Fund
EU	European Union
EuSEF	European Social Entrepreneurship Fund
EuVECA	European Venture Capital Fund
FATF	Financial Action Task Force (also known under the name GAFI)
FCP	Fonds Commun de Placement
FinCEN	Financial Crimes Enforcement Network
FSAP	Financial Sector Assessment Programme report
GAFI	Groupe d'action financière (also known under the name FATF)
GDP	Growth Domestic Product
IMF	International Monetary Fund
IML	Institut Monétaire Luxembourgeois
IRS	Internal Revenue Service

IVTS	Informal Value Transfer Systems
KYC	Know Your Customer
ManCo	Management Company
MSB	Money Service Businesses
ML	Money Laundering
MLRO	Money Laundering Reporting Officer
NAV	Net Asset Value
OECD	Organisation for Economic Co-operation and Development
PEP	Politically Exposed Person
RAIF	Reserved Alternative Investment Fund
SDD	Simplified Due Diligence
SICAF	Société d'investissement à Capital fixe
SICAR	Société d'Investissement en Capital à Risque/Risk capital investment company
SICAV	Société d'Investissement à Capital variable
SIF	Specialised Investment Fund
SOPARFI	Société de Participations financières
TA	Registrar and Transfer Agent
TF	Terrorist Financing
UCI	Undertaking for Collective Investments
UCITS	Undertakings for Collective Investment in Transferable Securities
U.K.	United Kingdom
UNODC	United Nations Office on Drugs and Crime
U.S.	United States of America

Abstract

This thesis on “Anti-Money Laundering and Counter-Terrorist Financing in the Luxembourg Investment Fund Market” is submitted by Andrea Dietz to obtain a Master of Business Administration Degree from the European University for Economics and Management in Luxembourg.

The field of Anti-Money Laundering and Counter-Terrorist Financing in their current form have had an important impact on the financial world for almost half a century. Today, Money Laundering and Terrorist Financing pose a threat to the integrity of the financial markets and systems worldwide. The intention behind implementing a regulatory Anti-Money Laundering and Counter-Terrorist Financing framework is to cut off the financial resources of criminals and to follow back the traces that financial transactions leave to the backers of the criminal organizations. Luxembourg, being the second largest center for investment funds in the world and the leading one in Europe, is dependent on its good reputation, a cornerstone of its success. Based on this, the risk exposure of the Luxembourg Fund Market with respect to Money Laundering and Terrorist Financing shall be assessed and a risk assessment for an investment fund established.

Firstly, a general introduction to Money Laundering and Terrorist Financing is provided, which is complemented by a chapter specifying details of each criminal offence, differences and similarities, and the threats and harms both crimes pose. Secondly, the legal definitions and local obligations of the market participants are presented. Thirdly, the Luxembourg Fund Market in terms of figures, products and its participants in investment fund structure are addressed. In a next step, the summary of three expert interviews is presented. The questions asked are based on the information, statements and findings in the previous chapters. All information obtained is then used to establish a general risk assessment of an investment fund and to draw the final conclusion.

The results show that the inherent risk of the Luxembourg Fund Market is concentrated on Money Laundering rather than on Terrorist Financing. The residual risk is completely dependent on the measures implemented by the single structures and therefore cannot really be quantified. It is very much dependent on the risk appetite of the market participants, their controls in place and the enforcement of the rules, especially when it comes to cross-border business.

1. Preface

The objective of the preface is to provide the information on the motivation for the topic, the main objectives of the paper, the methodology used to achieve the objectives and the structure of this thesis.

1.1. Motivation for the Topic

The choice of this topic was actually driven by a various reasons and motives. The main objective in the selection process of the topic was to complete a meaningful master's thesis, which is closely related to the real business world and, at best, can be supportive and/or provide new insights in my current field of employment. Therefore, it was without question to search at first for a suitable topic within my professional environment. Having worked in Luxembourg's Banking Sector for more than a decade, being exposed on different occasions to Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) laws and regulations and currently being employed as AML/ Know Your Customer (KYC) Manager for a Luxembourg Bank, it was obvious that the topic should be related to AML and/or CTF. My current professional field of expertise is situated in the investment fund sector involving cross-border fund activities. Subsequently, it seemed interesting to dig deeper into the regulatory requirements for investment funds and especially to analyze the Money Laundering (ML) and Terrorist Financing (TF) risks to which Luxembourg's Fund Sector and in particular investment funds are being exposed.

The second reason, which played a particular part, was the ongoing legal and social development in the fight against ML and TF. The latest terrorist attacks in Europe, namely Paris, Brussels, Nice and Berlin as well as several news reports about prevented attacks or arrested terrorist suspects have shown that the potential risk has grown in Europe as well. This development lead to the proposal for a Directive of the European Parliament and the Council amending 'Directive (EU) 2015/849'¹.

¹ DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

commonly known as '4th AML-Directive' and 'Directive 2009/101/EC'² on the prevention of the use of the financial system for the purposes of ML and TF, although the Directive (EU) 2015/849 has not yet been transposed into national law by most European Union (EU) member states. The deadline for this is June 26th, 2017. The shift from a common regulatory approach to fight ML and TF to a risk based one is clearly visible in the local as well as the international development. The approach obliges entities to critically analyze their own risk exposure to ML and TF, to identify their strengths and weaknesses, and to put specific measures in place to eradicate their shortcomings.

Another reason was the increasing number of scandals in failure of banks to prevent ML revealed through media during the last year. One current example is the corruption scandal caused by the Malaysian sovereign wealth fund 1MDB during which the operating licenses of the branches of BSI Bank Singapore and Falcon Private Bank Limited in Singapore were revoked by the Monetary Authority of Singapore. Further regulatory enforcements including monetary penalties were imposed on other financial institutions involved in this scandal. In addition, the number of regulatory enforcements and high fines imposed by financial authorities/regulators for failures to either have no AML/CTF framework/policies or for having ones with significant weaknesses, have significantly increased during the last years. In November 2016 the Irish Financial Regulator, the Central Bank of Ireland, imposed a fine of EUR 3.325.000 for such failures on Ulster Bank. Involvement in such a scandal or a fine imposed by a financial regulator leads in most cases to negative media attention and exposes the financial institutions involved to a high reputational risk.

In addition the number of reported suspicious activities to the Luxembourg Cellule de Renseignement financier (CRF) rose from one declaration made in 2014 by an Undertaking for Collective Investment (UCI) to 14 declared in 2015. This significant relative increase of 1,400% also caught my attention. In general, the number of alerts has increased in the financial sector, particularly in the investment fund market.³

² DIRECTIVE 2009/101/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent.

³ Cf. (Parquet du tribunal d'arrondissement de Luxembourg - Cellule de renseignement financier (CRF), 2016), p. 8.

Taking all the above listed reasons into account and the fact that there is hardly any literature, analysis or other material on this risk exposure of Luxembourg Investment Vehicles and/or the Luxembourg Fund Market to be found made up my motivation to choose the topic 'Anti-Money Laundering and Counter-Terrorist Financing in the Luxembourg Investment Fund Market'.

1.2. Objective

This thesis illustrates certain aspects of ML and TF in Luxembourg's Financial Sector setting the special focus on the Luxembourg Fund Industry.

The main objective of the thesis is focused on analyzing the risk exposure to ML and TF of the Luxembourg Fund Market and evaluating if both crimes pose the same threat to the market. This will be achieved by establishing a general risk assessment of an investment fund. The risk assessment takes the specific financial environment of Luxembourg into consideration and is based on the local legal and regulatory framework and the facts provided by the background information as well as in expert interviews. The conclusion provides a final summary.

Besides the above objective this thesis sets a further target on promoting a deeper understanding of the crimes of ML and TF by providing background information, definitions, explaining methods and illustrating differences and similarities. Furthermore, the thesis aims at presenting the main underlying legal frameworks and the most important legal obligations for the actors in the Luxembourg Fund Sector. A further objective is to provide a general overview of Luxembourg's Fund Market and the specific Luxembourg Fund Structures and their underlying regulatory regimes.

1.3. Methodology

The Methodology of this paper is inspired by the process suggested for the establishment of a company risk assessment by the Joint Committee of the European Supervisory Authorities (ESA) in their Joint Consultation Paper: 'The Risk Factors Guidelines'.

The guidelines propose to perform two distinct but related steps to establish a risk assessment:⁴

1. the ML/TF risk needs to be identified
2. the ML/TF risk must be assessed

The identification of the ML/TF risk prerequisites the understanding of the underlying offences. The understanding of the methods used, the activities performed, the objectives behind the offences, which would include similarities and differences and their interaction points with the financial sector in this case the Luxembourg Fund Sector, is essential to identify the ML/TF risks. To identify the interactions with the fund sector, the understanding of the fund market and its main activities are a mandatory requirements to identify possible risk factors with respect to ML/TF.

Information on the risk can and should be obtained from different sources such as the European Commission's supranational risk assessment, local governments' national risk assessments, policy statements, information from regulators, such as guidance and the reasoning set out in regulatory fines as well from other sources such as the Financial Intelligence Unit⁵, the Financial Action Task Force (FATF) reports etc. In addition, when establishing the risk exposure of a market segment, the whole range of services, specific segment activities and constellations need to be taken into account, which differs from the establishment of a business risk assessment of a single market participant. The risk identification in relation to the Luxembourg Fund Market is done by providing background information and analysis's in the chapters 2-5. The collected information will be used to illustrate a possible risk assessment of an investment fund.

Before the risk assessment is established, three expert interviews with representatives from different market participants were conducted. The questions were based on the information collected in chapter 2-5 on ML/TF activities and on possible risk factors identified. The aim was to understand whether the fund sector has a common perception of the current risk exposure to ML/TF and if the interpretation of the law, as laws always leave room for interpretation, is similar. Section 6.1 provides further information of the interviews and their development.

⁴ Cf. (Joint Committee of the European Supervisory Authorities, 2015), p. 13.

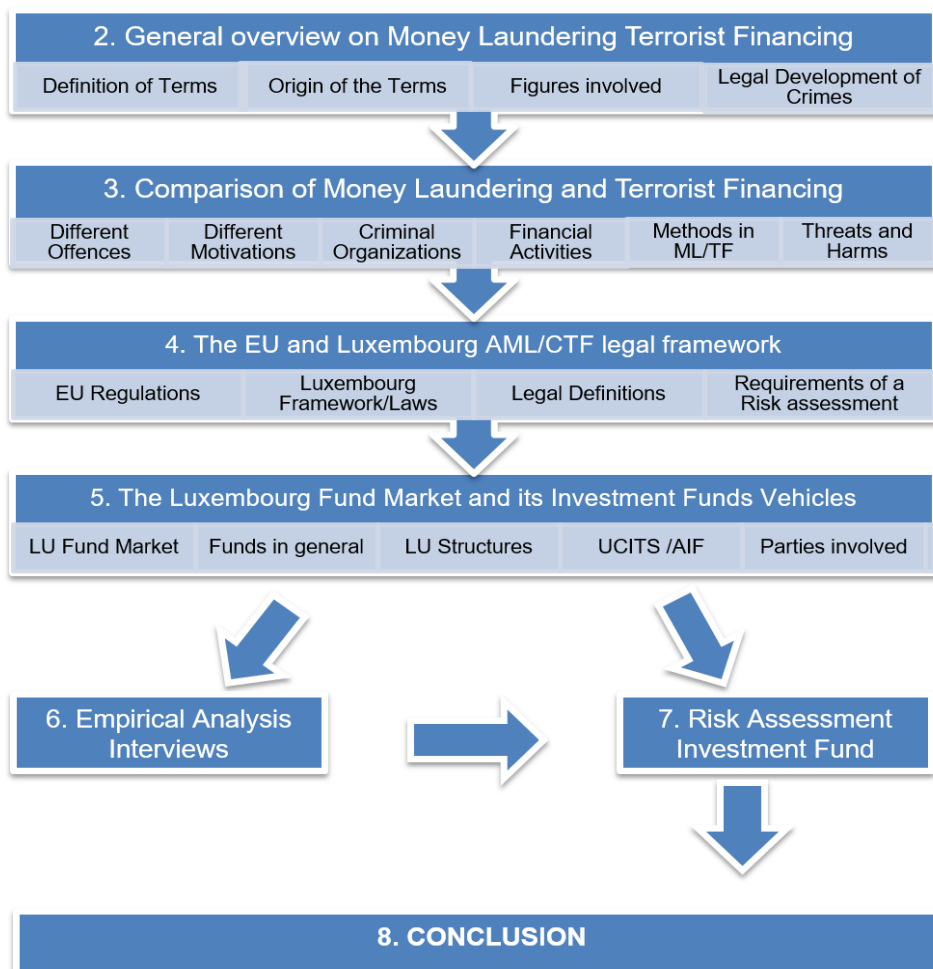
⁵ Cf. Ibid.

The assessment of the ML/TF is performed by attributing the identified risk factors to the business activity of specific market participants in the market segment to be analyzed. It needs to be understood that it can be the case that not all risk factors identified are applicable to the fund sector or that in the cause of the analysis additional sector or market specific risk factors might appear. The assessment of the risk is done in chapter 7 by performing a general risk analysis on an investment fund.

1.4. Structure

Figure 1 below provides a graphical overview on this thesis. The paper is divided into 8 chapters with additional sub-chapters. The topics of each chapter and the main topics of the sub-chapters are mentioned below.

Figure 1: Structure of this Thesis



Source: Own elaboration based on chapters 2-8.

The figure illustrates that the chapters 2-5 provide the theoretical background to be able to establish a risk assessment and in order to draw a final conclusion about the risk exposure of the Luxembourg Fund Industry in the end. Chapter 6 the empirical analysis of the expert interviews will further contribute to the establishment of risk assessment by using the provided feedback in addition to the theoretical information. Chapter 7 illustrates the establishment of a risk assessment of an investment fund based on the information provided in the previous chapters. The conclusion presents the summarized results of the risk assessments and an outlook of the Luxembourg Fund Market's risk exposure to ML and TF.

2. Money Laundering & Terrorist Financing - a general Overview

This chapter aims at providing a general overview on ML and TF as well as some historical background on the terms themselves and their evolution. The estimated amounts of money involved in ML and explains the development of the AML legislation is illustrated. The development of the CTF legislation will not be described as detailed. This is due to the fact that the international community is not able to define a common understanding of the term. The underlying reasons are presented later in this chapter. A general introduction to the topic is necessary to understand the risk assessment of an investment fund presented in chapter 7.

2.1. Money Laundering – Definition, Origin, Figures & legal Background

The term 'Money Laundering' is commonly used and generally understood worldwide even though the term lacks a uniform definition. In the absence of a single, all-purpose definition the three examples below were chosen to provide a general understanding of the term.

- The FATF, also known under its French name Groupe d'action financière (GAFI), describes ML as being:⁶

⁶ (Financial Action Task Force), para. 1.

“the processing of (.) criminal proceeds to disguise their illegal origin”.

- The United Nations Office on Drugs and Crime (UNODC) defines the term as:⁷

“the method by which criminals disguise the illegal origins of their wealth and protect their asset bases, so as to avoid the suspicion of law enforcement agencies and prevent leaving a trail of incriminating evidence.”

- The United States Internal Revenue Service (IRS) refers to ML as:⁸

“the activities and financial transactions that are undertaken specifically to hide the true source of the money. In most cases, the money involved is earned from an illegal enterprise and the goal is to give that money the appearance of coming from a legitimate source.”

All the above stated and further descriptions found in books or on the internet have several things in common. None of them provides an exact description of the criminal offence of ML but refers to terms such as process, methods, means and activities. However, all of them refer to disguising the origin of the funds, proceeds or wealth involved, which in addition originate from criminal offences or illegal activities. This leads to the conclusion that illegal money is laundered through many different activities, by different means, through different processes and schemes. Consequently, this means that there are no specific indicators or alarm signals that could be used to detect the laundering action every time.

While the technique of ML to try concealing the source of illicit proceeds or income and making them appear as being generated from a legitimate source is as old as crime itself, the term ‘Money Laundering’ in its current understanding is fairly new.⁹

Even though the origin of the concept itself dates way back into ancient history, the crime was only recently criminalized. As one famous potential source of the modern term Al Capone is often cited. It is said that in the 1920s, during the prohibition in the United States of America (U.S.), Al Capone tried to conceal his proceeds from selling his illegally produced alcohol by investing in the cash intensive business of laundrettes throughout Chicago. However, this seems to be myth. Another possible

⁷ (UNODC - United Nations Office on Drugs and Crime (a), 2016), para. 1.

⁸ (IRS – Internal Revenue Service, 2016), para. 1.

⁹ Cf. (Levy, 2016), p. 1ff.

origin refers to a real cleaning process, the so called 'washing' of coins for ladies in casinos in the early 1900s. The coins were cleaned so that the ladies' white gloves they wore would not get dirty while playing in the casino.¹⁰

The most probable origin of the term refers to a market manipulation technique used in the pre-1930s on Wall Street where fictitious stock quotations were created by swindlers. In these transactions, the criminals engaged as their own counterparts by using different brokers. This resulted in a so-called 'washed sale'. The method was commonly referred to as 'washing securities' or described as doing 'laundry work'. This method of market manipulation included also a series of transactions such as making deposits and withdrawals and initiating wire transfers which were clearly conducted for the sake of appearance rather than for investment purposes.¹¹

According to literature, the term first appeared in print in a newspaper in connection with the Watergate scandal in 1973 in the U.S.¹² The word was first used in a legal context in the judgment in the court case UNITED STATES v. \$4,255,625.39, 551 F. Supp. 314 in the District Court for the Southern District of Florida in 1982.¹³

The criminalization of ML in the U.S., the United Kingdom (U.K.) and Europe took place during the 1980s and the early 1990s. In 1986, the U.S. passed the 'US Money Laundering Control Act', while the U.K. did not classify ML as a distinct offence, but prosecuted the deed under various statutes, e.g. as the 1968 'Theft Act'. This act provides the legal grounds to prosecute launderers dealing with stolen assets.¹⁴ On November 8th, 1990 the Council of Europe published 'The Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime'¹⁵ in order to criminalize the laundering of the proceeds of crime and to confiscate instrumentalities and proceeds or property, the value of which corresponds to such proceeds. The convention aimed at facilitating international co-operation and investigation regarding proceeds obtained through criminal actions in the absence of a harmonized international legislation.

¹⁰ Cf. (Unger & van der Linde, 2013), p. 3.

¹¹ Cf. (Levy, 2016), p. 1ff.

¹² Cf. (Richards, 1999), p. 43.

¹³ Cf. (Unger & van der Linde, 2013), p. 3.

¹⁴ Cf. (Mugarura, 2016), p. 2.

¹⁵ Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime of 08 November 1990, ETS No.141, Council of Europe.

In Luxembourg, the first criminalized offence of laundering proceeds obtained from a crime was related to the crime of drug trafficking. It first appeared in the legal framework in the 'Law of 7 July 1989¹⁶' amending the amended 'Law of 19 February 1973¹⁷'.¹⁸

The first circular, 'IML 89/57 relating to Drug Money Laundering', being applicable to all professionals of the financial sector in Luxembourg, was issued by the Institut Monétaire Luxembourgeois (IML), the predecessor of the Commission de Surveillance du Secteur Financier (CSSF), in November 1989.¹⁹

On a global level, the establishment of an international framework was strengthened by the 40 recommendations issued by the FATF in 1990. These recommendations aimed at the prevention as well as the repression of ML and set out the framework for the 1st AML Directive established by the EU on June 10th, 1991,²⁰ namely 'COUNCIL DIRECTIVE 91/308/EEC²¹'. In the course of these publications, the scope of ML activities was extended to additional criminal offences including arms trafficking and organized crime.

In Luxembourg, the 40 recommendations and the Directive 91/308EEC were implemented with the 'Law of 5 April 1993²²' creating for the first time a legal obligation for financial service professionals to avoid being used for ML purposes. The law also contained sanctions to be applied in the case financial service professionals would not be compliant with the law. Upon this point in time all obligations for financial service professionals have only been laid down in circulars issued by the relevant regulatory or supervisory bodies. In 1994, an explanatory circular 'IML 94/112' followed the 'Law of 5 April 1993', providing detailed guidelines on the implementation and the expectations of the fulfillment of duties by the financial service professionals.²³

Until today the AML framework has been continuously updated and this process is likely to continue. The current Luxembourg AML Legislation is presented in chapter

¹⁶ Law of 7 July 1989 amending the system of coercive imprisonment and certain articles of the criminal code.

¹⁷ Law of 19 February 1973 on the sale of drugs and the fight against drug addiction.

¹⁸ Cf. (International Monetary Fund (a), 2004), p. 7.

¹⁹ Cf. (Reckinger), p. 5.

²⁰ Cf. Ibid.

²¹ COUNCIL DIRECTIVE of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering (91 /308/EEC).

²² Law of 5 April 1993 on the Financial Sector.

²³ Cf. (Reckinger), p. 5.

4. The necessity to further strengthen and develop the legislation and the framework on the fight against ML on the local as well as on a global level can be illustrated by the estimated figures on extent of the offence.

Table 1: Historically estimated Figures on the Amount of Money laundered globally

ESTI-MATION YEAR	GLOBAL VALUE OF LAUNDERED MONEY	TEXT/AUTHOR	TEXT/TITLE/PUBLICATION	PUBLI-CATION YEAR
1997	US \$ 300-500 bn	Bureau for International Narcotics and Law Enforcement Affairs	1997 International Narcotics Control Strategy Report	1998 March
1998	2-5% of the global GDP (= US \$ 622-1,556 bn)	Michel Camdessus for the International Monetary Fund	Money Laundering: the Importance of International Countermeasures-	1998 February 10 th
1998	US \$ 2,850 bn	John Walker	Modelling Global Money Laundering Flows - some findings	1998 November, 30 th
1998	US \$ 800 – 1,500 bn	Simon Maylam	Prosecution for money laundering in the UK	2003
2005	US \$ 1-2 trillion	Raymond W. Baker	Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System	2005
2009	2,7% of GDP (= US \$ 1,6 trillion)	UNODC	Illicit money: how much is out there?	2011 October 25 th

Source: Own elaboration based on (Bureau for International Narcotics and Law Enforcement Affairs, U.S. Department of State, 1998), para. 2; (International Monetary Fund (b), 1998), para. 2; (Knoema (a), 2016); (Maylam, 2003), p.158; (Walker, 1998), para. 1; (Baker, 2005), p. 163f & (UNODC - United Nations Office on Drugs and Crime (b), 2011), para. 1.

In any case, the estimated figures listed above should be treated with caution. The statistics provide an idea of the magnitude of the money laundered globally, but the figures are still only an estimate. Precise statistics are not available to give more exact estimations of the amount of laundered money, due to the illegal nature of the underlying transactions. For the reasons outlined above the FATF does not publish an estimate on the figures.²⁴ Nevertheless, if the estimation of the International

²⁴ Cf. (Financial Action Task Force, 2016), para. 8.

Monetary Fund (IMF) from 1998, which has been supported by research done for the UNODC Report of 2011, is correct that would lead to a sum between USD 1,470,046,819,167.858 equaling 2% and USD 3,675,117,047,919.645 equaling 5% of the 2015 global Growth Domestic Product (GDP), being laundered globally in 2015. These sums take the global GDP of 2015 of USD 73,502,340,958,392.9²⁵ as basis for the calculation. For a better understanding of these figures, the smaller amount quoted above can be compared to the GDP of Canada being estimated for USD 1,462,300,000,000 for 2016²⁶. The higher figure is even bigger than the estimated German GDP of USD 3,467,800,000,000 for 2016²⁷. Germany has been ranking fourth in the global GDP country list of in the last three years.²⁸

These figures are alarming, especially when considering that globally, according to the UNODC, less than 1% of the illicit financial flows are being seized and/or frozen.²⁹

The previous chapter provided an overview that is essential for understanding why the detection of ML is of high importance for the financial sector as well as for the global economy. A detailed analysis of the threats and harms is provided in Annex I: Threats & Harms posed by Money Laundering & Terrorist Financing.

2.2. Terrorist Financing – Definition, Origin, Figures & legal Background

Whereas ML is the act of disguising where the funds originate from, TF is the felony that supports illegal acts or groupings financially. This chapter provides a background on TF.

Even though local and global legislation as well as frameworks name AML and CTF in the same breath and suggest similar measures to prevent both, the felony of TF needs to be regarded separately from the one of ML. To understand the crime of TF, the term ‘Terrorism’ needs to be introduced and defined at first.

Already in 1974, Harvard Law Professor and later judge at the International Court of Justice Richard Reeve Baxter recognized that there is a general uncertainty about

²⁵ (Knoema (a), 2016), table.

²⁶ (Knoema (b), 2016), table.

²⁷ (Knoema (c), 2016), table.

²⁸ (Knoema (a), 2016), table.

²⁹ Cf. (UNODC - United Nations Office on Drugs and Crime (b), 2011), para. 2.

the interpretation and the usage of the term 'Terrorism' in the international legal framework by stating the following: ³⁰

"We have cause to regret that a legal concept of "terrorism" was ever inflicted upon us. The term is imprecise, it is ambiguous; and above all, it serves no operative legal purpose."

Almost a quarter of a century later in 1997, his opinion was mirrored by Rosalyn Higgins, at that time Judge to the International Court of Justice, expressing the following: ³¹

"Terrorism is a term without legal significance. It is merely a convenient way of alluding to activities, whether of States or of individuals, widely disapproved of and in which either the methods used are unlawful, or the targets protected, or both."

In 1988, A.P. Schmid and A.J. Jongman discussed and reviewed 109 different definitions of terrorism to find similarities and identical word categories used in the definitions, in order to provide a single definition.³² However, until now it has not been possible to find a uniform definition of the term. This is mainly due to the reasons listed below: ³³

- the different historical and contemporary criminal acts being considered as terrorism
- the different historical and contemporary groups/individuals performing the acts
- the different aims, visions, reasons and attitudes of the groups/individuals executing the acts
- the different attitudes, mind sets and views of terrorism researchers

The word 'Terrorism' is a relatively young word and originates from the Latin word 'Terror' meaning fright or fear as well as scare and horror. The term was first mentioned in a dictionary dating back to the time of the French Revolution. In the beginning, the term was used by the Jacobins as a positive self-description. A change in the meaning took place and the word was used to describe the violent acts

³⁰ (Baxter, 1974), p. 380.

³¹ (Higgins, 1997), p. 28.

³² Cf. (Schmid & Jongman, 1988), p. 5.

³³ Cf. (Stelzel, 2016), para. 2.

executed during the years of the French Revolution the so-called 'Regime de la Terreur' ('The Reign of Terror'). More recently, the term is used to describe a criminal act of violence, which was politically motivated.³⁴

In the absence of a uniform definition, state or government actors usually introduce a working definition of the term. These working definitions shall take into account the respective situation within a specific or several societies.³⁵

The FATF as the leading independent inter-governmental body, developing and providing the recommendations on the fight against terrorism, does not provide its own definition. On the contrary, it provides the following non-exhaustive listing under which circumstances a criminal act is or shall be considered as a terrorist act:³⁶

“(a) an act which constitutes an offence within the scope of, and as defined in one of the following treaties:

- (i) Convention for the Suppression of Unlawful Seizure of Aircraft (1970);*
- (ii) Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1971);*
- (iii) Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (1973);*
- (iv) International Convention against the Taking of Hostages (1979);*
- (v) Convention on the Physical Protection of Nuclear Material (1980);*
- (vi) Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1988);*
- (vii) Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (2005);*
- (viii) Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf (2005);*

³⁴ Cf. (Stelzel, 2016), para. 1.

³⁵ Cf. (Stelzel, 2016), para. 3.

³⁶ (Financial Action Task Force (b), 2016), p. 125.

- (ix) *International Convention for the Suppression of Terrorist Bombings (1997); and*
- (x) *International Convention for the Suppression of the Financing of Terrorism (1999).*

(b) any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a Government or an international organisation to do or to abstain from doing any act.”

The above description of acts declared as terrorism goes far beyond the original meaning of the word, when the term was first introduced to describe acts of violence. It is also to be understood as the working definition in this paper for terrorism or acts of terrorism since the EU uses the ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation’, the so-called ‘FATF Recommendations’ – as the conceptual basis for its AML/CTF legislation.

The FATF describes TF as the provision of money for terrorist acts, terrorists and/or terrorist organizations³⁷. The following definition of a terrorist is provided by the FATF:³⁸

“The term terrorist refers to any natural person who:

- (xi) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and wilfully;*
- (xii) participates as an accomplice in terrorist acts;*
- (xiii) organizes or directs others to commit terrorist acts; or*
- (xiv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist.”*

³⁷ Cf. (Financial Action Task Force (b), 2016), p. 125f.

³⁸ Ibid.

The same applies to the definition of a terrorist organization with the difference that when speaking of an organization, a group of terrorists is involved in the above acts.³⁹

After this general introduction to the term ‘Terrorism’, the next paragraphs illustrate a brief overview of the costs of terrorism. At first, an overview is provided on the estimated costs for several attacks committed by terrorists in the past.

Table 2: Overview of estimated operational Costs for Terrorist Attacks

Year	Terrorist Attack	Estimated operational costs	Source
1998	African Embassy bombings	> \$ 30,000 < \$ 50,000	Jean-Charles Brisard UN Monitoring Team
2000	USS Cole bombing	\$5,000 - \$10,000 < \$10,000	Jean-Charles Brisard UN Monitoring Team
2001	Sept 11, 2001	> \$500,000	Jean-Charles Brisard
2002	Djerba Mosque bombing	\$20,000	Jean-Charles Brisard
2002	Limburg bombing	\$127,000	Jean-Charles Brisard
2002	Bali bombing	\$74,000 < \$ 50,000	Jean-Charles Brisard UN Monitoring Team
2003	Marriott Hotel in Jakarta	\$ 30,000	UN Monitoring Team
2003	Istanbul truck bomb	< \$ 40,000	UN Monitoring Team
2004	Madrid train bombings	\$10,000	UN Monitoring Team
2005	London transport system	< GBP 8 000 (< \$10,000)	The Stationery Office London

Source: Own elaboration based on (Brisard, 2002), p. 6; (United Nations Security Council, 2004), p. 12 & (The Stationery Office, London, 2006), p. 23.

Table 2 illustrates that operational costs compared to the damage done in each attack are relatively low. Compared to the figures provided for ML, terrorists require a lot less money for their operations. But the operational costs are not the only ones that terrorist organizations have to provide for. Due to intensive research done on al-Qaida in relation to 9/11, this terrorist organization will be used as an example to illustrate the needs for money of a terrorist organization.

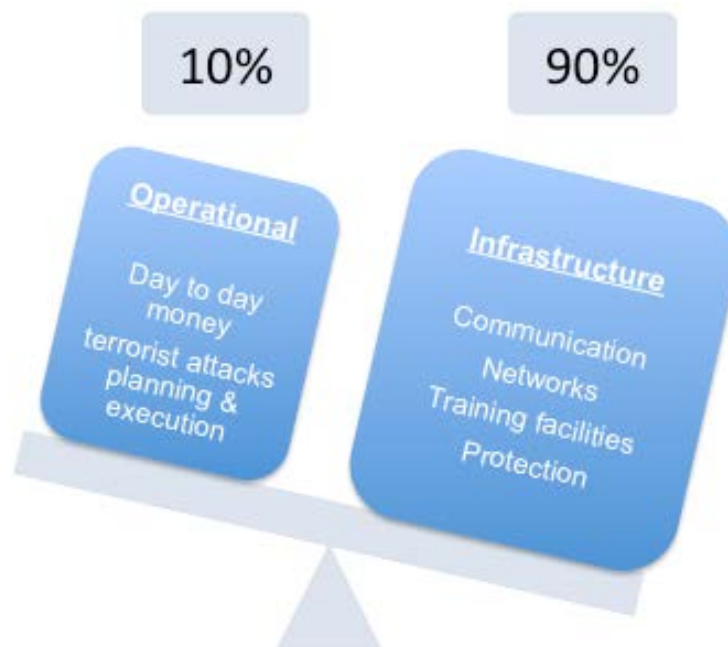
“Al-Qaida clearly distinguishes in various documents, including its training manual, the organizational funds and the “operational funds”. For al-Qaida,

³⁹ Cf. (Financial Action Task Force (b), 2016), p. 126.

operational funds have two main objectives, the first is to invest in projects that offer financial return to entertain local cells, the second is to carry out terrorist operations apart from the operational level, one must not confuse the requirements of al-Qaida in terms of daily logistics and the super-structure level, which is the real innovation introduced by Usama bin Laden.”⁴⁰

Figure 2 below illustrates the probable proportional distribution of the funds within the al-Qaida terrorist group to establish its infrastructure and to carry out its attacks.

Figure 2: Estimated Distribution of Funds within the al- Qaida Terrorist Network



Source: Own elaboration based on (Brisard, 2002), p. 7.

As shown in Figure 2, the maintenance of the infrastructure of a terrorist network drains most of the resources. The wide variation of different structures of terrorist groups is reflected in the diversity of their financing requirements. Large, state-like organizations have different and higher financial needs than small decentralized or self-directed local cells or networks. The past shows that terrorists adapt to the given situation and are opportunistic when it comes to raising funds. Their sources of funding range from legitimate sources, e.g. legitimate business activity to self-

⁴⁰ (Brisard, 2002), p. 6f.

financing via the abuse of charitable entities to obtain legitimate funds for their criminal activity. The range of criminal activity varies in scale and sophistication. Low-level crimes are part of the fundraising as well as organized fraud or drug trafficking. As an additional source of income, state sponsors or activity in failed states or other safe havens can be named.⁴¹

When funds derive from criminal activities, ML is usually involved and in this case, the borderline between the two activities becomes blurred. Moreover, in order to move money around, terrorists often use the methods of money launderers.⁴² The differences as well as the similarities between ML and TF will be illustrated in the following chapter.

3. Money Laundering & Terrorist Financing - Activities & Processes

This chapter aims at pointing out the differences and the similarities between ML and TF regarding the groups performing the crimes, their structures and the cash flows involved in both activities. Furthermore, the so-called 'Money Laundering Cycle', possible financing sources for terrorism and methods of transfer of funds within terrorists group are illustrated. The understanding of the similarities and the differences between ML and TF is essential to understand the risk exposure of the Luxembourg Investment Fund Market. This also accounts for the methods and means used in both criminal activities.

3.1. Differences & Similarities between Money Laundering & Terrorist Financing

Even though the current legislation covers the prevention of ML and the fight against terrorism under the same laws, it is necessary to understand the similarities as well as the differences of each criminal act.

The following states the similarities between organized crime and terrorist groups, as well as their unequivocal distinguishing features. The motivation for organized

⁴¹ Cf. (Financial Action Task Force (c), 2008), p. 4.

⁴² Cf. (Koh, 2006), p. 28.

crime is usually to pursue personal profit or greed and it seeks economic ends. Terrorist acts, on the other hand, are inspired by ideology, which can be driven by several underlying reasons and motivations, e.g. political, religious or personal ones. The selection of targets is also different. While actors in organized crime select targets that pose a threat to their group or network and try to avoid any public attention, terrorists want to achieve the opposite. Terrorists seek and want public attention and usually select symbolic or public targets for their attacks.⁴³ TF to support a future illegal act can be carried out with funds that derive from a legitimate source, whereas ML activities follow the illegal act to disguise the origin of the funds.⁴⁴

When comparing organized crime to terrorist groups several similarities in the group's organizational structures can be pointed out. Both groups are usually structured in large networks or smaller cells which requires a certain kind of infrastructure, depending on their size. Both require safe havens for their operations and hide outs. Being a group is important for both in order to pursue their goals, even if both are different in motives and objectives, to create a group spirit. Both need to recruit new members and try to include the group's recruits into their group spirit as young and early as possible. Organized crime as well as TF pose a threat of violence to external third parties.⁴⁵ To a certain extend the two groups are in need of the willing or unwilling assistance of the financial sector to transmit and handle their money.⁴⁶

The above description of the similarities shows, that to a certain extend both groups need the assistance of the financial sector to execute their financial transactions. The usage of different participants, the money flows and transactions within the financial sector differ in between the two activities. Table 3 Differences & Similarities between Terrorist Financing & Money Laundering illustrates the differences.

⁴³ Cf. (King, 2010), p. 7.

⁴⁴ Cf. (Financial Markets Limited, 2009), p. 3.

⁴⁵ Cf. (King, 2010), p. 7.

⁴⁶ Cf. (Financial Markets Limited, 2009), p. 3.

Table 3: Differences & Similarities between Terrorist Financing & Money Laundering

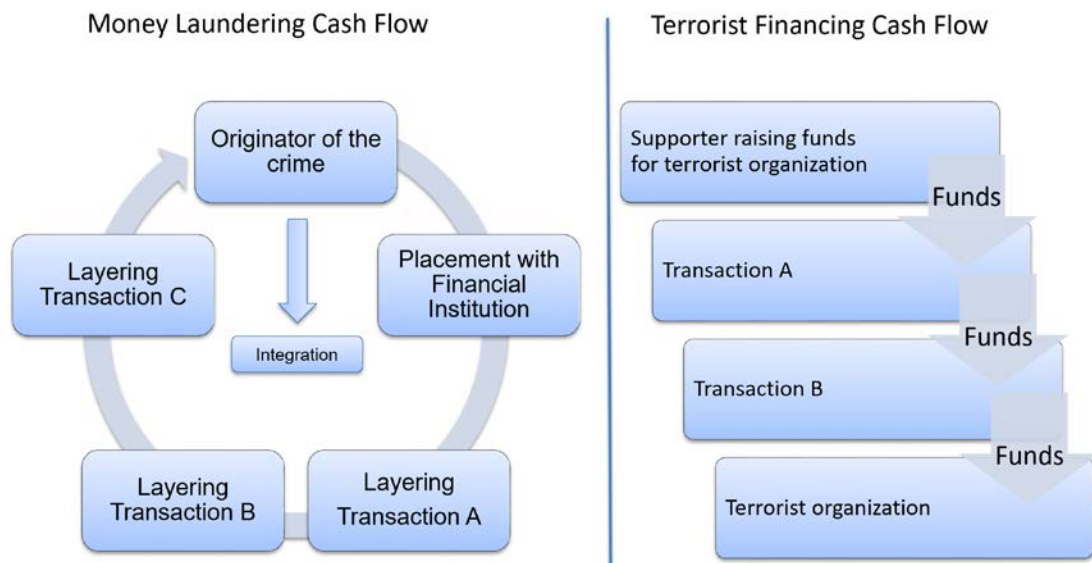
	Money Laundering	Terrorist Financing
Motivation	Personal Profit/Greed	Political/Religious Ideology
Source of Funds	Internally from within the criminal organization Founds are obtained illegitimate through commitment of crimes	Internally from self-funding cells (increasingly centered on criminal activity) Externally from benefactors and fundraisers
Conduits	Favors formal financial system	Favors cash couriers or informal financial systems such as hawala and currency exchange firms
Detection Focus	Suspicious transactions, such as deposits uncharacteristic of customer's wealth or the expected activity	Suspicious relationships, such as wire transfers between seemingly unrelated parties
Transaction Amounts	Large amounts often structured to avoid reporting requirements	Small amounts usually below reporting thresholds
Financial Activity	Complex web of transactions often involving shell or front companies, bearer shares, and offshore secrecy havens	No workable financial profile of operational terrorists exists, according to U.S. 9/11 Commission
Money Trail	Circular — money eventually ends up with person who generated it	Linear — money generated is used to propagate terrorist group and activities

Source: Own elaboration based on (Richards, James R. for Association of Certified Anti-Money Laundering Specialists, 2012), p. 99.

It is of particular importance to understand the different cash flows within the two activities. As explained in Table 3, the ML cash flow is a circular flow in which the illegal funds are eventually returned to the generator.⁴⁷ This circular flow has been analyzed over time and the process is commonly known as the 'Money Laundering Cycle'. It will be explained in detail in the next chapter. Contrary to this financing terrorism is a linear cash flow where the source or the originator of the funds is not necessarily related to the receiver of the funds. Figure 3: Money Laundering & Terrorist Financing Cash Flows illustrates the different cash flows for the two activities.

⁴⁷ Cf. (Turner, 2011), p. 6f.

Figure 3: Money Laundering & Terrorist Financing Cash Flows



Source: Own elaboration based on (Hopton, 2016), p. 2f & (Freeman & Ruehsen, 2013), p. 8ff.

From a prosecution point of view, the differentiation between the two activities is not as relevant as their detection. This is due to the following facts. Both types of assets, whether originating from organized crime or aimed at financing terrorism, pose the same threats to financial and public institutions. The main objective of the legal prosecutors is not to stop the act of processing the illegal funds, but to immobilize the funds themselves as well as the groups, people and organizations behind the process and the underlying crimes.⁴⁸

The sourcing needs of terrorism have changed over the years due to an increasing need for money, especially big terrorist groups need to support their network infrastructure. Therefore, criminal activities have gradually become an important part of terrorists' economic business. Such crimes are, but not limited to, drug trafficking, racketeering, trafficking in precious stones and holding hostages to ransom. In some cases, it has the appearance that a kind of objective alliance has been formed between criminal and terrorists organizations. The common interest in certain areas has fostered this cooperation. While criminals may profit from the ability of terrorists to damage, terrorists may take advantage of the benefits that criminal activities can provide them in terms of financing. A proof for the above statements can be made

⁴⁸ Cf. (Thony, 2005), p. 244f.

by taking into account the geographical origin of the terrorist groups and activities. Al-Qaida is based in Afghanistan within the world's hotspot of opium production, the Revolutionary Armed Forces of Colombia are situated in a coca producing area and the civil wars in Africa are situated around places where natural resources and precious gems are extracted.⁴⁹ All of the above have led to a commingling of organized crime activities and the financing of terrorism.

3.2. The Money Laundering Cycle

In literature, the process of ML is commonly referred to as the 'Money Laundering Cycle', the 'Money Laundering Scheme' or the so-called 'Three Stages of Money Laundering'.⁵⁰

Before the process of ML can take place, an underlying criminal activity generating the funds/proceeds to be laundered has to be committed. This activity is in legal terms referred to as a predicate offence for ML. Consequently, the crime of ML is impossible to commit without the commitment of a predicate offence taken place at first. Therefore, both criminal offences are not necessarily committed by the same persons and need to be considered as two separate criminal offences. The more crimes are designated as predicate offences of ML, the more the ML offence can be used in the fight against the underlying crimes.⁵¹ The predicate offence provides the two main reasons why the ML process has to take place. Firstly, without giving the proceeds a legitimate source, the origin of the proceeds could be traced back to the underlying crime, which secondly makes the proceeds vulnerable to seizure by the law enforcement or the authorities. As the process is dynamic and changes, the used means differ within the different schemes. ML is therefore described as a dynamic three-stage process.⁵² The following Figure 4: The three Stages of Money Laundering illustrates the single stages as well as their goals.

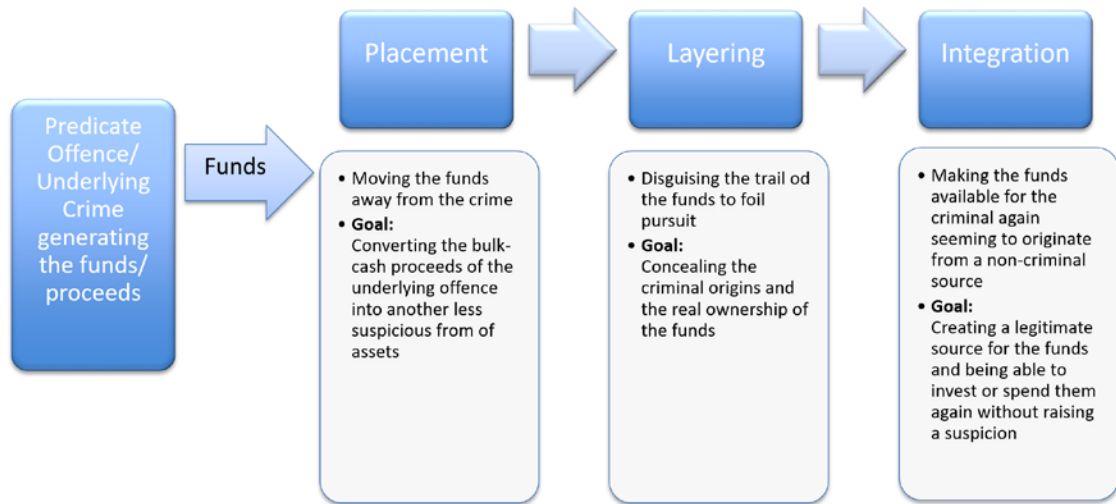
⁴⁹ Cf. (Thony, 2005), p. 244.

⁵⁰ Cf. (Madinger, 2012), p. 259.

⁵¹ Cf. (World Bank, 2009), Module 2, p. 10.

⁵² Cf. (UNODC - United Nations Office on Drugs and Crime (c), 2016).

Figure 4: The three Stages of Money Laundering



Source: Own elaboration based on (UNODC - United Nations Office on Drugs and Crime (c), 2016) & (Beare, 2007), preface IXff.

The placement process needs to be understood purely as the process of moving the illegally obtained cash proceeds away from its original source into another form. Once being in this new form the money launderer will take further actions, referred to as layering, to move the funds even further away from their original criminal source. Typically, the launderer tries to place the funds into the banking system to initiate the ML process. Before putting the cash into the banking system, there might be other transactions taking place in order to separate the funds from its illegal origin. Consequently, these actions have to be considered as placement as well and placement needs to be considered as the initial conversion of the unlawful obtained proceeds into another form of valuable assets.⁵³ One of the most common and well-known methods for placement is ‘Smurfing and Structuring’. This describes the breaking up of large sums of money into small ones to avoid the transaction reporting requirements when depositing cash into a bank account.⁵⁴ The placement process differs from ML scheme to scheme but in most cases, at least one of the following methods is involved:⁵⁵

⁵³ Cf. (Cox, 2014), p. 15f.

⁵⁴ Cf. (Unger & Busuioc, 2007), p. 89.

⁵⁵ Cf. (Madinger, 2012), p. 259.

- Stashing the proceeds (buried treasure)
- Transporting the cash, i.e. smuggling it offshore
- Using receipts of legitimate business for commingling the money with clean funds
- The placement of the funds with certain financial institutions. Not necessarily a commercial bank, e.g. currency exchanges, insurance companies or other financial institutions that are not banks

With regard to the last two points mentioned above, casinos can also be used to place the money. Gambling is a cash intensive business. Buying chips cash and converting them afterwards back into cash with a receipt of the transaction or into a check issued by the casino would make the money appear legitimate.⁵⁶

All the above named actions pose additional challenges to the launderer and usually involve the help of or the need for other people. The launderer's options are usually limited. To overcome these challenges, the launderer usually does one of the following:⁵⁷

- *“Act on his or her own behalf or with accomplices (smurfing or transporting the funds)*
- *Use nominees to conceal his or her interest in the transaction(s)*
- *Set up businesses to be used as fronts, to commingle funds, or hold bank accounts*
- *Establish one or more bank accounts to receive deposits.”*

The placement stage is the most dangerous one for the launderer and/or the criminal as it is the most vulnerable one to detection. This is due to the fact that the common means of payment in criminal transactions is cash. But in today's society the common means of payments are wire transfers, credit or debit card payments and other non-cash means and therefore large amount of cash payments might raise undesired attention and questions to the criminals on the origin of the money.⁵⁸ Most launderers try to integrate the money into the financial system as book/scriptural money as soon as possible.

⁵⁶ Cf. (Unger & Busuioc, 2007), p. 92.

⁵⁷ (Madinger, 2012), p. 259.

⁵⁸ Cf. (Grosse, 2001), p. 3.

Once the money is within the banking system, the launderers will commence with the layering. This process is to separate the funds further from their source through a series of financial transactions. The creation of a complex web of different and multiple financial transactions is intended to impede the detection of the origin of the funds by the law enforcement.⁵⁹ This is can be done by transferring the funds between several bank accounts, countries and individuals and/or corporation as well as by splitting of the money between the above. In the layering process, a common transaction is to withdraw money from one bank account in cash and deposit the cash into another account with a different bank. In case the money is moved around electronically via wire transfers, the funds are often routed through countries, which have a strict banking or professional secrecy. In addition, offshore companies are named as the account holders abroad, which also helps to disguise the ownership of the funds.⁶⁰

The last and final stage completing the process is the integration of the funds. If the previous stages were executed correctly, the money should now be appearing as originating from a legal source and can be returned in their current form to their source. Once returned, the criminal can freely make use of the funds for whatever purpose, legal or illegal.⁶¹

The following transactions are examples for what the funds can be used for in the integration stage:⁶²

- *“Purchase of property (for personal use or investment)*
- *Purchase of other high-value items, for example, jewelry, antiques, works of art*
- *Purchase of legitimate businesses*
- *Purchase of investment for income*
- *Any purchase for personal use with a check, credit card, or other payment method”*

⁵⁹ Cf. (Schikora, 2012), p. 57.

⁶⁰ Cf. (OECD - Organisation for Economic Co-operation and Development, 2009), p. 13.

⁶¹ Cf. (World Bank, 2009), Module 1, p. 7.

⁶² Ibid.

All the above named financial transactions can also be executed with proceeds that have not been laundered and thus do not differ in the means of execution from each other.

Therefore, from the point of view of the law enforcement, the complexity of an integration scheme is not the problem of preventing the integration. It is rather the fact that once the money reached this stage, it already appears to be from a legitimate source. The easiest of the three stages is to put the money back into the white economy once it has passed the first and second stage.⁶³ This might also be due to the fact that criminals are even willing to pay taxes on the returns of their investment purchased with illegal proceeds, which gives them some sort of legal cover for their illegal activities.⁶⁴ In addition, criminals are willing to pay fees between 20-35% for having their money laundered, depending on the sum, the timeline, the complexity of the scheme and the cash still involved.⁶⁵

Understanding the cash flow cycle and the intentions of the launderer is essential for the detection of the different schemes because no scheme will be exactly set up in the same way. It is the basis to establish the risk assessment in chapter 7.

3.3. Methods of Terrorist used for Financing & financial Transactions

A similar process or pattern, as described by the 'Money Laundering Cycle', has not yet been identified for the movement of proceeds within terrorist organizations. Nevertheless, investigations have revealed that terrorists typically use certain types of financing and that there are also preferred methods for the movements of their funds. This chapter introduces some of these methods.

Unlike the organized crime, where the money originates from a crime executed by a criminal organization, terrorists use a vast variety of sources to obtain the operational and infrastructural funds needed. In addition, terrorists and their devotees are experts in constantly changing their way to collect, transfer, receive and obtain

⁶³ Cf. (Madinger, 2012), p. 259.

⁶⁴ Cf. (Unger & Busuioc, 2007), p. 92.

⁶⁵ Cf. (Mardinger, Doyle, & Ferrara, 2017), para. 1ff.

access to the funds.⁶⁶ Table 4 below provides a non-exhaustive overview on the sources from which terrorists obtain their money.

Table 4: Possible Sources for financing Terrorism

Illegal Sources/Funding	Legal Sources/Funding	Other Sources/Funding
Drug trade/trafficking	Personal donations: <ul style="list-style-type: none"> • Individuals • Corporates 	State sponsors
Kidnapping	Business profits	Membership fees
Smuggling of weapons and other goods	Charitable organizations: <ul style="list-style-type: none"> • Misapplying donations • Scam charities 	Dispersed diaspora Communities
Fraud: <ul style="list-style-type: none"> • Checks • Credit Cards 	Government Programs: <ul style="list-style-type: none"> • Misapplying funds • Social benefits 	
Extortion of local business	Self-Funding e.g.: <ul style="list-style-type: none"> • Savings • Regular income 	
Organized retail theft/petty theft		

Source: Own elaboration based on (Financial Transactions and Reports Analysis Centre of Canada, 2015), para. 1; (Ryder, 2015), ch. 1.3; (Freeman, Financing Terrorism: Case Studies, 2016), p. 7f & (Financial Action Task Force (c), 2008), p. 11ff.

When moving money, terrorists have to consider certain circumstances to decide which method to use for a specific transfer:⁶⁷

- The volume of funds terrorist are able to move with the chosen method compared to the amount of money needed to be transferred
- The risks involved in the method:
 - Detection/seizure by authorities/law enforcement
 - Degree of anonymity of the transfer within the chosen method
 - Reliability of the method
- Convenience/accessibility of the method in the regions of transfer

⁶⁶ Cf. (European Commission, 2017), para. 1.

⁶⁷ Cf. (Freeman & Ruehsen, 2013), p. 5ff.

- Simplicity of the transfer
 - Fewest steps possible
 - Lowest technology level
- Costs such as payment fees or transaction charges
- Speed of the transfer to its final destination

The next paragraphs provide an overview on some of the methods used to transfer funds by terrorists. An analysis of the methods with regard to the risk stated above will not be performed as a part of this thesis.

The oldest method used to transport physical cash is making use of cash couriers.⁶⁸ Any person within the country or across borders can move cash physically. Usually, the cash is concealed in vehicles, ferries, packages and luggage or in any thing that is able to hold large volumes of cash, such as containers, boxes or other forms of cargo. In areas with insufficient border controls the cash is often transported unconcealed. It can also be transported and concealed within postal mail or via postal parcels.⁶⁹

A second possibility to transfer funds are the so-called Informal Value Transfer Systems (IVTS), which exist in various countries in parallel to the formal banking system. These systems have usually been established before the formal banking systems and provide the possibility to transfer money to people who do not, cannot or do not want to participate in the regular, modern banking system. IVTS are established as networks. Within these networks, values are transferred outside of the regulated, conventional financial system. The transfers are in most cases executed through non-financial institutions or other businesses, whose main activities are not the execution or the processing of money transfers. Most of the systems operate more or less in obscurity and make use of close-knit networks and industries with hardly any or no transparency. This does not mean that these are illegal and work underground. On the contrary, the systems are used by legitimate companies, traders, individuals and even by government agencies. However, due to

⁶⁸ Cf. (Financial Action Task Force (d), 2015), p. 3.

⁶⁹ Cf. (Financial Action Task Force (d), 2015), p. 27.

lack of transparency, the line between legal operations and abuse for illegal purposes is very thin. The systems are based on trust and there is a strong element of honesty with regard to the relationship between all participants. The system best known and existing in all continents is the Arabic Hawala system, which is known in India and Pakistan as 'hundi'. Other similar value transfer systems exist in several other countries. In China, the name is 'fei ch'ien', in Thailand the system is called 'poe kuan' and 'Black Market Peso Exchange' in South America.⁷⁰

Another means for transferring funds, which can also be used by terrorists, are Money Service Businesses (MSB) that are common in the U.S. The definition of a MSB by the Financial Crimes Enforcement Network (FinCEN) a bureau of the 'U.S. Department of the Treasury' is the following:⁷¹

"The term "money services business" includes any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities:

(1) Currency dealer or exchanger. (2) Check casher. (3) Issuer of traveler's checks, money orders or stored value. (4) Seller or redeemer of traveler's checks, money orders or stored value. (5) Money transmitter. (6) U.S. Postal Service. An activity threshold of greater than \$1,000 per person per day in one or more transactions applies to the definitions of: currency dealer or exchanger; check casher; issuer of traveler's checks, money orders or stored value; and seller or redeemer of travelers' checks, money orders or stored value. The threshold applies separately to each activity -- if the threshold is not met for the specific activity, the person engaged in that activity is not an MSB on the basis of that activity. No activity threshold applies to the definition of money transmitter. Thus, a person who engages as a business in the transfer of funds is an MSB as a money transmitter, regardless of the amount of money transmission activity."

This method of transferring funds is used because there are no official KYC statutes or regulation in place, comparable to the ones for opening a bank account. Some

⁷⁰ Cf. (Acharya, 2009), p. 75f.

⁷¹ (Financial Crimes Enforcement Network), para.1ff.

transactions can be executed without presenting an identification document if the transaction is below a certain threshold.⁷²

The use of false trade invoicing is another means with which terrorists can move money without being detected and make it appear having another purpose than to finance terrorism. False documentation and declarations of goods and services are made usually by misrepresenting the price, the quantity or the quality of the commodities that are traded. Common means are the over- and under-invoicing or multiple invoicing of the traded goods and services and over-or under-shipment of the goods as well as making false descriptions of goods and services.⁷³

Another way to move funds are high-value commodities such as diamonds and other precious stones/gems or metals. These commodities are relatively stable in value over time and not so easily traceable. Their high value compared to their bulk ratio is very favorable and small quantities can be sold on the world market easily.⁷⁴ Converting their cash into diamonds makes it easy for terrorists to transport or smuggle bigger sums in smaller repositories and conceal them. For the concealment the absence of an odor is also a helpful fact. Furthermore diamonds or gold e.g. serve as a form of currency or a means of payment for certain specific goods.⁷⁵

The last possibility used by terrorists to move funds is also the most concerning one. Terrorists transfer their money via the formal banking system. The groups are playing the openness of the international financial system, although knowing the transactions in this system leave a trail. A lot of their funding is provided by legitimate sources. Subsequently, terrorists are able to store these proceeds in front companies and transferring them relatively freely through the common routes of the national or international financial sector without being recognized as TF transactions.⁷⁶ The banking sector also provides access to paper checks, credit and debit cards, electronic payment systems and bank to bank transfers, which makes the movement of money easier.⁷⁷

⁷² Cf. (LaHood), p. 11f.

⁷³ Cf. (Gurulé, 2008), p. 179.

⁷⁴ Cf. (Norwitz, 2009), p. 129.

⁷⁵ Cf. (United States General Accounting Office, 2010), p. 216.

⁷⁶ Cf. (Aufhauser, 2003), para. 4ff.

⁷⁷ Cf. (Money Laundering Threat Assessment Working Group, 2005), p. 1.

To prevent the financing of terrorism, it is necessary to understand the ways and means by which terrorists move funds, in particular the ways, which are used to abuse the formal banking system to do so. Otherwise, the risk which the fund industry is exposed to cannot be assessed.

3.4. Threats & Harms posed by Money Laundering & Financing Terrorism

Nowadays, in any kind of media, articles about threats and harms that the predicate offences of ML and TF pose to the people are present. This chapter aims at illustrating and explaining these threats.

In March 2004, the Bureau of International Narcotics and Law Enforcement Affairs stated in its 'International Narcotics Control Strategy Report' that ML and TF are global threats and the international recognition of these threats is increasing. ML has been identified to threaten the national as well as the international security. Corruption of officials and legal systems are to be named as well as the undermining of free enterprises by crowding out the private sector. It also poses a threat to the financial stability of certain countries since the income gained by certain drug-trafficking organizations can easily exceed the budget available to the law enforcement and security services of emerging markets countries. In addition to the above, terrorism inflicts additional damage through the loss of life and economic after-effects inflicted by a terrorist attack.⁷⁸

In July 2010, the FATF published their 'Global Money Laundering & Terrorist Financing Threat Assessment' providing a much deeper assessment and a global view on the systemic threats and ultimate harms that both activities can pose.⁷⁹ This assessment reveals that the threats and harms can actually occur on individual and local level as well as on community and regional level and on national and international level. Another important point is that certain harms or threats are relating predominately to the predicate offence. Because ML cannot take place without the commitment of the predicate offence and terrorist attacks could not take place without financing, ML and TF can be regarded as the cause of the harms and

⁷⁸ Cf. (Bureau of International Narcotics and Law Enforcement Affairs, 2004), para. 1f.

⁷⁹ Cf. (Financial Action Task Force (e), 2010), p. 3.

threats.⁸⁰ The table in Annex I: Threats & Harms posed by Money Laundering & Terrorist Financing provides a detailed overview on the identified harms and threats and illustrates that the consequences go way beyond the damage of the underlying crimes and attacks. ML/TF posing threats in several areas of the global economic and social infrastructure as well as on people's personal well-being. Consequently, various actions are required on the different fronts to prevent ML/TF. One of the actions was to pass legislations on the financial industry to prevent ML and TF, which are presented in the next chapter.

4. The current European & Luxembourg Anti-Money Laundering & Counter-Terrorist Financing legal Framework

This section provides a summary of the current AML/CTF legislation applicable at European and Luxembourg level.

Luxembourg, being an EU member state, is obliged to transpose EU-Directives into national law and adopt EU Regulations as stay stand as national law.⁸¹ Hence, the national AML/CTF legislation is governed by the following EU-Directives and Regulations:⁸²

- 'Directive 2005/60/EC⁸³' (commonly known as the 3rd AML-Directive)
- 'Commission Directive 2006/70/EC⁸⁴' and
- 'Regulation (EC) No 1781/2006⁸⁵'

From the list above only the 'Regulation (EC) No 1781/2006' is directly applicable in Luxembourg. The two directives had to be transposed into national law, which was

⁸⁰ Cf. (Financial Action Task Force (e), 2010), p. 65.

⁸¹ Cf. (European Union, 2015), para. 8.

⁸² Cf. (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 7.

⁸³ DIRECTIVE 2005/60/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 October on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

⁸⁴ COMMISSION DIRECTIVE 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis.

⁸⁵ REGULATION (EC) No 1781/2006 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 November 2006 on information on the payer accompanying transfers of funds.

done by passing the ‘Law of 17 July 2008⁸⁶’, which amended inter alia the ‘Law of 12 November 2004⁸⁷’.⁸⁸

The ‘Law of 12 November 2004’, as amended is the cornerstone of the Luxembourg AML/CTF Regulation.⁸⁹ Since its passing, the ‘Law of 12 November 2004’ has been amended to include further AML/CTF requirements imposed by newly passed EU-Directives or by several national laws. A list of the laws can be retrieved in Annex II. Besides the ‘Law of 12 November 2004’ the following laws complete the AML/CTF framework of Luxembourg:⁹⁰

- ‘Grand-ducal Regulation of 1 February 2010⁹¹’ (coordinated version)
- ‘Law of 27 October 2010⁹²’
- ‘Grand-ducal Regulation of 29 October 2010⁹³’ (coordinated version)
- ‘CSSF Regulation No 12-02⁹⁴’
- ‘Commission Delegated Regulation (EU) 2016/1675⁹⁵’

⁸⁶ Law of 17 July 2008 - transposing Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

⁸⁷ Law of 12 November 2004 on the fight against money laundering and terrorist financing transposing Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering.

⁸⁸ Cf. (International Bar Association, 2015), para. 7.

⁸⁹ Cf. (PWC, 2016), p. 482.

⁹⁰ Cf. (CSSF Commission de Surveillance du Secteur Financier, 2016).

⁹¹ Grand-ducal Regulation of 1 February 2010 providing details on certain provisions of the amended law of 12 November 2004 on the fight against money laundering and terrorist financing.

⁹² Law of 27 October 2010 enhancing the anti-money laundering and counter terrorist financing legal framework; organising the controls of physical transport of cash entering, transiting through or leaving the Grand Duchy of Luxembourg; implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing.

⁹³ Grand-ducal regulation of 29 October 2010 enforcing the law of 27 October 2010 implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing.

⁹⁴ CSSF Regulation No 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing.

⁹⁵ COMMISSION DELEGATED REGULATION (EU) 2016/1675 of 14 July 2016 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council by identifying high-risk third countries with strategic deficiencies.

In addition to the above, the 'Directive (EU) 2015/849' will have to be transposed into national law no later than June 26th, 2017. On the same day, 'Regulation (EU) 2015/847⁹⁶' will enter into force in all EU Member States.⁹⁷

Since the national law transposing the 'Directive (EU) 2015/849' into local law is not yet available, this thesis and the risk analysis established later will only take the current legislation into account.

4.1. The legal Definitions of Money Laundering & Terrorist Financing in the European Union

At EU level the crimes, of ML and TF are described in the 'Directive 2005/60/EC':⁹⁸

"The following conduct, when committed intentionally, shall be regarded as money laundering:

- a) the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action;*
- b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity;*
- c) the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity;*
- d) participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing points.*

⁹⁶ REGULATION (EU) 2015/847 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006.

⁹⁷ Cf. (CSSF - Commission de Surveillance du Secteur Financier, 2016) & (PWC, 2016), p. 482.

⁹⁸ (EU DIRECTIVE 2005/60/EC, 2005), art. 1, number 2, 3.

3. Money laundering shall be regarded as such even where the activities which generated the property to be laundered were carried out in the territory of another Member State or in that of a third country.”

“‘terrorist financing’ means the provision or collection of funds, by any means, directly or indirectly, with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out any of the offences within the meaning of Articles 1 to 4 of Council Framework Decision 2002/475/JHA of 13 June 2002 on combating terrorism.”⁹⁹

The term ‘Criminal Activity’ is defined within the Directive as: “any kind of criminal involvement in the commission of a serious crime”¹⁰⁰ The meaning of ‘serious crimes’ according to the Directive shall be at least: ¹⁰¹

- a) acts as defined in Articles 1 to 4 of Framework Decision 2002/475/JHA;
- b) any of the offences defined in Article 3(1)(a) of the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances;
- c) the activities of criminal organisations as defined in Article 1 of Council Joint Action 98/733/JHA of 21 December 1998 on making it a criminal offence to participate in a criminal organisation in the Member States of the European Union;
- d) fraud, at least serious, as defined in Article 1(1) and Article 2 of the Convention on the Protection of the European Communities' Financial Interests;
- e) corruption;
- f) all offences which are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as regards those States which have a minimum threshold for offences in their legal system, all offences punishable by deprivation of liberty or a detention order for a minimum of more than six months.”

⁹⁹ (EU DIRECTIVE 2005/60/EC, 2005), art. 1, number 4.

¹⁰⁰ (EU DIRECTIVE 2005/60/EC, 2005), art. 3, number 4.

¹⁰¹ (EU DIRECTIVE 2005/60/EC, 2005), art. 3, number 5.

4.2. The legal Definitions of Money Laundering & Terrorist Financing in Luxembourg

The 'Law of 12 November 2004' provides the Luxembourg definitions for ML and TF.

*“Money laundering” shall, in accordance with this law, mean any action as defined in articles 506-1 of the penal code and 8-1 of the law of 19 February 1973, as amended, concerning the sale of medicinal substances and measures to combat drug addiction.*¹⁰²

The article 506-01 of the penal code is the first article of the 'Section V – Money Laundering offences'. This article starts by stating the penalty for the offence: The following are punishable by imprisonment of one to five years and a fine between EUR 1,250 and EUR 1,250,000, or only one of these penalties. Point (1) states that the penalties apply to those who knowingly facilitated by any means the false justification of the nature, origin, location, disposition, movement or ownership of the property referred to article 32(1), constituting directly or indirectly the object or proceeds followed by a list of the predicate offences. It further states in points 2-4 these penalties also applicable to those:¹⁰³

- who knowingly assisted in a placement, concealment, disguise, transfer or conversion of property referred to in article 32(1) forming directly or indirectly the object or proceeds of the offenses listed in point (1) or constituting any patrimonial advantage derived from one or more of these offenses
- who have acquired, held or used property referred to in article 32(1) forming directly or indirectly the object or proceeds of the listed offenses in point (1) of this article or constituting an advantage of any kind arising out of one or more of those offenses, knowing, at the time of their receipt, that the monies came from one or more of the offenses referred to in (1) or participation in one or more of these offenses
- who attempt to commit the offences specified in points (1) to (3)

The following Table 5: Examples of predicate Offences of Money Laundering in Luxembourg provides a brief overview on the predicate offences of ML in Luxembourg based on the article 506-1 of penal code and article 8 of 'Law of 19

¹⁰² (Law of 12 November 2004, 2015), art. 1.

¹⁰³ Cf. (Code Pénal, 2016), art. 506-1.

February 1973'. Table 5 is a non-exhaustive list and does not provide the legal details on each predicate offence.

Table 5: Examples of predicate Offences of Money Laundering in Luxembourg

Predicate Offences for Money Laundering in Luxembourg (penal code)		
Attacks on internationally protected persons	Participation in or formation of an organized crime group	Sexual exploitation, including the one of children / Prostitution
Terrorism including Financing terrorism	Illegal smuggling of migrants	An offense against the law on arms and ammunition
Abduction of minors	Trafficking in human beings	Counterfeiting currencies
Rape	Fraud & Deception	Corruption
Counterfeiting & piracy of products	Illicit trafficking in narcotic drugs & psychotropic substances	Copyright violations
Environmental crimes	Theft	Market abuse
Counterfeiting or falsifying the seals, stamps, stamps or marks either of any Luxembourg authority or of a legal person governed by public law or under Luxembourg law		
Any other offense punishable by deprivation of liberty for a minimum of or more than 6 months		

Source: Own elaboration based on (Code Pénal, 2016), art. 560-1.

To understand the extent of all predicate offences is essential to understand the ML risk to which a person or an entity might be exposed. A recent example is the decision of 12th Chamber of the District Court of Luxembourg, No 1981/2016, June 29th, 2016 on the so-called 'Lux leaks case'. The main focus of the case was whether the former PwC employees would be eligible to the protection offered by article 10 of the European Convention on Human Rights (more specifically, the right to receive information) to whistle-blowers. But two of the defendants were found guilty inter alia of the offence of ML, in this case Auto-Laundering. The court's decision is based on the fact that the employees possessed the documents, which have been obtained through theft and considered this as a case of self-laundering.¹⁰⁴

¹⁰⁴ Cf. (Allen & Overy, 2016), p. 11f.

*“Terrorist financing” shall, in accordance with this law, mean any action as defined in Article 135-5 of the Penal Code.”*¹⁰⁵ The article describes the offence as follows:

It is an act of TF to provide or collect by any means, directly or indirectly, illicitly and deliberately, funds, securities or property of any kind for or used in whole or in part for the purpose of committing or attempting to commit one or more of the offenses referred to in paragraph (2) of this article. Even though not directly used to commit or in the attempt of committing any of these offences or not related to one or more specific terrorist acts.¹⁰⁶

It is also an act of TF to provide or collect by any means, directly or indirectly, illicitly and deliberately, funds, securities or property of any kind with the intention of using or knowing that the funds will be used, in whole or in part, by a terrorist or a terrorist group. This also includes the absence of any link with one or more specific terrorist acts.¹⁰⁷

The understanding of the legal definition of TF is of high importance to detect the risks of TF originating from a fund structure, a client, service or product. In addition to the definitions of ML/TF the local regulatory framework provides the obligations applicable to all actors on the market subject to the Luxembourg AML Regime in order to fight ML/TF.

4.3. Legal Obligations in the Fight against Money Laundering & Terrorist Financing in Luxembourg

The obligations to be followed in the fight against ML/TF, set out by government and the CSSF, are applicable to the participants of local fund industry being a part of the financial market. Further to the obligations, the law also provides instructions on how to execute these obligations and risk factors which must be considered. This chapter provides an overview on the legal obligations.

In order to fight ML and TF Luxembourg has adapted a risk-based approach. This approach is laid down in the ‘Law of 12 November 2004’. It allows professionals to determine suitable measures according to their risk exposure identified for their

¹⁰⁵ (Law of 12 November 2004, 2015), art. 2.

¹⁰⁶ Cf. (Code Pénal , 2016), art. 135-5, number 1.

¹⁰⁷ Cf. (Code Pénal , 2016), art. 135-5, number 3.

business activities when performing due diligence on their customers. The aim is to focus the collection of information of the customer in the areas where it is really needed according to the customer activities.¹⁰⁸

The following paragraphs of this chapter provides the main articles laying down the requirements, highlighting the most important sections. The legal obligation to implement a risk-based approach and to document the outcome is laid down in art. 3(3) of 'Law of 12 November 2004'.¹⁰⁹

“Professionals are required to perform an analysis of the risks inherent to their business activities. They must set down in writing the findings of this analysis.”

This legal obligation is complemented and further specified by 'CSSF Regulation No 12-02'.

*“(...) professionals shall identify and assess the money laundering and terrorist financing risks to which they are exposed. The nature and scope of this risk assessment shall be adapted to the nature and volume of their business.”*¹¹⁰

“This risk assessment also includes the identification and assessment of money laundering or terrorist financing risks which may arise in relation to (i) the development of new products and new business practices, including new delivery mechanisms, and (ii) the use of new or developing technologies for both new and pre-existing products.

*This risk assessment shall take place prior to the launch of new products, business practices or the use of new or developing technologies.”*¹¹¹

The specifications of the CSSF regulation illustrate that the risks to which a participant of the financial sector is exposed might be very different due to their business activities. Subsequently, the outcome of each risk analysis of a market participant will be different.

¹⁰⁸ Cf. (Debroise, 2015), para. 21.

¹⁰⁹ (Law of 12 November 2004, 2015), art. 3(3).

¹¹⁰ (CSSF 12-02, 2012), art. 4(1).

¹¹¹ (CSSF 12-02, 2012), art. 4(2).

The obligations for the customer due diligence to be performed on each customer are also set out in art. 3(3) of the 'Law of 12 November 2004', but also depending on the inherent risk assessment.

“Professionals shall apply (...) customer due diligence measures (...), but may determine the extent of such measures on a risk-sensitive basis depending on

- *the type of customer,*
- *business relationship,*
- *product or transaction.*

Professionals shall be able to demonstrate that the extent of the measures is appropriate in view of the risks of money laundering and terrorist financing.”¹¹²

Whereby the term 'Business Relationship' means according to the law the following:¹¹³

“(...) a business, professional or commercial relationship which is connected with the professional activities of the institutions and persons covered by this law and which is expected, at the time when the contact is established, to have an element of duration.”

This article of the 'Law of 12 November 2004' provides the main risk categories for the market participant's assessment of its customers. Again the 'CSSF Regulation No 12-02' provides further details.

“(...) the professionals shall categorise all their customers according to the different risk levels with regard to money laundering and terrorist financing. Besides the cases where the risk level shall be considered as high pursuant to the Law or the Grand-ducal regulation, this level shall be assessed according to a consistent combination of risk factors defined by each professional according to the activity exercised and inherent to the following risk categories:

- *customers;*
- *countries or geographic areas;*

¹¹² (Law of 12 November 2004, 2015), art. 3(3).

¹¹³ (Law of 12 November 2004, 2015), art. 1(13).

- *products, services, transactions or delivery channels and marketing arrangements.” 114*

To be able to understand the specific risk that each customer presents in terms of ML/TF, the professional is further required to establish risk variables under each risk category.

“When assessing the risk level, the professionals shall take into account the risk variables relating to the above-mentioned risk categories. These variables, either singly or in combination, may increase or decrease the potential risk of money laundering or terrorist financing. Examples of such variables include:

- *the purpose of an account or business relationship;*
- *the level of assets to be deposited by a customer or the size of expected or undertaken transactions;*
- *the regularity or duration of the business relationship.” 115*

A risk factor or also referred to as a risk variable is defined as a variable that, either on its own or in combination with one or several other variables, may increase or decrease the ML/TF risk posed by an individual business relationship or occasional transaction.¹¹⁶

The regulatory framework points out in various articles examples for risk variables to be taken into account by the market participant.

“(…) the obligation to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent economic or lawful purpose. Special attention shall notably be paid to: significant transactions relative to a business relationship, transactions that exceed certain limits, very high account turnover inconsistent with the size of the balance, or transactions which fall out of the regular pattern of the account's activity”¹¹⁷

“Professionals shall pay special attention to any activity which they regard as particularly likely, by its nature, to be related to money laundering or terrorist financing and in particular complex or unusually large transactions and all

¹¹⁴ (CSSF 12-02, 2012), art. 5(1).

¹¹⁵ (CSSF 12-02, 2012), art. 5(2).

¹¹⁶ Cf. (Joint Committee of the European Supervisory Authorities, 2015), p. 11.

¹¹⁷ (Grand-ducal Regulation of 1 February 2010, 2015), art. 1(3).

unusual patterns of transactions which have no apparent economic or visible lawful purpose.”¹¹⁸

“(…), the professionals shall identify complex or unusual transactions (…) by taking into account, notably:

- *the importance of the incoming and outgoing assets and the volume of the amounts involved. The transactions which involve small amounts but which are unusually frequent are also concerned;*
- *the differences compared to the nature, volume or frequency of the transactions usually carried out by the customer in the framework of the business relationship concerned or the existence of differences compared to the nature, volume or frequency of the transactions normally carried out in the framework of similar business relationships;*
- *the differences compared to the declarations made by the customer during the acceptance procedure and which concern the purpose and nature of the business relationship, in particular, as regards the origin and destination of the funds involved.”¹¹⁹*

In addition two measures are always required when performing Customer Due Diligence (CDD).

1. *“identifying the customer and verifying the customer’s identity on the basis of documents, data or information obtained from a reliable and independent source”¹²⁰ and*
2. *“identifying, where applicable, the beneficial owner and taking “reasonable measures” to verify his identity so that the professional is satisfied that it knows who the beneficial owner is, including, as regards legal persons, trusts and similar legal arrangements, taking “reasonable measures” to understand the ownership and control structure of the customer”¹²¹*

When establishing a risk assessment, art. 5(3) of the ‘CSSF Regulation No 12-02’ sets an exception to the risk categorization of each customer. The regulation refers to cases already identified by the regulatory framework posing under any circumstances a higher or high risk exposure.¹²² As examples, the subscription of

¹¹⁸ (Law of 12 November 2004, 2015), art. 3(7).

¹¹⁹ (CSSF 12-02, 2012), art. 32.

¹²⁰ (Law of 12 November 2004, 2015), art. 3(2)(a).

¹²¹ (Law of 12 November 2004, 2015), art. 3(2)(b).

¹²² Cf. (CSSF 12-02, 2012), art. 5(3).

shares or units in an investment vehicle through an intermediary¹²³, cross-border correspondent banking¹²⁴ and similar relationships¹²⁵, relationships with politically exposed persons (PEP)¹²⁶ or business relationships with entities situated in countries or territories which do not or insufficiently apply AML/CTF measures¹²⁷ can be named. In addition, the professionals must be in the position to demonstrate that the extent of measures defined in the customer risk assessment for the customer risk classification are appropriate in view of the risk exposure to ML/TF of the professional.¹²⁸

The focus of the '4th AML-Directive', which enters into force on June 26th, 2017, is to put the European AML Legislation in line with the '2012 International Standards of the FATF' and to establish a common understanding of the risk-based approach throughout Europe. In this context, on October 21st, 2015, the ESA has issued a joint consultation paper: 'The Risk Factors Guidelines' to provide the European Financial Market participations assistance with the establishment of their risk assessment as well as examples for risk factors. The guidelines are divided into two parts. The first part, Title II, is generic and provides risk factors to be applied by all financial firms. The second part, Title III, relates to specific risk factors for different sectors of the financial industry divided into nine chapters where chapter 8 concerns investment managers and chapter 9 providers of investment funds.¹²⁹

The full, but not exhaustive list of generic risk factors in the different categories as well as the specific ones for investment manager and fund services providers can be reviewed in Annex III: Risk Factors according to European Supervisory Authorities Risk Factor Guidelines. As the translation of the '4th AML-Directive' into local law is not yet published a comparison cannot be performed at this point of time. The assessment which can currently be performed is that 'The Risk Factors Guidelines' published are more detailed with regard to the different financial areas and more exhaustive in their listing.

Having provided the legal background and the legal definitions of ML and TF, the next chapter introduces the Luxembourg Fund Market in terms of figures and

¹²³ Cf. (CSSF 12-02, 2012), art. 3.

¹²⁴ Cf. (CSSF 12-02, 2012), art. 28.

¹²⁵ Cf. (CSSF 12-02, 2012), art. 29.

¹²⁶ Cf. (CSSF 12-02, 2012), art. 30.

¹²⁷ Cf. (CSSF 12-02, 2012), art. 31.

¹²⁸ Cf. (Law of 12 November 2004, 2015), art. 3(3).

¹²⁹ Cf. (Joint Committee of the European Supervisory Authorities, 2015), p. 2ff.

numbers, investment funds in general and the Luxembourg Fund Structures. Furthermore, the concept of UCITS and alternative investment funds as well as the involved parties of a fund structure are presented.

5. The Luxembourg Fund Market & local Investment Fund Vehicles

In the previous chapter all the different aspects of ML and TF were highlighted. The aim of this chapter is to provide a general overview on the Luxembourg Investment Fund Market, an investment fund in general and the Luxembourg Investment Vehicles. At first, a general introduction including figures and statistics on the local fund market is provided. Afterwards, the concept of an investment fund is introduced. Followed by the presentation of Luxembourg Fund Vehicles including their specific legal requirements. The last section of this chapter will introduce the different participants of an investment fund including their roles, duties and responsibilities within the fund structure. It is vital to have an understanding of the Luxembourg Fund Market, its vehicles and its extent regarding the later analysis of the risk assessment.

5.1. The Luxembourg Fund Market

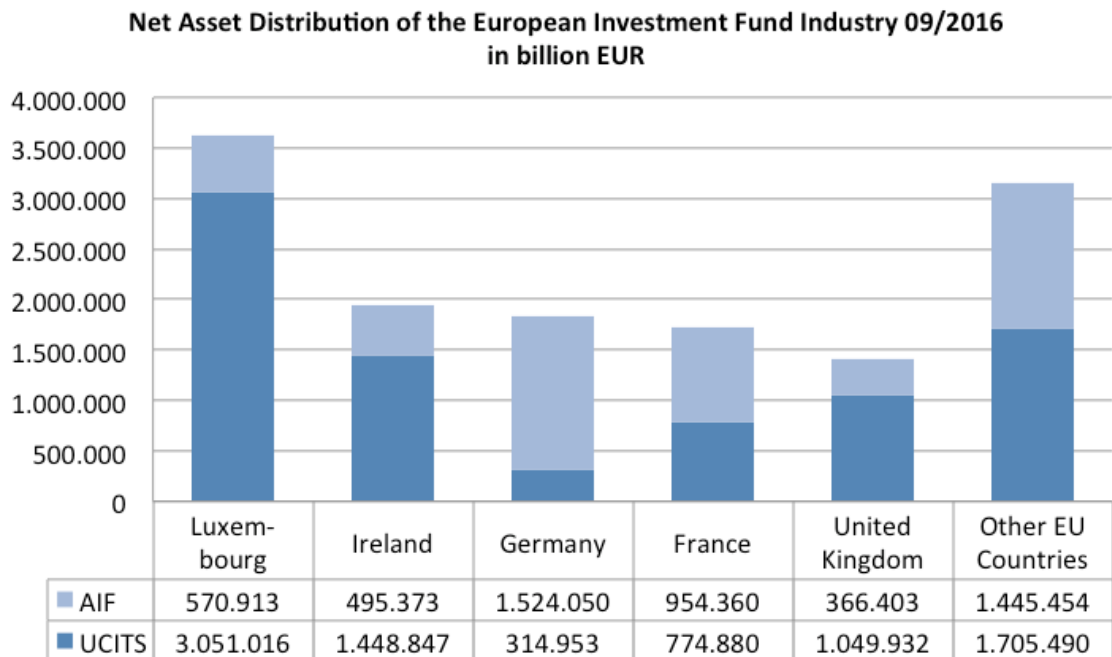
In October 2016, the Net Assets under Management in Luxembourg's Investment Funds accounted for EUR 3.626.498 billion. This represented a growth rate of 3.22% over the past 12 month.¹³⁰ This is an increase of 0.13% compared to the September figure of EUR 3.621,929 billion assets under management.¹³¹ These figures make Luxembourg the leading European Investment Fund Center and the second biggest one worldwide after the U.S.¹³² To illustrate the importance of the Luxembourg Fund Sector the following Figure 5: Net Asset Distribution of European Investment Funds by Country & Funds Type provides an overview on the net asset distribution of European Investment Funds by country, divided into Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) per September 2016. The differences will be explained later in the thesis.

¹³⁰ Cf. (ALFI - Association of the Luxembourg Fund Industry (c), 2017), table 1.

¹³¹ Cf. (ALFI - Association of the Luxembourg Fund Industry (d), 2017), para. 1.

¹³² Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre(b)), para. 1.

Figure 5: Net Asset Distribution of European Investment Funds by Country & Funds Type



Source: Own elaboration based on (Delbecque & Carroll, Efama - Quarterly Statistical Release, 2016), pp. 6 & 11.

The figures above clearly state the importance of Luxembourg as a fund and a financial center. The sum of assets under management is mentioned to illustrate the volume and importance of the local fund market. The more assets under management the more financial transactions moving money will be created in the financial market and the higher will be the market's inherent risk exposure. Unfortunately no statistics on the transactions and their volume concerning the Luxembourg Fund Market are available publicly.

The attractiveness of Luxembourg for the fund industry can be explained by the following reasons:¹³³

- political and social stability and strong economy,
- stable legal and tax environment,
- attractive range of fund solutions including tax efficiency for products achievable through direct and indirect taxation at investor and fund level,

¹³³ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre(a)), para. 2f; (ALFI - Association of the Luxembourg Fund Industry (e), 2013), p. 4f & (EY, 2016), p. 6.

- innovation in financial product such as umbrella funds with several compartments being on legal structure, but with different asset classes per compartment,
- international orientation including a multilingual and multicultural workforce,
- modern and competitive legal and regulatory framework for all types of investment funds,
- the financial infrastructure,
- the unique concentration of expertise in investment funds knowledge through the all services within the fund sector,
- the access to the European passport for UCITS and the existing expertise for cross boarder distribution funds,
- strong investor protection,
- a sound AML regulation.

In addition, to the above the local investment fund tax regime is very attractive. The only tax applicable, except for the Société d'Investissement en capital à Risque / Risk capital investment company (SICAR) structure, is the annual subscription tax, the 'taxe d'abonnement'.¹³⁴ Depending on the fund structure and specific conditions applicable for certain setups the tax differs between 0.05% and 0.01% of the Net Asset Value (NAV).¹³⁵ Furthermore, all Luxembourg Fund Structures are not subject to net wealth tax and dividends received, capital gains realized and other income obtained are generally not taxable unless in a SICAR structure under certain conditions.¹³⁶ The previous brief overview on taxation was given, as low tax rates might be interesting for criminals who want to invest their laundered funds.

After having obtained an overview on the fund market, the next section provides a general introduction on investment funds.

¹³⁴ Cf. (PwC - PricewaterhouseCoopers, 2015), p. 59.

¹³⁵ Cf. (KPMG, 2016), p. 26f.

¹³⁶ Cf. (PwC - PricewaterhouseCoopers, 2015), p. 59.

5.2. Investment Funds in general

In general, an investment fund also referred to as an UCI can be characterized as follows: it is a vehicle that raises money from a number of different and unrelated investors with the objective to undertake collective investments. The capital raised from the investors is distributed to several investments according to the previously defined investment policy of the vehicle to the benefit of the investors. Generally, the principle of risk spreading is applied when selecting the investments. The number of investors, who are the shareholders of the funds, is not fixed. Shares or Units can be distributed publically or being reserved for a certain kind of specific investors, such as (well-) informed, qualified or institutional investors. Units can be distributed through private placement, direct distribution, distributors or being traded on a stock exchange. The lifespan of a UCI is either defined as a fixed period at setup or as open-ended depending on the structure. The investments/portfolio ranges from transferrable securities and/or other assets e.g. real estate and private equity to such specific assets as vintage wines, paintings or copyrights to name some very exotic ones. The fund can aim at generating income to distribute it to its investors or at maximizing the capital value of its investments.¹³⁷ The following Table 6: UCIs according to Key Characteristics provides an overview on the key characteristics of different funds in terms of investments, investor and investment recommendation.

¹³⁷ Cf. (ALFI - Association of the Luxembourg Fund Industry (b), 2012) para. 1f & (EY, 2016), p. 5.

Table 6: UCIs according to Key Characteristics

Fund Type	Typical Asset Classes	Typical Investor Profile	Investment Horizon
Equity	Shares/stocks	Retail Investors High Net Worth Individuals Institutional (e.g. pension funds and insurers)	medium to long-term
Fixed income: Money market	High quality short-term money market instruments and deposits with credit institutions		short to medium-term
Fixed income: Bonds	Longer term fixed income securities (e.g. government bonds, corporate bonds, convertible bonds, mortgage backed securities)		medium to long-term
Mixed	Mixture of instruments (e.g. equity and fixed income securities)		medium to long-term
Exchange traded	Exposures to baskets of equity, fixed income or other securities or commodities tracking an underlying index		short to long-term
Hedge funds	Wide range of financial instruments (e.g. equities, fixed income securities, financial derivative instruments such as options, futures, swaps, contracts for differences, etc), securities lending and borrowing,	High Net Worth Individuals Institutional (e.g. pension funds and insurers)	medium to long-term
Real estate	Property assets or structures holding property assets		long-term
Infrastructure	Development infrastructure (e.g. new transport or utility infrastructure), operational infrastructure (e.g. operating motorways), infrastructure technology (e.g. water treatment)		long-term
Private equity	Equity, debt or other exposures to non-listed companies		long-term
Thematic	Exposures to investments with a specific theme such as responsible investment, specific segments such as healthcare, collectible goods and intangibles		long-term

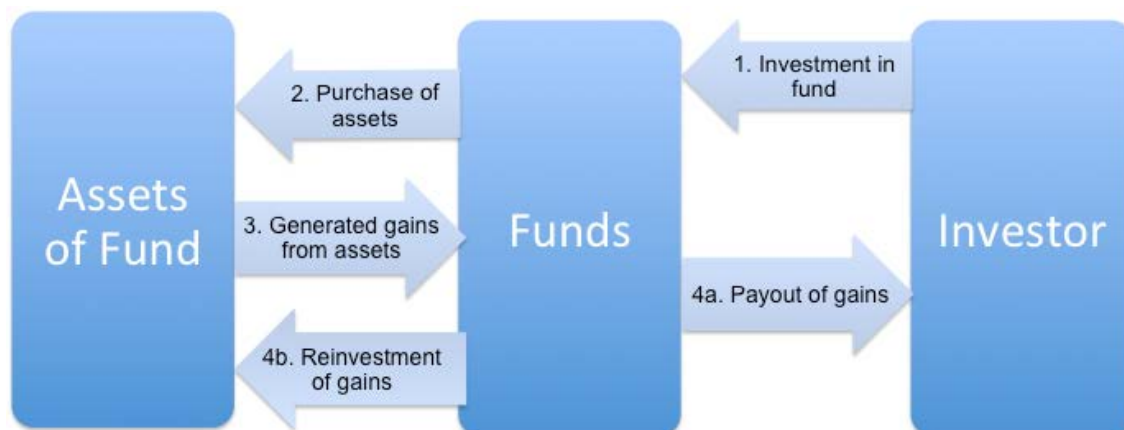
Source: Own elaboration based on (EY, 2015), p. 385.

From an investor perspective a fund is regarded as a financial intermediary collecting funds from all investors, who want to invest according to the investment policy of the fund. The investors pay their money to the fund. In return units/shares of the fund according to the participation rate in the fund's assets are received. The Investment-/Fund- Manager invests the money into various assets selected. The returns on investment are paid back to the investors.¹³⁸ Figure 6: Main Cash Flows within a Fund Structure explains the main cash flows within an investment fund. The understanding of these cash flows is essential to perform a risk assessment. The

¹³⁸ Cf. (Steiner, 2010), p. 38f.

figure does not illustrate all cash flows within a fund, the ones for paying fees, taxes or other expenses are not presented.

Figure 6: Main Cash Flows within a Fund Structure



Source: Own elaboration based on (BVI Bundesverband Investment und Asset Management e.V. BVI – Deutscher Fondsverband, 2014), p. 6.

The previous section provided a general overview on the structure and the cash flows of an investment fund. The next section explains the Luxembourg Fund Structures in more detail.

5.3. The Luxembourg Fund Vehicles

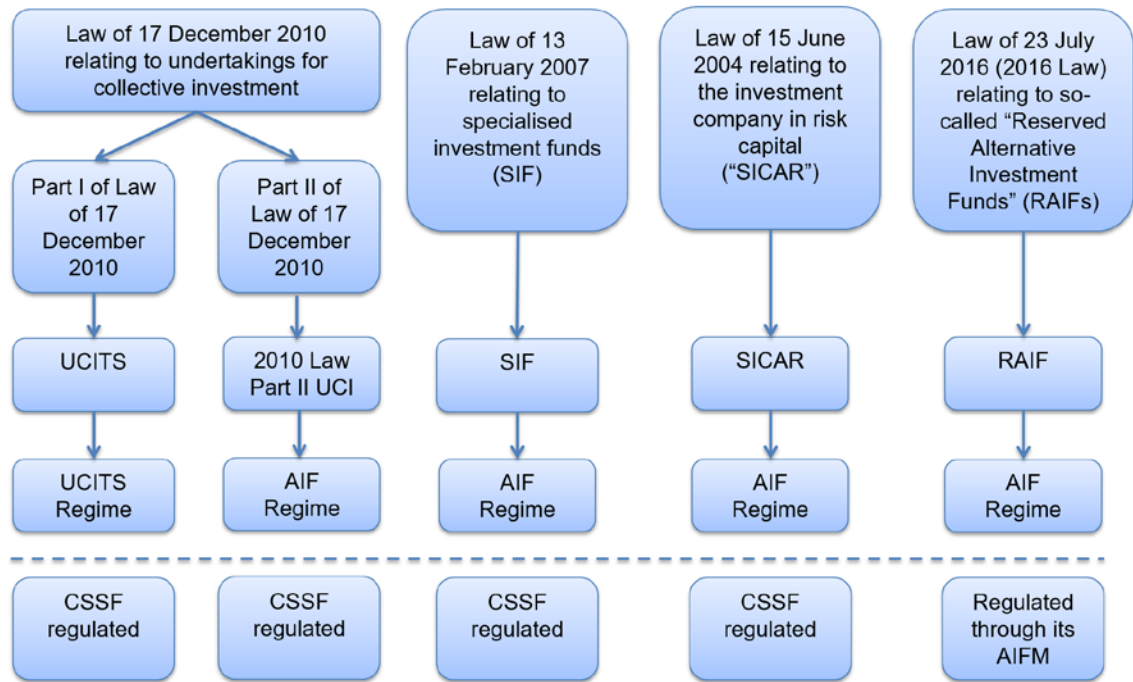
There is a wide range of different structures for UCIs in Luxembourg, which are subject to different laws and therefore different levels of regulation. The choice, under which law the vehicle is established depends mainly on the investment strategy and the type of the investors that are targeted by the marketing strategy. The two main UCI categories are the UCITS, the Undertakings for Collective Investment in Transferable Securities, which comply with the 'Directive 2014/91/EU¹³⁹', and the AIFs. The AIFs covers all other types of funds such as, real estate, venture capital and private equity funds as well as hedge funds.¹⁴⁰ The legal framework is provided

¹³⁹ DIRECTIVE 2014/91/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

¹⁴⁰ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (b), para. 1f.

in different laws for the different product regimes and is illustrated in the following Figure 7. In addition, Figure 7 refers to the common name of the UCI and the common name of the fund regime to which the vehicle belongs. Below the line the figure states to which kind of regulatory supervision the fund is subject to.

Figure 7: Fund Regimes in Luxembourg



Source: Own elaboration based on (EY, 2016), p. 9f.

The Reserved Alternative Investment Fund (RAIF) is mentioned but not taken into consideration for this thesis. This is due to the fact that the RAIF was only introduced by the 'Law of 23 July 2016¹⁴¹' and is therefore a fairly new fund structure. General market experience as well as figures and statistics for this fund structure are not available yet.

¹⁴¹ Law of 23 July 2016 on Reserved Alternative Investment Funds.

There are three legal vehicle structures available that can be used for any fund incorporated under the 'Law of 17 December 2010'¹⁴² and the 'Law of 13 February 2007'¹⁴³, commonly referred to as the SIF-Law.¹⁴⁴

The first one is the Fonds Commun de Placement (FCP) also known as Common Investment Fund, which is a contractual structure similar to separate assets (Sondervermögen) in Germany. Being a contractual legal structure and therefore having no legal personality it needs to be managed by a Management Company (ManCo).¹⁴⁵

The second is the Société d'Investissement à Capital variable (SICAV) commonly known as an Investment Company with variable Capital. This means that the share capital of the company matches at any time the value of the fund's total assets. Consequently, the investment fund shares do not state a value.¹⁴⁶ It is open-ended and requires no formalities to increase or decrease its share capital.¹⁴⁷

The third vehicle structure is the Société d'investissement à Capital fixe (SICAF) or referred to as Investment Company with fixed Capital.¹⁴⁸ That means that an increase in capital can only be made by the shareholders. It can be set up as an open- or closed-ended structure. Changes to the SICAF's authorized capital must be notified and published. A SICAF can also repurchase its own shares.¹⁴⁹

Both the SICAV as well as the SICAF are legal entities. Subsequently, the vehicles can either be self-managed or appoint a ManCo to manage their assets. Neither an externally managed nor a self-managed vehicle is allowed to manage any other assets but its own.¹⁵⁰ The company purpose is the management of the funds or company assets according to the principle of risk spreading.¹⁵¹

Even though SICAV or SICAF vehicles can be set up under three laws, the choice of the underlying corporate entity is for some vehicle types limited by law. In contrary,

¹⁴² Law of 17 December 2010 relating to undertakings for collective investment: – transposing Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

¹⁴³ Law of 13 February 2007 relating to specialised investment funds.

¹⁴⁴ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 4.

¹⁴⁵ Cf. (DZ PRIVATBANK S.A., 2017), para. 4.

¹⁴⁶ Cf. (LCG International AG, 2013), p. 3.

¹⁴⁷ Cf. (SEI Global Asset Management, 2012), p. 1.

¹⁴⁸ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre(b)), para. 3.

¹⁴⁹ Cf. (SEI Global Asset Management, 2012), p. 1.

¹⁵⁰ Cf. (LCG International AG, 2013), p. 3.

¹⁵¹ Cf. (DZ PRIVATBANK S.A. , 2017), para. 4.

the SICAR is already a vehicle structure and consequently only needs to decide upon the underlying cooperate entity and cannot be established in a contractual form. Under the SICAR-Law there are no limitations in terms of the underlying company structures to choose from.¹⁵² The following Table 7: Corporate Entity Structures under the different Fund Laws provides an overview on the possibilities.

Table 7: Corporate Entity Structures under the different Fund Laws

Company forms (Official Abbreviation English Name / French Name)	SICAV UCITS / Part I	SICAF UCITS / Part I	SICAV UCI / Part II	SICAF UCI / Part II	SICAV /SIF	SICAF /SIF	SICAR
S.A. Public Limited Company Société Anonyme	✓	✓	✓	✓	✓	✓	✓
S.E. European Company / Société Européenne	✓	✓	✓	✓	✓	✓	✓
S.C.A. Partnership Limited by shares / Société en commandite par actions	✗	✓	✗	✓	✓	✓	✓
S.à r.l. Limited Liability Company / Société à responsabilité limitée	✗	✓	✗	✓	✓	✓	✓
S.C.S. Limited Partnership / Société en commandite	✗	✗	✗	✓	✓	✓	✓
S.C.Sp. Special Limited Partnership / Société en commandite spéciale	✗	✗	✗	✓	✓	✓	✓
S.Co.S.A. Co-operative in the form of a Public Limited Company / Coopérative sous la forme de la société anonyme	✗	✓	✗	✓	✓	✓	✓

Source: Own elaboration based on (EY, 2016), p. 32 & (KPMG, 2016), p. 6f.

The corporate entity also lays down the minimum capital requirements and other minimum requirements that are linked to the underlying company form chosen to establish an investment fund in Luxembourg. The Table 8: Overview of Corporate Entity Setup Requirements provides an overview on the most important requirements related to setting up a corporate entity.

¹⁵² Cf. (KPMG, 2016), p. 6f & (EY, 2016), p. 32.

Table 8: Overview of Corporate Entity Setup Requirements

	S.A.	S.E.	S.à r.l.	S.C.A.	S.C.S.p	S.C.S.	S.Co.S.A.
Minimum subscribed share capital	31,000€	120,000€	12,500€	31,000€	None	None	None
Notarial deed required	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Legal Entity	Yes	Yes	Yes	Yes	No	Yes	Yes
Listing possible	Yes	Yes	No	Yes	No	No	No
Minimum Number of shareholders/partners/members	1	1	1	2 partners (1 general / 1 limited)	2 partners (1 general / 1 limited)	2 partners (1 general / 1 limited)	
Maximum Number of shareholders/partners/members	Unlimited	Unlimited	100	Unlimited	Unlimited	Unlimited	Unlimited
Transferability of shares	Free, subject to restriction in articles of incorporation		Restricted	Free, subject to restriction in articles of incorporation		Requires unanimous consent of all partners	Not transferable to third parties
Minimum numbers of Directors or mangers	One-tier: 3 Directors Two tier: 2 members of Management and 3 ones of supervisory Board		3 mangers	3 Mangers or a general partner whose Board is composed of at least three member			3 Directors

Source: Own elaboration based on (EY, 2016), p. 32.

In addition to the minimum subscribed share capital of the corporate entity if required, there is minimum capital base that the vehicle must reach within six month for a UCITS or UCI Part II and twelve month for a SIF or a SICAR following its authorization. This minimum amount of net assets is for a FCP and a SICAV/SICAF at least EUR 1,250,000. Furthermore a self-managed SICAV/SICAF must have a capital base of EUR 300,000 on the date of authorization.¹⁵³

The above-mentioned vehicles can either be established as stand-alone funds, having a single investment portfolio or can be setup as multi compartment funds also known as umbrella funds. Within an umbrella structure separate compartments or sub-funds can be structured under the roof a single structure, whereby every sub-funds functions as an independent entity. For each sub-fund, a particular investment policy, targeted distribution markets and/or investor profiles can be determined. In addition, each fund/ sub-fund can issue different share classes. These classes differ

¹⁵³ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (d), 2015), p. 1.

e.g. in the setup of commissions or enable the fund to tailor its shares to specific needs of certain markets or for particular investor demands.¹⁵⁴

The choice of the investment policy and the targeted investor base will determine if the fund will be considered as a UCITS or an AIF. The two fund concepts will be described in the next sections.

With reference to Figure 5: Net Asset Distribution of European Investment Funds by Country & Funds Type, it becomes clear that the Luxembourg Fund Market is dominated by the UCITS structures. UCITS constitutes 84.21% of the market share in terms of the total assets under management compared to a 15.79% market share of alternative funds as of November 2016.¹⁵⁵ Under the UCITS regime 1,888 investment funds are incorporated,¹⁵⁶ being subdivided into 9.792 sub-funds.¹⁵⁷ The number of AIFs accounts to 2000 from which 355 are incorporated under the Part II-Law and 1.645 under the SIF-Law.¹⁵⁸ The Part II-Funds have 946 sub-funds while the SIF-Funds are sub-divided into 3.494 ones.¹⁵⁹

5.3.1. UCITS

This chapter provides an overview of the UCITS-Funds in Luxembourg. In particular possible investments, eligible investors and distribution possibilities are illustrated.

All investment funds set up as a UCITS-Fund are incorporated under the 'Law of 17 December 2010'. This law implemented the concept of the 'Directive 2009/65/EC'¹⁶⁰,¹⁶¹ the latest amendment being 'Directive 2014/91/EU' known as UCITS V.¹⁶² The Directive sets out a single European Regulatory Regime for open-ended funds investing in transferable securities. It aims at providing the highest level of investor protection through regulating the organization, the management and

¹⁵⁴ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre(b)), para. 5f.

¹⁵⁵ Cf. (CSSF - Commission de Surveillance du Secteur Financier (b)), picture 2.

¹⁵⁶ Cf. (CSSF - Commission de Surveillance du Secteur Financier (c), 2017), p. 3.

¹⁵⁷ Cf. (CSSF - Commission de Surveillance du Secteur Financier (d)), table 2.

¹⁵⁸ Cf. (CSSF - Commission de Surveillance du Secteur Financier (c), 2017), p. 3.

¹⁵⁹ Cf. (CSSF - Commission de Surveillance du Secteur Financier (d)), table 2.

¹⁶⁰ DIRECTIVE 2009/65/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

¹⁶¹ Cf. (ALFI - Association of the Luxembourg Fund Industry (f), 2017), para. 1.

¹⁶² Cf. (HM Treasury, 2016), para 7.

oversight of these investment funds. It provides the rules to be followed in terms of diversification, liquidity and the use of leverage.¹⁶³

The UCITS-Funds are also often referred to as traditional investment funds and include equity and bond funds, money market funds as well as mixed funds.¹⁶⁴ Due to the high investor protection the assets that are eligible as investments are limited to:¹⁶⁵

- Transferable securities and money market instruments admitted to or dealt on a regulated market.
- Units of UCITS authorized according to 'Directive 2009/65/EC' and/or other UCIs within the meaning of article 1(2)(a) and (b) of 'Directive 2009/65/EC' if meeting certain conditions.
- Deposits with credit institutions, which are repayable on demand and maturing in no more than 12 months, if the credit institution is equivalently regulated according to EU regulation.
- Financial derivative instruments, including equivalent cash-settled instruments, dealt on a regulated market and/or financial derivative instruments dealt in over the counter transactions under certain further conditions.
- Money market instruments other than those dealt in on a regulated market and which fall under article 1 of the 'Law of 17 December 2010' under certain further conditions.

In the financial language the above assets are referred to as eligible assets including, e.g. money-market instruments, bonds, shares and any other instruments offering the right to acquire these securities through subscription or exchange, as well as other funds and bank deposits.¹⁶⁶

In addition to the above, there are other investments that are excluded from the investment fund's portfolio of UCITS. A UCITS-Fund is not allowed to acquire any kind of precious metals or certificates representing them. Furthermore, the investment portfolio is not allowed to be made up by more than 10% of assets in

¹⁶³ Cf. (ALFI - Association of the Luxembourg Fund Industry (f), 2017), para. 1.

¹⁶⁴ Cf. (EY, 2016), p. 17.

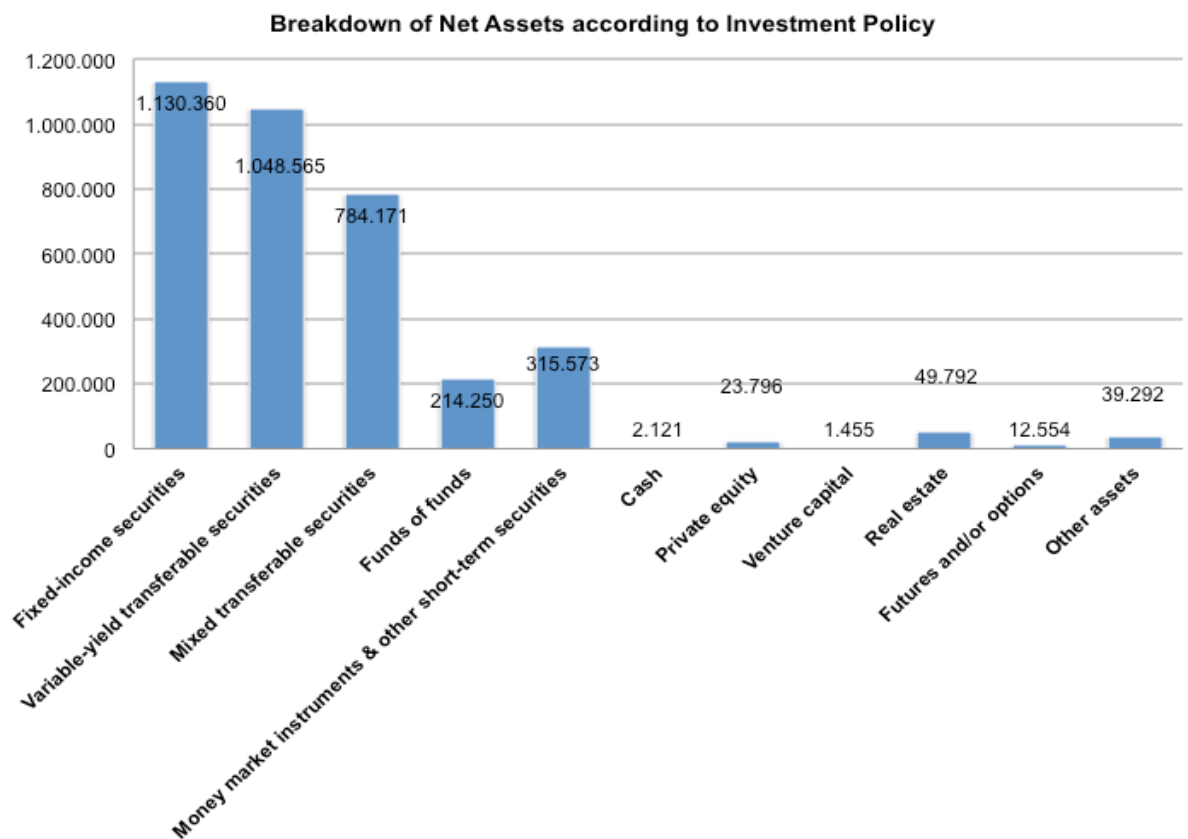
¹⁶⁵ Cf. (Law of 17 December 2010, 2016), art. 41 (1).

¹⁶⁶ Cf. (ALFI - Association of the Luxembourg Fund Industry (g), 2012), para. 4.

transferable securities or money market instruments other than those referred to in paragraph 41 (1) of the 'Law of 17 December 2010'.¹⁶⁷

The following Figure 8 provides an overview of the asset allocation per investment policies of the different funds. It also includes investment policies of AIFs, which are addressed later in the thesis.

Figure 8: Breakdown of Net Assets according to Investment Policy



Source: Own elaboration based on (CSSF - Commission de Surveillance du Secteur Financier (d)), table 1.

Within each general investment policy, the specific asset allocation for each fund or sub-fund is laid down in the fund's prospectus.¹⁶⁸ It must be in line with the diversification requirements for investment portfolios according to the risk management standards outlined in articles 42-51 of the 'Law of 17 December

¹⁶⁷ Cf. (Law of 17 December 2010, 2016), art. 41 (2).

¹⁶⁸ Cf. (ALFI - Association of the Luxembourg Fund Industry (g), 2012), para. 4.

2010'.¹⁶⁹ The risk spreading within a UCITS is high due to the high level of investor protection. The most commonly known rule, in addition to many others, is the 5/10/40 rule.¹⁷⁰

“The general “5/10/40” rule requiring that no more than 10% of a UCITS net assets may be invested in transferable securities or money market instruments issued by the same body, with a further aggregate limitation of 40% of net assets on exposures of greater than 5% to single issuers.”¹⁷¹

Another important rule is that the investments in other funds must be less than 20% of the fund's portfolio. Out of those 20%, no more than 30% can be invested in Non-UCITS-Funds. UCITS are not allowed to invest in other funds either, which in turn hold more than 25% of their assets in other funds.¹⁷²

Other rules relate to unlisted securities, control rules (of issuing bodies), index-tracking funds, government securities, cash deposits, investment in other open-ended collective investment schemes, borrowing, derivatives as well as the global risk exposure.¹⁷³

In addition, there are liquidity requirements so that an investor can sell or buy shares without delay. The sale or purchase of shares is performed without knowing the exact price. The price is calculated after the deal has been placed. The price of a share is established by using the latest official market closing prices to value publicly traded securities or by providing a fair market value. These valuation requirements shall prevent market timing, late trading and/or other practices that can affect the value of a fund.¹⁷⁴

In terms of risk management and oversight, and safekeeping, there are additional requirements such as the independency of the risk management function from the portfolio management activity to avoid potential conflicts of interest or the duties of the investment compliance function in terms of monitoring the compliance with the investment rules. A special role within the oversight function is played by the depositary that under Luxembourg Law needs to be registered in Luxembourg and

¹⁶⁹ Cf. (Law of 17 December 2010, 2016), art. 42 – 52.

¹⁷⁰ Cf. (DZ PRIVATBANK S.A. , 2017), para. 3.

¹⁷¹ (Dillon Eustace, 2008), p. 9f.

¹⁷² Cf. (ALFI - Association of the Luxembourg Fund Industry (g), 2012), para. 10.

¹⁷³ Cf. (Carne Group, 2014), p. 51ff.

¹⁷⁴ Cf. (ALFI - Association of the Luxembourg Fund Industry (g), 2012), para. 14ff.

must be a bank approved by the CSSF or have a local Luxembourg branch if located in another EU Member State. It must keep the fund's assets separate from its own and has monitoring functions concerning the sale, issue, repurchase and cancellation of shares carried out in line with law, it oversees the collection of the fund's income, e.g. dividends and it verifies that the NAV of the fund is calculated in line with the fund's own rules.¹⁷⁵

Each UCITS incorporated in Luxembourg is allowed to market its shares in any EU Member State other than their home one, prior to a notification to the competent authority of the host member state in question via the CSSF.¹⁷⁶

In terms of distribution, UCITS-Funds are admitted to public distribution and therefore accessible for retail and institutional investors.¹⁷⁷

The second pillar of the Luxembourg Fund Market is the AIF Market or also referred to as Non-UCITS-Fund Market, which is presented in the next section.

5.3.2. Alternative Investment Funds/Non-UCITS-Funds

This chapter provides an overview of the Luxembourg Alternative Fund Market, in particular on investments, eligible investors and distribution possibilities.

Commonly, the term 'Alternative Investment Fund' refers to all funds, which are not covered by the UCITS-Directive. As well-known examples hedge funds, funds of hedge funds, venture capital and private equity funds as well as real estate funds can be named.¹⁷⁸

Most AIFs are incorporated as SIF, SICAR or as UCI established under Part II of the 'Law of 17 December 2010' not necessarily only investing in transferable securities. The following Figure 9: Number and Net Assets of Alternative Investment Funds according to the Law under which the funds are incorporated as of December 31st, 2015 provides an overview on the split of the different fund types.

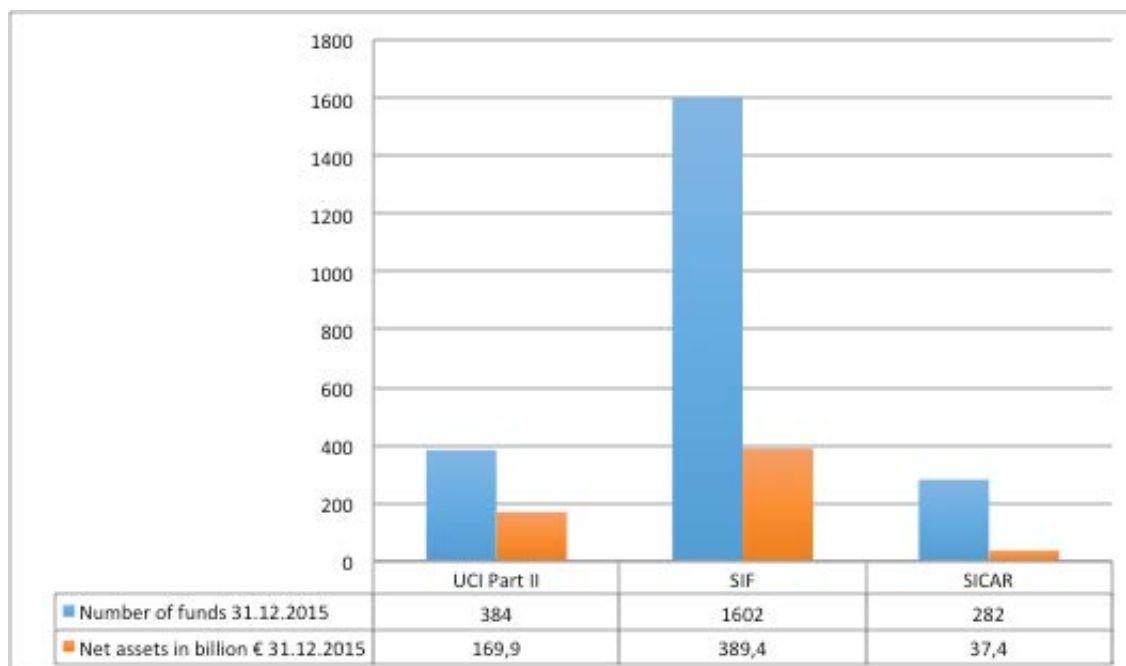
¹⁷⁵ Cf. (ALFI - Association of the Luxembourg Fund Industry (g), 2012), para. 16ff.

¹⁷⁶ Cf. (CSSF - Commission de Surveillance du Secteur Financier (e)), para. 1f.

¹⁷⁷ Cf. (DZ PRIVATBANK S.A., 2017), table 1.

¹⁷⁸ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 1.

Figure 9: Number and Net Assets of Alternative Investment Funds according to the Law under which the funds are incorporated as of December 31st, 2015.



Source: Own elaboration based on (CSSF - Commission de Surveillance du Secteur Financier (f)), p. 159.

The differences between an AIF and a UCITS are mainly the asset and the investor side. AIFs have no legal restrictions on the type of assets to invest in. However, the fund's investment policy is subject to approval of the local regulator, in Luxembourg the CSSF. In addition, there are certain requirements for risk diversification, but by far not as strict as for a UCITS.¹⁷⁹

SIF-Funds have no constraints with regard to eligible assets types for their investments and therefore profit from a lighter supervisory regime. However, a SIF must have an active portfolio management.¹⁸⁰

The SIF is exclusively reserved for well-informed investors, given the lower level of investor protection provided by the fund. The term 'Well-Informed Investor' means any institutional investors, professional investors and other investors which meet the following criteria: The investor confirms in writing that this status applies to him and either invests at least EUR 125,000 or has been assessed by a credit institution, an

¹⁷⁹ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 4.

¹⁸⁰ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 12f.

investment firm or a ManCo which certifies the investor's ability to comprehend the associated risk with the investment in a SIF-Structure.¹⁸¹

SIFs have lighter publication requirements than publically distributed funds, but must also establish effective processes for monitoring, measuring and managing the risk in the investment portfolio. The fund must be structured in a way to avoid possible conflicts of interest between the fund and the related investors. Furthermore, several conditions apply when delegating tasks to third parties. The SIF is also subject to supervision of the CSSF.¹⁸²

The SIF-Law was amended by the 'Law of 12 July 2013'¹⁸³ (AIFM-Law/AIFMD), which split the SIF-Law into two sections. A general one applicable to all SIFs and a second part only applicable to the SIFs qualifying as AIF and therefore must be managed by an authorized Alternative Investment Fund Manager (AIFM).¹⁸⁴ The AIFM can be established in Luxembourg, in a Member State of the EU or in a third country. The SIF itself can be the AIFM when internally managed. If the AIFM of the SIF is authorized within the EU, the SIF can benefit like the UCITS from a passport allowing the AIFM to market the fund to eligible investors EU wide through the regulator-to-regulator notification regime.¹⁸⁵

A SIF-Fund can also qualify as a European Venture Capital Fund (EuVECA) or a European Social Entrepreneurship Fund (EuSEF) and therefore be subject to the EuVECA and EuSEF regulation, which also introduce a marketing passport for such funds to eligible investors based in the EU.¹⁸⁶ Pass porting regulations will not be further explained, as the regulations itself are not relevant for this thesis. The possibility to passport will be addressed later in this thesis.

The purpose of the SICAR in the Luxembourg Fund Landscape is to provide a regulated vehicle, which is tailor-made for investments in private equity and venture capital.¹⁸⁷ The distribution is restricted to well-informed investors as well.¹⁸⁸

¹⁸¹ Cf. (ALFI - Association of the Luxembourg Fund Industry (h), 2017), para. 2.

¹⁸² Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 15.

¹⁸³ Law of 12 July 2013 on alternative investment fund managers.

¹⁸⁴ Cf. (ALFI - Association of the Luxembourg Fund Industry (h), 2017), para. 4.

¹⁸⁵ Cf. (ALFI - Association of the Luxembourg Fund Industry (h), 2017), para. 17f.

¹⁸⁶ Cf. (ALFI - Association of the Luxembourg Fund Industry (h), 2017), para. 30.

¹⁸⁷ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 26.

¹⁸⁸ Cf. (ALFI - Association of the Luxembourg Fund Industry (i), 2017), para. 1.

As eligible assets only direct or indirect investments in securities representing risk capital are allowed. Risk capital is defined as high risk investments in connection with the contribution to the capital of a company in terms of their launch, development or listing on a stock exchange.¹⁸⁹ The investments must comply with the following two criteria. Firstly, investments must be opportunistic or high risk (which might be due to poor liquidity, since the company is not listed) and secondly an underlying intention to develop the company must be visible. This can be e.g. restructuring, modernization, product development or improving the allocation of resources.¹⁹⁰ On an exceptional basis, the SICAR can also hold a small percentage of its investment in financial derivative instruments or temporarily invest in other assets qualifying as investment in risk capital.¹⁹¹

For a SICAR there are no investment diversification rules. The structure can focus the investments on one single company operating in a particularly narrow field such as biotechnology or geological prospecting.¹⁹²

The SICAR-Law was also amended by the AIFM-Law that split the SICAR-Law into two sections. A general one applicable to all SICARs and a second one only applicable to SICARs qualifying as AIFs and hence to be managed by an authorized AIFM. The same pass porting rules already described for the SIF apply.¹⁹³

A UCI - undertakings for collective investment established under Part II of the 'Law of 17 December 2010', commonly referred to as Part II-Fund, is a Non-UCITS-Fund not subject to a specific product law and can be marketed to all types of investors.¹⁹⁴ For the assets of its investment portfolio there are no restrictions regarding eligible assets. But the CSSF needs to approve the investment objective and strategy. Hence, it is a regulated fund vehicle. Even though the Part II-Fund is fairly free in its choice of investments, there are still certain risk diversification requirements to be followed.¹⁹⁵

They are also subject to the AIFM-Law and have to appoint an AIFM, if not one of the limited exemptions applies. The same conditions in terms of the AIFM and the

¹⁸⁹ Cf. (ALFI - Association of the Luxembourg Fund Industry (i), 2017), para. 5.

¹⁹⁰ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 28f.

¹⁹¹ Cf. (ALFI - Association of the Luxembourg Fund Industry (i), 2017), para. 5.

¹⁹² Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (c)), para. 30.

¹⁹³ Cf. (ALFI - Association of the Luxembourg Fund Industry (i), 2017), para. 4.

¹⁹⁴ Cf. (ALFI - Association of the Luxembourg Fund Industry (j), 2017), para. 1f.

¹⁹⁵ Cf. (ALFI - Association of the Luxembourg Fund Industry (j), 2017), para. 5f.

pass porting as for the SIF and SICAR apply.¹⁹⁶ Furthermore, some Part II-Funds could also be subject to the EuVECA and/or EuSEF regulation like the SIF.¹⁹⁷

To complete the overview, the Société de Participations financières (SOPARFI) needs to be mentioned. It is an unregulated financial holding company, which is governed by the common law in this case the 1915 'Law on commercial companies'. Tax burdens can be reduced if its activity is limited to holding and structuring investments in way that the SOPARFI can make use of the tax regime applicable to parent-subsiary companies. This company form is often used in connection with the structuring of risk or venture capital and to hold private equity investments.¹⁹⁸

Summarizing the differences between UCITs and AIFs it can be said that their main differences are in the eligible investments. Consequently, the differences are visible in their investment objectives and policies, their targeted investor types and the protection the funds offer to and the risk posed for the investors.

5.4. Parties within a Fund Structure & their Duties

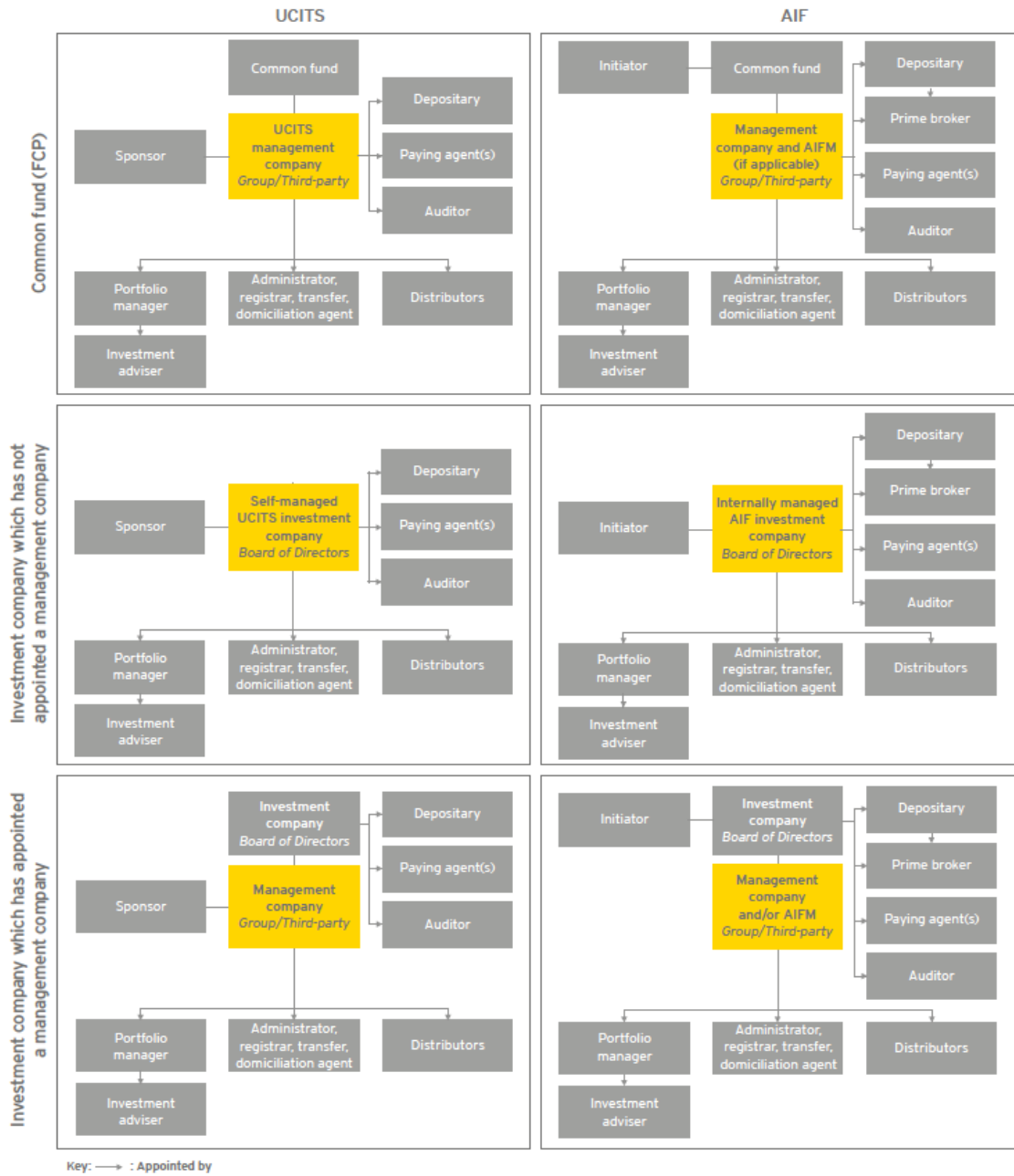
This section provides an overview of parties, which can be involved in fund structure in Luxembourg. The following Figure 10: Common organizational Setups of UICs illustrates common examples of setups of UCIs in forms UCITS and AIFs. Additional setups are possible but the additional illustration does not contribute any further value to the objective of this thesis.

¹⁹⁶ Cf. (ALFI - Association of the Luxembourg Fund Industry (j), 2017), para. 18f.

¹⁹⁷ Cf. (ALFI - Association of the Luxembourg Fund Industry (j), 2017), para. 27.

¹⁹⁸ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (g)), para. 1ff.

Figure 10: Common organizational Setups of UICs



Source: (EY, 2016), p. 19.

a) Sponsor, Initiator or Promoter

These terms are generally used for the person who requests the setup of the new fund structure. For UCITS, the creator is referred to as sponsor. In addition, the sponsor needs to confirm to the CSSF that the UCITS will be managed according to

its legal requirements. The sponsor is often the main shareholder of the ManCo or a group entity to which the main shareholder belongs.¹⁹⁹

The founder of a Part II-Fund is commonly known as a promoter, while the creator of a SIF is labeled as initiator. Generally, the promoter/initiator can also hold other roles within the UCI. The promoter/initiator can also be the portfolio manager or adviser, be part of the oversight of the activity of the UCI as board member of the UCI, its ManCo or its AIFM, be one of the ManCo's shareholder or be part of the distribution network of the fund.²⁰⁰

b) ManCo and/or AIFM

If included in the structure the ManCo or the AIFM is responsible for managing the UCI. This includes portfolio management, according to the defined investment policy in the asset management rules and in the interest of shareholder, risk management, the administration and the marketing of the fund.²⁰¹ A ManCo can under certain conditions also apply for an AIFM license and act as AIFM.²⁰² Under certain conditions laid down in the regulation, a ManCo/AIFM can delegate activities to third parties, but this does not change the fact that the ultimate responsibility and liability stays with the ManCo/AIFM. The outsourcing party must ensure that the third party, performing the activities, is compliant in terms of organizational requirements, conflict of interests and rules of conduct.²⁰³ With regard to AML responsibilities, the ManCo/AIFM is responsible for performing due diligence on the fund. This includes the assessment of the structure's AML/CTF framework and, in line with its mandate, needs to ensure that the implementation and enforcement of the framework on behalf of the UCI is done properly. The ManCo/AIFM can also take the function of the Global Distributor.²⁰⁴

c) Portfolio Manager /Investment Manager

The UCI or the ManCo appoints a portfolio manager if this task is not performed internally. The responsibility of the portfolio manager is to allocate the assets of the

¹⁹⁹ Cf. (EY, 2016), p. 19.

²⁰⁰ Cf. *Ibid.*

²⁰¹ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (e)), para. 1.

²⁰² Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (e)), para. 3.

²⁰³ Cf. (Arendt & Medernach, 2013), p. 11.

²⁰⁴ Cf. (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 8.

fund in line with the investment policy. A portfolio manager can also be only appointed for a specific sub-fund or compartment.²⁰⁵

d) Investment Adviser

If requested or needed by the UCI and/or the ManCo the investment advisor, being a professional providing investment advice, is appointed to advice on transactions relating to financial instruments, having normally no final decision-making power.²⁰⁶

e) Administrator (part of the Central Administration)

The main functions of the administrator are keeping the accounting records of the structure, calculating the NAV, assisting in preparing the financial statements and is the primary contact for the CSSF and the auditor.²⁰⁷

f) Registrar and Transfer Agent (TA) (part of the Central Administration)

The responsibility of the TA is the execution of subscription, redemption and transfer orders of the fund's shares. The TA also maintains the fund's shareholder register.²⁰⁸ In case the fund/ManCo has delegated this activity, the TA acts under mandate and operates under the responsibility of the fund/ManCo to the extent that the measures applied are those ones provided by the fund/ManCo. The TA is also subject to its own legal obligations as a financial service provider including the cooperation with authorities.²⁰⁹

g) Domiciliation Agent (part of the Central Administration)

The main function is the provision of a correspondence address and assistance in fulfilling the fund's legal and regulatory obligations. This includes fund reporting, preparation of shareholder general meetings and board meetings, managing the legal publication requirements and providing the shareholders with legally required information.²¹⁰

h) Distributor

The distributor is appointed either by the promoter/initiator or in the prospectus or in any other document and the main role is to receive orders on behalf of the fund. The

²⁰⁵ Cf. (EY, 2016), p. 19.

²⁰⁶ Cf. (Arendt & Medernach, 2013), p. 14.

²⁰⁷ Cf. (EY, 2016), p. 19.

²⁰⁸ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (f)), para. 3.

²⁰⁹ Cf. (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 8.

²¹⁰ Cf. Ibid.

distributor is an intermediary playing an active part in the fund's distribution process by marketing the fund's shares.²¹¹ In case the TA is not the global distributor, the influence on the selection process of the sub-distributors and the influence on the inclusion of AML/KYC clauses is very limited on the agreements signed between the global and the sub-distributors.²¹²

i) Paying agent

*"The paying agent arranges for payment of distributions made by the UCI. A paying agent may be required in each country where the UCI is distributed. (...) Paying agent is a term used differently in the context of the EU Savings Directive."*²¹³

j) Prime broker

The prime broker is a financial regulated entity and is used as a counterpart to finance and/or execute deals in financial instruments.²¹⁴

k) Depositary

The main functions are the safekeeping of the structure's assets and their day-to-day administration. The depositary executes this function based on the instructions given by the asset manager(s) or the ManCo and needs to monitor if the instructions are in line with the constitutional document.²¹⁵ The depositary must know at any time the allocation of the assets and how and where the assets are available.²¹⁶ The depositary does not have any AML/KYC obligation in terms of the structures' investor due diligence,²¹⁷ but needs to fulfill its legal obligations in terms AML/KYC duties according the business relationship with the fund/ManCo as requested by the 'Law of 12 November 2004'.²¹⁸

²¹¹ Cf. (Arendt & Medernach, 2013), p. 14.

²¹² Cf. (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 9.

²¹³ (EY, 2016), p. 20.

²¹⁴ Cf. Ibid.

²¹⁵ Cf. Ibid.

²¹⁶ Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre (f)), para. 6.

²¹⁷ Cf. (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 9.

²¹⁸ Cf. (Law of 12 November 2004, 2015), art. 2(1).

l) Nominee

A Nominee is an intermediary between the final investor and the fund. It subscribes, redeems or transfers shares on behalf of underlying investors, normally its own customers, in its own name.²¹⁹

m) Market Maker

“Market makers are intermediaries participating on their own account and at their own risk in subscription and redemption transactions of UCI shares or units.”²²⁰

n) Independent Auditors

A fund’s account must be audited at least once a year by an authorized external auditor, designated by the fund/ManCo and approved by the CSSF.²²¹

When it comes to AML/CTF duties the following key principle needs to be understood:

“(…) it is the responsibility of the UCI or management company (in the case of an unincorporated UCI) to develop and maintain a distribution network which complies with the Regulation. Whilst the UCI or management company may rely on Professionals assisting the UCI to fulfill its AML and CTF obligations, responsibilities for performing such duties must be clarified to ensure that such obligations are being complied with at the Customer level.”²²²

The understanding of the different parties involved in a fund structure including their activities, responsibilities, duties and services provided to the investment fund is essential to establish a risk assessment for a fund and determine the specific risk that this structure might be exposed to in terms of ML and TF.

²¹⁹ Cf. (Arendt & Medernach, 2013), p. 14.

²²⁰ (EY, 2016), p. 20.

²²¹ Cf. (Arendt & Medernach, 2013), p. 13.

²²² (ALFI - Association of the Luxembourg Fund Industry, 2013), p. 8.

6. Empirical Analysis

This chapter explains the establishment, the conduction and the results of the empirical analysis, performed in the form of three expert interviews.

6.1. Interview Development

As mentioned in section 1.3 Methodology the entire paper is aligned to the process of establishing a risk assessment. This also applies to the development of the interview question catalogue.

While performing the background search on information about ML/TF and due to the identified lack of literature on this topic, a different source of expertise was needed to collect information and confirm the finding in the chapters 2-5. The ESA guidelines on risk factors suggest several sources that can be consulted in addition to publically available ones. After reviewing the suggestions, with regard to the purpose of this thesis, the expertise and knowledge of experts would suit best, preferably experts who have worked in different areas of the fund sector and have been exposed to the ML/TF field on several occasions.²²³

In general an expert is considered as a:²²⁴

“Professional who has acquired knowledge and skills through study and practice over the years, in a particular field or subject, to the extent that his or her opinion may be helpful in fact finding, problem solving, or understanding of a situation.”

For this specific topic as an expert a Money Laundering Reporting Officer (MLRO) or a Compliance Officer with the relevant exposure to AML/CTF having worked in the AML/CTF area several years matches the above description. This was taken into consideration by the choice of the interview partners, who will be presented in the next sections.

²²³ Cf. (Joint Committee of the European Supervisory Authorities, 2015), p. 14.

²²⁴ (WebFinance Inc., 2017), para. 1.

6.2. Interview Partners

This section provides a brief introduction on the Interview Partners and the reasons why these persons were chosen as experts for the interviews.

6.2.1. Interview Partner I

Interview I was conducted with the Global Head of AML in his function as local MLRO (Interviewee I) of a prestigious international Financial Institution based in Luxembourg. The interviewee is as well a member of the executive committee representing the compliance function. In addition, he participates in the ALFI AML Working Group, the Luxembourg Association for Risk Management and is a member of the AML Committee of the CSSF. The Financial Institution provides assets and custody services, payments and treasury services for financial and other institutional investors, as well as Third Party Transfer Agent services. The interviewee was chosen as an expert due to the various functions he is holding, his in depth knowledge of AML/CTF matters, the Luxembourg Fund Market and his current AML/CTF legislation and his daily exposure to AML/CTF issues in his position as MLRO. Therefore the interview partner can be considered an expert in the area of AML/CTF in the local fund sector.

The interview was conducted face to face on February 20th, 2017. The interview questions were provided upfront. All questions were addressed and answered, but only the main statements were summarized in the Interview I provided in Annex IV. The summary was provided by the interviewee.

6.2.2. Interview Partner II

The second Interview, was conducted with the MLRO and Head of Compliance (Interviewee II) of the Luxembourg subsidiary of a well-known global Asset Manager. He is also the Conducting Officer of the global Asset Manager. Previous to his current role, the interviewee worked in different fields of the fund industry namely investment compliance, accounting, marketing, product development and risk management from which he profits in his current position. The Asset Manager listed on the New York stock exchange. One of the firms specialties are index and exchange traded funds. The company has approximately 135 investment teams in 30 countries worldwide.

The interviewee was selected as interview partner due to his role of MLRO and Head of Compliance at the Asset Manager. Having a wide range of experience in the fund sector outside of the pure AML topic in product related fields and the fact that the company provides services such as Asset Management, Management Company Services and ETFs services, qualifies the interviewee as an expert in this topic. The Interview is presented in Annex IV Interview II.

6.2.3. Interview Partner III

The third expert interview was conducted face-to-face with the European Head of Financial Crime of a well-known and well-established bank providing several services for investment funds, having an office in Luxembourg. As this interview is reflecting the personal opinion of the interviewee, the interviewee on this occasion prefers to stay anonymous.

The interview partner was chosen as expert due having more than 16 years of experience in the AML/CTF field. Having worked for several international financial institutions with different countries of origin in different countries in the AML/CTF field and being responsible the European Oversight of the Financial Crime Unit of an international financial institution makes this person an expert in this field. Having experience in the different regulatory AML/CTF frameworks and being able compare them to each other has potential to provide new insights for this thesis. The interview is presented in Annex IV Interview III.

6.3. Interview Results

This chapter provides the summary of the most important facts and statements of the three expert interviews conducted with regard to the establishment of the risk assessment to be established in chapter 7.

The conclusion drawn from the interviews is that there are two different risks with regard to ML are present in an investment fund and consequently in the fund sector. The first arises from the fact that an investment fund is a financial product itself and like any other product is sold or purchased by clients, in this case its shareholders. The second arises from the investment structure where the structure itself could be used to hide or trade in illegally acquired assets.

All experts agreed that considering the three stages of ML the placement is the most unlikely to happen in the fund market because it usually involves the deposit of cash into the financial system.²²⁵ Normally, subscriptions are made with assets already in the banking system and whose origin should have been verified already. The only exception would be if contributions in kind/physical assets are accepted, which would most likely happen in the alternative fund area.²²⁶ The layering phase poses the biggest challenges and the most risk exposure to the fund industry.²²⁷ Especially, considering the focus of Luxembourg's Fund Industry on cross-border distribution²²⁸ and hence on the dependency on financial institutions in other countries executing the AML/KYC controls. The integration risk exposure is also present, whereas in this case it is equivalent to the ones of other assets used for integration in the financial sector.²²⁹ The biggest challenge is detecting the layering schemes and prevent the integration, while the latter is considered the more difficult task.²³⁰

From the answers provided by the experts to the question whether ML or TF poses the bigger threat to the Luxembourg Fund Industry, it became clear that the focus of the efforts is set on preventing ML.²³¹ The reasons given, where that in TF mostly transitory cash flows are involved and that the level of criminal maturity is more pronounced in the area of ML. In addition, the analysis performed on terrorist attacks did not find similar sustainable patterns to be used to detect TF like it was found for ML in the past, illustrated by the ML Cycle.²³²

The next set of questions is related to the structure of the fund vehicles themselves. The question if delegating tasks to third parties increases the risk, was answered from the different perspectives of the market participants. The inherent risk increases²³³, but the fund, being ultimately responsible for the AML controls regardless of the entity performing those, needs to perform an oversight of the activities. The fund also needs to instruct the third party, which controls to implement, based on the fund's risk appetite and the minimum regulatory requirements.²³⁴ A

²²⁵ Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

²²⁶ Cf. (European Head of Financial Crime, 2017), Interview III.

²²⁷ Cf. (Interviewee I, 2017), Interview I & (Interviewee II, 2017), Interview II.

²²⁸ Cf. (European Head of Financial Crime, 2017), Interview III.

²²⁹ Cf. (Interviewee I, 2017), Interview I.

²³⁰ Cf. (Interviewee II, 2017), Interview II.

²³¹ Cf. (Interviewee II, 2017), Interview II & European Head of Financial Crime, 2017), Interview III.

²³² Cf. (European Head of Financial Crime, 2017), Interview III.

²³³ Cf. *Ibid.*

²³⁴ Cf. (Interviewee I, 2017), Interview I & (European Head of Financial Crime, 2017), Interview III.

similar opinion was expressed with regard to the possibility of using the European passport for cross-border distribution. It is the fund's responsibility to perform due diligence on its distribution network and to ensure that the underlying AML/KYC controls of the investors are properly performed.²³⁵ Nevertheless, as the European AML/KYC Standards are not yet harmonized²³⁶, the question turns back to the initial questions of ML, namely is to understand, who the beneficial owner behind the investment is and to identify the source of funds and wealth of the beneficial owner.²³⁷

Another aspect answered by two slightly different statements, based on the perspective of the relevant participant, was the question whether the different fund vehicles pose different risk exposures in terms of their regimes, their investor base and their investments. The first statement concluded that the fundamental characteristics are the same, even if the way a fund operates is different. The concentration of the risk differs when, e.g. comparing a more dedicated product to a widely distributed fund. While for a more dedicated fund, the risk is more concentrated due to the smaller number of investors involved, the possibility to detect a launderer is higher than within a widely distributed structure in which the possibility is more diluted. This again is related to the control and oversight of the distribution network.²³⁸ The concept of the nominee investor was also mentioned in this context, where normally a financial institution invests on behalf of its underlying clients in the fund. Closely linked to the latter is the distribution via fund platforms. In both distribution channels, the underlying investor might not be known directly and the fund does not perform the AML controls on the underlying investors themselves.²³⁹ The risk of a fund structure is determined by its type of clients, investments, countries involved and its distribution channels. The risk exposure on the investment side was regarded higher in the alternative fund segment due to the fact that difficult-to-value assets or under- or overpricing can be done more easily with typical alternative investments. The manipulation of an asset in a UCITS fund, usually being traded at a regular market and therefore having a price record, would be much more difficult.²⁴⁰

²³⁵ Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

²³⁶ Cf. (Interviewee I, 2017), Interview I.

²³⁷ Cf. (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

²³⁸ Cf. *Ibid.*

²³⁹ Cf. (European Head of Financial Crime, 2017), Interview III.

²⁴⁰ Cf. (Interviewee I, 2017), Interview I & (European Head of Financial Crime, 2017), Interview III.

In addition, the fact that launderers seek anonymity, it is assumed that the use of company structures would be better to invest into a fund than making a direct investment. An investment through a company would put an additional ownership layer between the criminal/the launderer and the investment.²⁴¹ In terms of new structures or trends and the risk exposure these might present, all three experts shared the same opinion. The risk exposure is also linked to the area of activity of the structure and which entities perform which controls in which manner, as the underlying concept of an investment fund will not change fundamentally. The risk factors so far identified for investment funds might be adapted or a new one, being structure- or product- specific needs to be added.²⁴²

The next question was related to the current regulatory framework in the Luxembourg Market. The basis of having only one legal framework was acknowledged by all three experts²⁴³. Nevertheless, one expert thought it is to be mainly addressed to private banking business.²⁴⁴ All experts came to the conclusion that additional clarifications on certain articles would lead to a possible further risk mitigation to the risk exposure to ML and TF in the Luxembourg Fund Market.²⁴⁵ A law always leaves room for interpretation, which is positive to give the market participants room to implement their own risk based approaches.²⁴⁶ On the other hand, clear instructions for the funds on their duties in terms of the due diligence to be performed on the distribution network and on the nominees as well as particular oversight measures or responsibilities could further mitigate the risk of ML/TF.²⁴⁷

The interviews also aimed to identify risk factors specific to investment funds. The main issue identified is that market participants need to understand that there are differences in the risk exposure of each investment fund established and that each fund should be regarded separately. At first, the reason why a fund is set up or will be set up in certain way needs to be understood. This also includes the assessment of the related parties involved and the delegation of duties in the fund structure. If there is a delegation of duties, the implemented controls within the ongoing oversight

²⁴¹ Cf. (Interviewee I, 2017), Interview I.

²⁴² Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

²⁴³ Cf. Ibid.

²⁴⁴ Cf. Interviewee II, 2017), Interview II.

²⁴⁵ Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

²⁴⁶ Cf. (European Head of Financial Crime, 2017), Interview III.

²⁴⁷ Cf. (Interviewee I, 2017), Interview I & (European Head of Financial Crime, 2017), Interview III.

need to be sufficient and to address the fund specific risk profile. It is essential to understand who the persons are that are having the control over the fund's investment strategy and who make the decisions in the name of the fund. The identification of the beneficial owner of the fund, the knowledge of the source of funds and the understanding of the source of wealth must also be included in the assessment if applicable and reasonable from a risk based approach. In the absence of a beneficial owner, the controlling persons need to be identified. On the investment side the types of assets, their valuation methods and the countries of the origin of the assets need to be taken into consideration. From a regulatory perspective there is no requirement to screen the assets other than in relation to investments in cluster munition, which is forbidden by law. Regarding the investors, the type of investors targeted by the fund need to be looked at and analyzed. The investor's country of origin, business activity, source and origin of the funds and wealth, and the channels used to transfer their money into fund can be named as possible risk factors to be considered. Another risk factor to be considered is the intermediation risk, especially when considering the local fund market's focus on cross-border distribution. The lack of transparency with regard to the final investor in case of investments through an omnibus/nominee account or a platform is a risk factor. In addition, the characteristics of the local distribution markets outside of Luxembourg must be understood, in particular the specific requirements and controls in terms of AML/KYC. These differ from market to market and in some cases even with the fund product distributed in the specific market. The distribution networks and channels are also to be regarded as risk factors, depending on the countries and contracts involved. As the last main risk factor the people who are working in the fund sector can be named. The risk is also determined by the understanding of the fund structure, the ability to identify the possible risk factors and the means and manner by which the people perform the implemented controls.²⁴⁸

The knowledge obtained in the interviews combined with the theoretical background illustrated in chapters 2-5 is used to establish the risk assessment in the next chapter.

²⁴⁸ Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

7. Establishment of an Investment Fund's Risk Assessment

This chapter aims at providing an example of how to establish a risk assessment of an investment fund, based on the theoretical knowledge provided in chapters 2-5 and the interviews conducted and presented as summary in chapter 6. The assessment focuses on the holistic view of a fund vehicle and will therefore not take into account the legal requirement for each market participant to establish a business specific risk assessment. In reality, each entity involved in a fund structure needs to establish its own risk assessment in connection with the services and products provided first and then assesses the risk connected with each fund structure the entity services afterwards. The ManCo/AIFM must establish the risk appetite and assessment for the vehicle itself. All risk assessments established for one structure will be slightly different, depending on the actor performing the assessment and the responsibilities and functions of the actor within the fund vehicle.

7.1. Identification of the inherent Risk

In a first step, the inherent risk needs to be understood. It cannot be questioned that the financial system in each country is exposed to a certain risk to be abused for ML and/or TF activities. Subsequently, the presence of an inherent risk in Luxembourg's Financial Sector must be considered a given fact, which the participants need to understand and take into consideration when establishing the participant's own business risk assessment.

As stated in the interview, the risk for the fund sector differs from the one of the private banking sector.²⁴⁹ This means that as a first step, the activities of ML and TF have to be regarded in terms of their methods, cash flows and other activities involved, have to be analyzed and possible interconnections with these activities in the fund sector have to be identified.

At first, the offence of ML is analyzed. From a theoretical point of view the financial activities in the fund sector, in terms of the criteria identified in Table 3: Differences & Similarities between Terrorist Financing & Money Laundering, would suit the

²⁴⁹ Cf. (Interviewee II, 2017) Interview II.

following descriptions launderers would seek. It is part of the formal financial system, large amounts that can also be structured can be relatively easy moved, complex structures or transactions are not uncommon depending on the fund's investment strategy, its purpose and/or target investor base.²⁵⁰

In terms of cash flows on the investor side, a fund usually pays back to the same investor from which the fund received the money. Third party payments, where money is received from or paid back to any other party than the investor are regarded as suspicious.²⁵¹ This payment cycle would fit into the ML cash flow cycle, described in Figure 3: Money Laundering & Terrorist Financing Cash Flows, either in the layering phase or in the integration phase. In particular for the Luxembourg Fund Market, as described in section 5.1, being specialized in cross-border activities, meaning that investors from other countries including states outside the EU are common practice and therefore cross-border cash flows are day-to-day business.²⁵² This statement was confirmed by all three experts interviewed. The placement activity was not considered as posing the same threats, due to fact that here cash is in most cases converted into book money and this is very unlikely to happen in the fund sector, especially when cross-border distribution is involved.²⁵³

The above paragraph already takes Luxembourg's main expertise, cross-border distribution into account when assessing the different stages of ML in terms of their risk exposure. It becomes clear that in the placement phase, the cross-border distribution is clearly a risk mitigating factor, while in the layering and integration phase, it presents a higher risk exposure. This leads to the conclusion that the risk exposure for each activity has to be assessed in every stage of the ML Cycle separately.

Secondly, the TF offence is analyzed. For TF it was so far not possible to track patterns or financial operating profiles equivalent to the ones in the ML Cycle. The common denominators are: usually small amounts, below the reporting thresholds, uncommon relationships and transfers between seemingly unrelated parties and the fact that transfer methods outside of the formal banking system are actually

²⁵⁰ Cf. (Richards, James R., 2012), p. 99.

²⁵¹ Cf. (Interviewee I, 2017), Interview I & (Interviewee II, 2017), Interview II.

²⁵² Cf. (Luxembourg for Finance - Agency for the Development of the Financial Centre(b), para. 2f; (ALFI - Association of the Luxembourg Fund Industry (e), 2013), p. 4f & (EY, 2016), p. 6.

²⁵³ Cf. (Interviewee I, 2017), Interview I; (Interviewee II, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

preferred.²⁵⁴ Furthermore, the requirement of a transitory cash flow to transfer the cash from person A to person B. This is quite hard to set up within an investment fund, but of course not impossible²⁵⁵. However, terrorist normally have a different focus, as presented in section 3.3, when transferring money in terms of timeline, amounts to be transferred, degree of anonymity, the regions from which to which the funds need to be transferred and the availability of the methods in these regions, the costs involved etc.²⁵⁶ As the law enforcement's focus is set on single persons or entities having been identified as having relations to a terrorist organization or being a terrorist, terrorists do often not mind to leave a trace as most people involved cannot be directly linked to the terrorist activities immediately. As mentioned above currently there are no detection patterns or profiles available and as long as the persons are not associated directly with terrorism, the possibility of detection is fairly low as terrorists often do not need big sums of money to execute their attacks. Another factor to be considered is that it cannot be excluded that investments in investments funds are used to generate income which will be later used for TF or to park money owned by terrorists that is currently not needed. If this is done by an inconspicuous person having no visible ties to a terrorist organization it will pose similar challenges to be detected as the laundered funds invested in the integration phase by criminals in the ML Cycle.

Summarizing the above facts and also taking the interview results into consideration it can be concluded that the inherent risk exposure to ML in the Luxembourg Fund Sector is higher than the one for TF. This conclusion shall not lead to the assumption that TF is not possible in the fund industry and therefore to the neglect to implement measures to prevent and detect TF. The main risks within the ML Cycle are posed by the layering and the integration phase on which the efforts of preventing ML should consequently be concentrated.

²⁵⁴ Cf. (Richards, James R., 2012), p. 99.

²⁵⁵ Cf. (European Head of Financial Crime, 2017), Interview III.

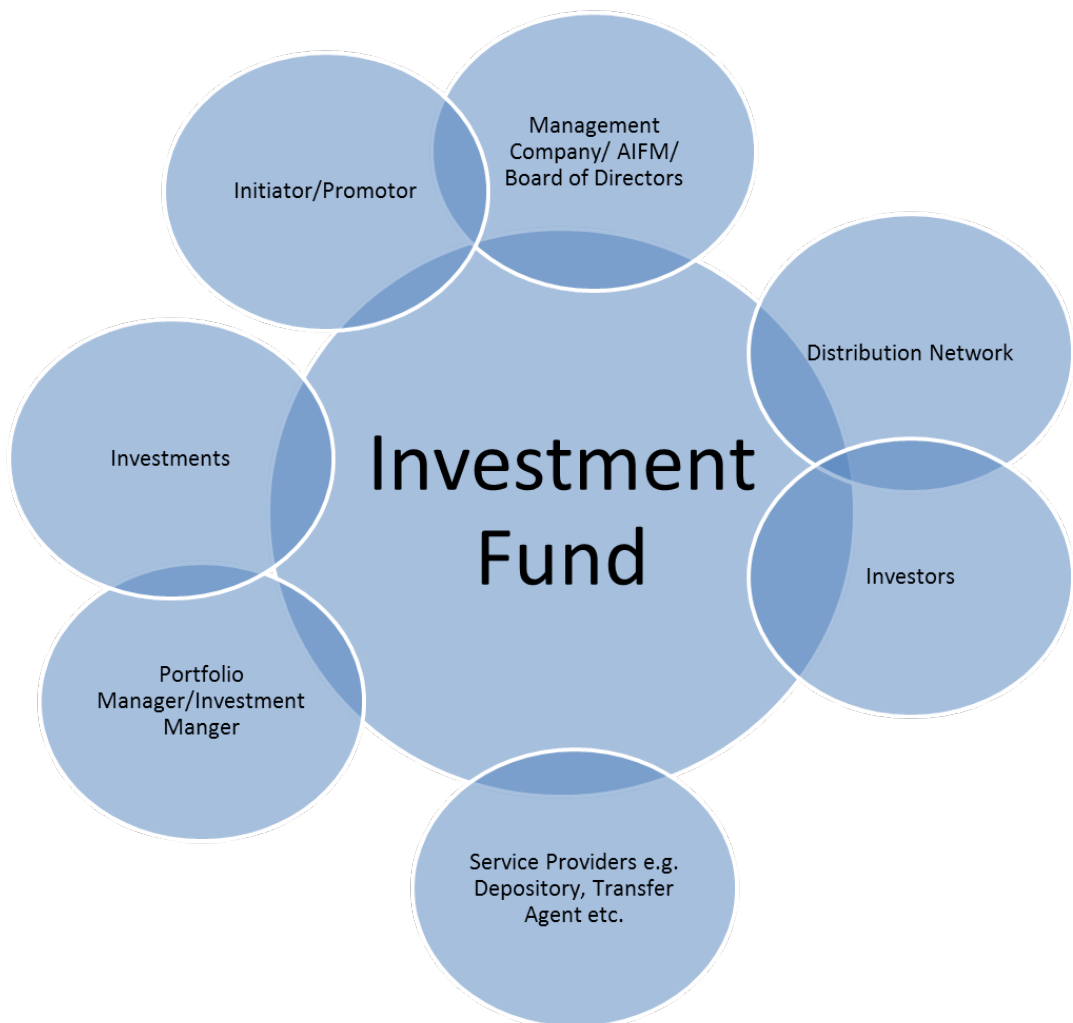
²⁵⁶ Cf. (Freeman & Ruehsen, 2013), p. 5ff.

7.2. Risk Assessment of an Investment Fund

As Figure 10: Common organizational setups of UICs already illustrated, there are various possibilities to structure a fund with regard to the parties involved, their relationships amongst each other and the duties executed by the involved parties. In addition, certain activities and roles within the fund can be combined in one entity, e.g. the ManCo can also be the Initiator/Promotor, the Portfolio Manager and e.g. the Registrar and Transfer Agent. Consequently, a uniform illustration of a risk assessment suitable for all investment vehicles is not possible. Therefore, the main components of an investment fund are pointed out in Figure 11: Components of Investment Funds presenting a potential Risk Exposure to Money Laundering and/or Terrorist Financing. Furthermore, some possible risk factors, determined by the previous theoretical chapters and the knowledge gained from the interviews, to be considered will be presented. The presentation will not be exhaustive due to the various structuring options, which provide different possibilities to setup various ML schemes. However, the listing will only consider funds established under Luxembourg Investment Fund Laws and not unregulated structures. The risk assessment is based on the Joint Risk Factor Guidelines in Annex III and amended to fit Luxembourg Investment Vehicles. The Guidelines are already more detailed than the current regulatory requirements, but still not country and/or local investment market specific as they are issued to cover the whole EU. They do not take into consideration the investment fund vehicle as such, but the gives advices for service providers of investment funds.

In addition for an investment fund the identification of the beneficial owner(s) holding 25% or more might not always be the most suitable risk factor to be considered in term as for beneficial ownership. For widely held funds, e.g. UCITS, which are daily traded the beneficial owner structure changes on a daily basis. For these kind of investment funds, in addition to the beneficial ownership, the controlling person(s) should always be identified, as these are the person(s) who exercise the effective control over the structure's assets and have the decision power on the day-to-day management. The identification of the controlling person is recommended to be established for any kind of corporate structure as very often the day-to-day management is executed by other persons than the legal owner(s) of the corporate structure.

Figure 11: Components of Investment Funds presenting a potential Risk Exposure to Money Laundering and/or Terrorist Financing



Source: Own elaboration based on (EY, 2016), p. 19; (Zwick, 2017), Interview I; (Vlamynck, 2017), Interview II & (European Head of Financial Crime, 2017), Interview III.

The first component presenting a ML risk to be analyzed is the initiator/promotor of the vehicle. The initiator/promotor can be analyzed in terms of the following criteria presenting potential risk factors:

- Who is the person/s or company wanting to setup the fund?
Is it a one-man-shop with no previous experience in the fund sector or is a well-known market player initiating a new fund?
- From which country or geographical area does the initiator/promotor come?
- From which country will the seed capital be paid (source of funds)?
From which country does the wealth of the initiator/promotor originate?

Will the fund's seed capital be paid by the initiator/promotor?

Who is the beneficial owner of the seed capital if other than the initiator/promotor?

- Why does the initiator/promotor want to do business with the relevant entities? The purpose of the relationship needs to be questioned.
- Is there any negative or adverse media found relating to promotor/initiator/? Is there a reputational risk in doing business with the promotor/initiator?
- Is the promotor/initiator subject to economic sanctions?

The next information to gather is on the structure itself. The aim is to understand why the fund is set up in certain way and the reasons behind the setup.

- What is the purpose of setting up the fund?
Especially taking the new CSSF circular 17/650 on tax crimes into account and possible relations to other funds of the same initiator/promotor.
- What will be legal and corporate forms of the fund and why in this context this particular setup has been chosen?
- Who will be the beneficial owner of the fund and the controlling person of the fund?
Will it be a dedicated fund for a small group of investors?
- Are there politically exposed persons involved in the structure?
- Will the structure become a multi-promotor structure or a platform fund?

The next risk component to be considered is the ManCo and/or the AIFM. The ManCo and/or the AIFM are the responsible for the AML oversight and investment rules for the fund if it is not self-managed. Therefore, particular attention should be paid to the AML-framework. Circumstances that would represent an additional risk exposure can be the following.

- Is the ManCo and/or the AIFM located in a different country than the domiciliation of the fund?
If yes, does the country of incorporation pose a higher risk with regards to ML/TF exposure?
- Which AML/KYC regime is applicable?
If it is not the Luxembourg one, is it to be considered equal to the local one, having the same control standards and requirements?

- Is the established AML framework in line with the Luxembourg regulatory requirements?
- Are there any negative or adverse media found relating to the ManCo and/or the AIFM and/or any other party related to the latter?
- Is there a reputational risk in doing business with the ManCo and/or the AIFM?
- Is the ManCo and/or the AIFM or any related person subject to economic sanctions?

Another component to be analyzed in terms of ML/TF risk is the distribution network. The assessment of the network is essential to understand the structure's ML/TF risk exposure.

- In which countries will the fund be distributed?
Are these countries subject to economic sanctions?
- Are the financial sectors of the countries subject to an AML/KYC regime equivalent to the one in Luxembourg?
- Are there any country specific AML/KYC regulations concerning distributors or the distribution of funds in general?
- Are the distributors regulated, financial entities?
- Can the distributors delegate the distribution to further sub-distributors?
If yes, who is responsible for the AML/KYC controls on the Investors?
- Are the distributors in the distribution network subject to enhanced due diligence by the responsible party?
Are also sub-distributors included?
- Are there any negative or adverse media found relating to any entity involved in the distribution network and/or any related party?
Is there a reputational risk in doing business with any entity involved in the distribution network?
- Is any entity involved in the distribution network and/or any related party subject to economic sanctions?

The investors are the next component to be considered when establishing the risk assessment of the fund.

- Which are the countries of domicile, nationalities, citizenship, postal and business addresses?

- Which country/countries are the source of funds and the source wealth of the investors?
- Can the investors contribute assets in kind?
- Who is the beneficial owner or the controlling person of the money invested from an investor?
- Can a legal entity investing in a fund issue bearer shares?
- Are omnibus accounts involved?
- Does the fund allow third party payments?
- Are any of the investors subject to economic sanctions?
- Are any of the investors subject to adverse media?

Following the investors, the investment side should also be considered, as this component could also increase the risk exposure to ML/TF of the structure.

- Which countries are targeted for investments?
Are these countries compliant with FATF-standards?
- Which kind of investments are involved according to the investment policy?
Is there an exposure to diamonds, art, precious metals horses or any sector regarded posing a high ML/TF risk?
- Is the fund investing in Private Equity and/or Real Estate?
If yes, are the valuation methods common market practice?
Is there any unusual setup in the structuring of the investments?
- Does the fund provide Microfinance?
If yes, which countries are concerned?
- Does the fund invest in sanctioned securities/money market instruments?

The last component to be looked at are the service providers of the fund. These can be the depository, the registrar and transfer agent, the domiciliation agent, the investment/portfolio manager/s, additional investment advisors depending on the setup of the funds and the delegation of tasks. In this case, a due diligence on each entity should be done taking into account at least the following questions:

- Which are the countries of incorporation and business activity?
- Who are the beneficial owners and/or controlling persons?
- What are the duties and responsibilities according to the business relationship and contracts in place?
- In case of the depository, who are the sub-custodian of the depository?

- Who is making the decisions in terms of the investment strategy of the fund?
- Are any of the service providers and/or any of their related parties subject to economic sanctions?
- Are any of the service providers subject to relevant adverse media or would jeopardize the reputation of the fund structure?

The above questions provide an overview, but not an exhaustive list of questions to establish the ML risk exposure of a fund vehicle when setting up the fund. Once the fund is in place the transactions made by fund can also be compared to either other funds with a similar investment strategy or with the previous behavior of the fund.

The most important question in terms of transactions is to identify if the kind of transactions are in line with the fund's investment strategy and to verify the transaction's economical background. Special attentions should be paid to where the cash flows of transactions are geographically targeted to and if they are related to the investments done by the fund. In particular this is of high importance in the sector of alternative assets, e.g. real estate, private equity and/or microfinance. On investor side no third party payments should be allowed to mitigate the risk of ML/TF. Constantly changing payment instructions should also to be considered a risk factor.

The entity establishing the risk assessment needs to decide which factors to be considered in their risk assessment as the assessment is linked to their risk exposure identified in their own business risk assessment.

As already stated, the regulatory framework provides numerous possibilities to setup a fund structure, therefore an exhaustive risk assessment to cover all funds cannot be provided. A risk assessment is a dynamic tool. It needs to be reviewed and adapted to the current market situation as soon as changes either in the regulatory framework, in the structure of the fund or the involved parties occur. A risk rating established through a risk assessment has to be verified after a certain period of time, to ensure that the statements made at the beginning of the relationship are in line with the activities of the fund. This also accounts for the inherent risk assessment of the Luxembourg Fund Market, as with the ongoing regulatory developments and the evolving technological possibilities in the financial sector, e.g. the means by which money is transferred the environment changes rapidly.

The next chapter summarizes the main and most important facts and statements of the previous chapter to conclude the thesis.

8. Conclusion

The Luxembourg Investment Market is an important part of the Luxembourg's Financial Market and the biggest European Fund Market. The market is dominated by cross-border business for which it provides the ideal conditions. Nevertheless, the fund market has, as the rest of the financial sector, a risk exposure to ML and TF.

As illustrated in section 7.1, the inherent risk exposure is mainly with regard to ML: Within the ML Cycle the layering and integration phases pose the highest threat to the fund sector. In this assessment, the fund sector differs, e.g. from the retail banking sector, where placement with regard to ML and TF is also considered as posing a high risk exposure. Considering the findings of this thesis the inherent risk exposure in the layering and integration phase is to be considered medium or high for Luxembourg's Fund Sector.

The numerous possibilities to set up fund structures for different purposes, with different investment strategies, different target investment countries, different target investor base, different distribution networks and different service providers involved makes each fund structure unique in its own way with regard to its risk exposure to ML/TF. This leads to the necessity to establish a single risk assessment for each fund in the market. The risk assessment should be done by the ManCo/AIFM for the vehicle and its service providers and by the service providers for the ManCo/AIFM and the structure, each putting their inherent business risk assessment and own risk appetite into perspective. This can also lead to differences in the perception of the risk a fund structure will expose the related parties to. The risk assessment will lead to an inherent risk rating according to the risk exposure identified in line with the risk appetite of the fund.

For some risks factors mitigating measures can be put in place. These measures will lower the ML/TF risk exposure. This can be e.g. assessment of the AML policies of the fund or the service providers, additional controls to be performed by the distributor or ManCo/AIFM when onboarding a new investor, additional controls to identify and verify the source of funds and source of wealth, regular reviews on controls, imposing of rules for outsourced activities on third party service providers only to name a few. In some cases, combinations of risk factors might increase or lower the risk, when connecting them.

The individuality of the structures in the fund sector and the resulting variety of risk factors and their individual combination possibilities linked with the individual mitigating measures and risk appetite for each market participant makes it impossible to determine the residual risk of the Luxembourg Fund Industry with regards to ML/TF. However, a residual risk can be determined for each fund on the Luxembourg Market after having taken all risk mitigation measures into account.

The lack of a uniform method to determine the residual risk will lead to a concentration of the risk with certain market participants. This concentration can have several causes. Entities having a very high risk appetite might not consider all possible mitigation measures or might not implement or execute them in the most effective manner. Another reason is that some structures are set up in such complex ways that experts need to be consulted to understand why the setup was done this way. This is often the case when funds are used as tax optimization vehicles. Another important factor is to understand the beneficial owner structure and to identify the controlling persons as well as the source of funds and the origin of wealth contributed to the fund. The controlling persons in an investment structure are often the key figures because they execute the day-to-day management and have the effective control over the fund's assets. The origin of the funds plays an important role as without knowledge about the fund's origin a detection of ML/TF is impossible. However, for the fund sector it can be regarded as an additional risk factor that each investment fund is considered as a single financial institution and no interconnection between the different funds and the movements of cash can be established. Furthermore, the AML/KYC responsibilities need to be clarified. Failures to fulfill these duties pose the biggest risk with regard to ML/TF in the fund sector.

On the other hand, a risk assessment cannot be considered a static tool in a non-developing environment. The Luxembourg Fund Sector is subject to constant changes in its legal and regulatory environment. A current example is the CSSF circular 17/650, which includes tax crimes in the predicate offences for ML. The knowledge about the offences is the basis that enables detecting unusual or suspicious activities within the fund's activities, which do not have to relate to financial transactions only. The regulatory changes, the introduction of new fund structures, e.g. the RAIF will add new specific risk factors to the risk assessment. The same applies to new technologies used for fund distribution and to new service

delivery channels. New insights in ML schemes or TF activities can also influence the risk assessment and the mitigation measures identified.

All of the above illustrates that the risk exposure is changing and developing constantly and the risk has to be assessed on a regular basis, to take all the new developments into consideration. The timely adaptation of the risk factors in the risk assessment plays an important role to lower the risk exposure with regards to ML/TF and not to leave loopholes for criminals.

One very important factor not to be neglected are the employees performing the daily work. A risk assessment can be very well established but the people using it need to understand to which unusual patterns attention need to be paid to. The knowledge and the constant training of the workforce on the AML/CTF regulations and the understanding of the inherent risks exposure, the companies own business risk assessment and the measures to be taken to mitigate the risk are a key factors to prevent the Luxembourg Fund Sector to be abused for ML/TF.

The reputation of the Luxembourg Fund Market and the expertise of its market participants is a unique selling proposition. To uphold the reputation, the exposure to ML/TF needs to be minimized. The key factor, therefore, is the implementation of a risk based approach when performing a risk assessment. Only when the relevant risks are identified by the market participants and the matching mitigation measures are correctly implanted and executed, the risk exposure can be minimized. Maybe this can only be done by specifying the AML/CTF framework for the fund industry based on the common regulatory framework. This will be main the challenge for coming years in the Luxembourg Fund Industry.

Annex I: Threats & Harms posed by Money Laundering & Terrorist Financing

	INDIVIDUAL/LOCAL	COMMUNITY/REGION	NATIONAL/INTERNATIONAL
PHYSICAL	<p><u>Individual death, injury or illness:</u></p> <ul style="list-style-type: none"> • Through use of commodities or services controlled by organized criminals (e.g., through drug abuse, or as a facilitated illegal migrant). • Through being the victim of terrorist activity (for example an attack or a kidnapping). • As a consequence of personal involvement in organized criminal activity (e.g., as a victim of intergang violence) or as a terrorist (e.g., as a suicide bomber). 	<p><u>Incidence of deaths, injuries or illnesses within a particular community or geographical area:</u></p> <ul style="list-style-type: none"> • Through use of commodities or services controlled by organized criminals (e.g., concentrations of drug related deaths, or of sexually exploited human trafficking victims). • As a consequence of direct involvement in organized criminal activity (e.g., drug debt or terrorism related kidnaps or spates of organized crime or terrorism-linked violence). 	<p><u>Levels and patterns of deaths, injuries, illnesses within a country:</u></p> <ul style="list-style-type: none"> • Through use of commodities or services controlled by organized criminals (e.g., total annual drug related deaths). • As a consequence of direct involvement in organized crime (e.g., drug debt or terrorism kidnaps or spates of organized crime/terrorism- linked violence).
SOCIAL	<p><u>Damage to individuals through their criminal and other undesirable behaviors, and the effects on others:</u></p> <ul style="list-style-type: none"> • Behavior of those involved in organized crime or using its commodities or services (e.g., propensity to violence, prolific offending resulting from drug addition, spiraling criminal behavior). • Negative influences on others (e.g., young people drawn to crime or terrorism by easy money, power or sense of affiliation). • Effects on victims of organized criminal or terrorism (e.g., distress/inconvenience caused to a victim of terrorism or identity fraud) 	<p><u>Damage to sense of ‘well-being’ in a particular geographical area, or within or between ethnic or other identifiable social groups:</u></p> <ul style="list-style-type: none"> • As a result of organized criminal or terrorist activity (e.g., low levels of confidence in local law enforcement and wider criminal justice system). • As a result of the availability of its commodities or services (e.g., high rates of acquisitive crime near drug markets leading to increased fear of crime and community tension). • As a result of the prevalence of extremist views. 	<p><u>Damage to national society, undermining social responsibility, belief in the rights of others, respect for the law:</u></p> <ul style="list-style-type: none"> • As a consequence of serious criminal or terrorist activity, or the availability of its commodities or services (e.g., ‘low- level’ criminal/non-compliant behaviors, such as ‘recreational’ drug use or personal tax evasion; unwillingness to support the criminal justice system, for example to act as witness to a crime or to perform jury service)/ • As a consequence of the prevalence of extremist views.

	INDIVIDUAL/LOCAL	COMMUNITY/REGION	NATIONAL/INTERNATIONAL
ENVIRONMENTAL	<p><u>Degeneration of a locality (including a single property):</u></p> <ul style="list-style-type: none"> As a result of organized criminal activities (e.g., physical damage to a dwelling or other premises used to manufacture or sell drugs, or through its use for prostitution linked to human trafficking) As a result of it being the site of a terrorist attack. As a result of the actions of those using its commodities or services (e.g., discarded drug paraphernalia) 	<p><u>Damage to an area (e.g., an estate, neighborhood, town):</u></p> <ul style="list-style-type: none"> As a result of organized criminal or terrorist activity, including any hidden health and safety hazards (e.g., unsafe disposal of chemical waste from drug production or presence of explosive materials). As a result of it being the site of a terrorist attack. As a result of those using organized crime's commodities or services (e.g., the creation of deprived/'abandoned' areas through the concentration of drug users or illegal immigrants, leading to further degeneration). 	<p><u>Damage to the nation as a whole, or to large areas, or to other countries:</u></p> <ul style="list-style-type: none"> As a result of organized criminal activity, or the availability of its commodities or services (e.g., demand in some countries for class A drugs causing deforestation in South America). As a result of widespread terrorist attacks.
STRUCTURAL	<p><u>Damage to individual perceptions of the integrity of public and private institutions and systems:</u></p> <ul style="list-style-type: none"> As a result of organized criminal activity (e.g., fear of using new technology due to perceived risk of online fraud). As a result of terrorist activity (e.g., fear of particular locations due to perceived risk of terrorist attack or disinclination towards them due to previous attack). As a result of the actions of those using organized crime's commodities and services (e.g., individuals losing faith in ability of bodies to protect them/their property from the consequences of criminality, including organized crime). 	<p><u>Damage to commonly shared perceptions of the integrity of public and private institutions and systems:</u></p> <ul style="list-style-type: none"> As a result of organized criminal activity, or the actions of those using its commodities and services (e.g., local areas dominated by seemingly 'untouchable' criminal elements, or local political or business leaders corrupted by or under the malign influence of organized crime). As a result of terrorist activity (e.g., local areas infiltrated by extremist views). 	<p><u>Damage to perceptions of the country internationally:</u></p> <ul style="list-style-type: none"> As a result of organized criminal activity (e.g., concerted attack on the financial sector including subprime mortgage fraud and 'boiler room' fraud). As a result of the actions of those using commodities and services or organized crime (e.g., widespread organized illegal immigration undermining the integrity of the borders). As a result of the prevalence of terrorism.

	INDIVIDUAL/LOCAL	COMMUNITY/REGION	NATIONAL/INTERNATIONAL
ECONOMIC	<p><u>Costs to/economic impacts on individuals or families:</u></p> <ul style="list-style-type: none"> • Using organized crime commodities or services (e.g., loss of current employment and long-term employability through drug addiction). • Costs to victims and the wider public (e.g., from thefts, costs of security, higher insurance premiums and other costs passed on to consumers). 	<p><u>Costs to/economic impacts of organized criminal and terrorist activities on businesses, services & communities in a particular town, city or region:</u></p> <ul style="list-style-type: none"> • On legitimate businesses due to organized crime (e.g., losses as a result of fraud or robbery, or loss of trade or failed businesses as a result of illegitimate). • On legitimate businesses due to terrorism (e.g., losses as a result of not being able to trade because of damaged premises or deterred customers, and the cost of rebuilding damaged property). • To local public & social services (e.g., costs of health services for criminals and victims of crime and terrorism, and costs of repairing damaged property and infrastructure). • To local communities (e.g., through overall downturn in trade or lost opportunities for inward investment). 	<p><u>Costs to/economic impacts on the nation of organized criminal and terrorist activities:</u></p> <ul style="list-style-type: none"> • Direct (e.g., consequences of illegal working on the availability of jobs and competitiveness of national industry; loss of direct and indirect tax and duty revenue from smuggling of goods and from fraud). • Indirect (e.g., public expenditure required to combat organized crime and terrorism through law enforcement and through regulation and controls, and the costs of repairing damaged property and infrastructure).

Source: Own elaboration based on (Financial Action Task Force (e), 2010), p. 66ff.

Annex II: Laws amending the Law of 04 November 2004

1. Law of 13 July 2007 on markets in financial instruments transposing:
 - Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Directive 93/22/EEC
 - Article 52 of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of said Directive

2. Law of 17 July 2008 transposing
 - Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing;
 - Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of politically exposed persons and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis;

3. Law of 10 November 2009 on payment services, on the activity of electronic money institution and settlement finality in payment and securities settlement systems and transposing
 - Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC;

4. Law of 18 December 2009 concerning the audit profession and:
 - transposing Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

- organising of the audit profession,
5. Law of 27 October 2010
 - enhancing the anti-money laundering and counter terrorist financing legal framework;
 - organising the controls of physical transport of cash entering, transiting through or leaving the Grand Duchy of Luxembourg;
 - implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing;
 6. Law of 20 May 2011 transposing
 - Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC;
 - Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on the financial collateral arrangements as regards linked systems and credit claims
 7. Law of 21 December 2012 on the activity of Family Office
 8. Law of 12 July 2013 on alternative investment fund managers
 9. Law of 12 July 2013 on professionals of the insurance sector
 10. Law of 24 July 2015

Annex III: Risk Factors according to European Supervisory Authorities Risk Factor Guidelines

General Risk Factors:

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

Customer risk factors

- When identifying the risk associated with their customers, including their customers' beneficial owners, firms should consider the risk related to:
 - a) the customer's and the customer's beneficial owners' business or professional activity;
 - b) the customer's and the customer's beneficial owners' reputation; and
 - c) the customer's and the customer's beneficial owners' nature and behavior.

- Risk factors that may be relevant when considering the risk associated with a customer's or their beneficial owners' business or professional activity include:

Does the customer or beneficial owner have links to sectors that are associated with higher corruption risk, such as construction, pharmaceuticals and healthcare, arms trade and defense, extractive industries and public procurement?

 - a) Does the customer or beneficial owner have links to sectors that are associated with higher ML or TF risk, for example certain MSB, casinos or dealers in precious metals?
 - b) Does the customer or beneficial owner have links to sectors that involve significant amounts of cash?
 - c) Where the customer is a legal person, what is the purpose of their establishment?
 - d) Does the customer have political connections, for example, are they a PEP, or is their beneficial owner a PEP? Does the customer or beneficial owner

have any other relevant links to a PEP, for example, are any of the customer's directors PEPs and if so, do these PEPs exercise significant control over the customer or beneficial owner? Where a customer or their beneficial owner is a PEP, firms must always apply enhanced due diligence measures in line with Article 20 of Directive (EU) 2015/849.

- e) Does the customer or beneficial owner hold another public position that might enable them to abuse public office for private gain?
 - f) Is the customer a legal person subject to enforceable disclosure requirements that ensure that reliable information about the customer's beneficial owner is publicly available, for example public companies listed on stock exchanges that make such disclosure a condition for listing?
 - g) Is the customer a credit or financial institution from a jurisdiction with an effective AML/CTF regime and is it supervised for compliance with local AML/CTF obligations?
 - h) Is the customer a public administration or enterprise from a jurisdiction with low levels of corruption?
 - i) Is the customer's or their beneficial owner's background consistent with what the firm knows about their former, current or planned business activity, their business' turnover, the source of funds and the customer's or beneficial owner's source of wealth?
- The following risk factors may be relevant when considering the risk associated with a customer's or their beneficial owners' reputation:
 - a) Are there any adverse media reports about the customer, for example are there any allegations of criminality or terrorism (proven or not) against the customer or their beneficial owners? If so, are these credible? Firms should determine the credibility of allegations on the basis of the quality and independence of the source data and the persistence of reporting of these allegations, among others.
 - b) Is the customer, beneficial owner or anyone associated with them subject to an asset freeze due to criminal proceedings or allegations of terrorism or terrorist financing? Does the firm have reasonable grounds to suspect that the customer or beneficial owner or anyone associated with them has, at some point in the past, been subject to such an asset freeze?

- c) Does the firm know if the customer or beneficial owner has been subject to a suspicious activity report in the past?
 - d) Are there suggestions that the customer or beneficial owner or anyone associated with them may have handled the proceeds from crime?
 - e) Does the firm have any in-house information about the customer's or their beneficial owner's integrity, obtained, for example, in the course of a long-standing business relationship?
- The following risk factors may be relevant when considering the risk associated with a customer's or their beneficial owners' nature and behavior:
 - a) Does the firm have any doubts about the veracity or accuracy of the customer's or beneficial owner's identity?
 - b) Are there indications that the customer might seek to avoid the establishment of a business relationship?
 - c) Is the customer's ownership and control structure transparent and does it make sense? If the customer's ownership and control structure is complex or opaque, is there an obvious commercial or lawful rationale?
 - d) Does the customer issue bearer shares or have nominee shareholders?
 - e) Is the customer a legal person or arrangement that could be used as an asset holding vehicle?
 - f) Is there a sound reason for changes in the customer's ownership and control structure?
 - g) Does the customer request transactions that are complex, unusually or unexpectedly large or have an unusual or unexpected pattern without apparent economic or lawful purpose or a sound commercial rationale? Are there grounds to suspect that the customer is trying to evade certain thresholds?
 - h) Does the customer request unnecessary or unreasonable levels of secrecy? For example, is the customer reluctant to share CDD information, or do they appear to disguise the true nature of their business?
 - i) Can the customer's or beneficial owner's source of wealth or source of funds be easily explained, for example through their occupation, inheritance or investments?
 - j) Does the customer use their products and services as expected when the business relationship was first established?

- k) Where the customer is a non-resident, could their needs be better serviced elsewhere? Is there a sound economic or lawful rationale for the customer requesting the type of financial service sought?
- l) Is the customer a non-profit organization whose activities could be abused for TF purposes?

Countries and geographic areas

- When identifying the risk associated with countries and geographic areas, firms should consider the risk related to:
 - a) the jurisdiction in which the customer or beneficial owner is based;
 - b) the jurisdictions which are the customer's or beneficial owner's main place of business; and
 - c) the jurisdiction to which the customer or beneficial owner has relevant personal links.
- Risk factors firms should consider when identifying the level of ML/TF risk associated with a jurisdiction include:
 - a) Is the country a Member of the FATF or a FATF-style regional body, e.g. MoneyVal that assess their members for compliance with the FATF's Recommendations and publishes their assessment?
 - b) Is there information from more than one credible and trustworthy source about the quality of the jurisdiction's AML/CTF controls, including information about the quality and effectiveness of regulatory enforcement and oversight? Examples of possible sources include FATF Mutual Evaluations, the FATF's list of high risk and non-cooperative jurisdictions, International Monetary Fund assessments, Financial Sector Assessment Programme reports (FSAPs) and Organisation for Economic Co-operation and Development (OECD) reports
 - c) Is there information, for example from law enforcement or the media, suggesting that a jurisdiction provides funding or support for terrorist activities or that designated terrorist organizations are operating in the country?
 - d) Is the jurisdiction subject to financial sanctions, embargoes or measures that are related to terrorism, financing of terrorism or proliferation issued by, for example, the United Nations and the EU?
 - e) Is the jurisdiction a known tax haven, secrecy haven or offshore jurisdiction?

- f) Is there information from credible sources about the level of predicate offences to money laundering, for example corruption, organized crime or fraud? Examples include Transparency International's Corruption Perceptions Index; OECD country reports on the implementation of the OECD's anti-bribery convention; and the UNODC World Drug Report.
- g) Is there information from more than one credible and trustworthy source about the capacity of the jurisdiction's investigative and judicial system effectively to investigate and prosecute these offences?
- h) Is the jurisdiction politically stable?
- i) Is there information from more than one credible and trustworthy source about the level of international cooperation and information exchange with foreign public authorities? Examples of credible sources include FATF Mutual Evaluations and reports from the Global Forum on Transparency and Exchange of Information for Tax Purposes.

Firms should note that Directive (EU) 2015/849 does not recognize 'equivalence' of third countries and that European Member States' list of equivalent jurisdictions is no longer being maintained. To the extent permitted by national legislation, firms should be able to identify lower risk jurisdictions in line with Annex II of Directive (EU) 2015/849. Where firms deal with natural or legal persons established in third countries that the Commission has identified as presenting a high money laundering risk, firms must always apply enhanced due diligence measures.

Products, services and transactions risk factors

- When identifying the risk associated with their products, services or transactions, firms should consider the risk related to:
 - a) the level of transparency, or opacity, the product, service or transaction afford;
 - b) the complexity of the product, service or transaction; and
 - c) the value or size of the product, service or transaction.
- Risk factors that may be relevant when considering the risk associated with a product, service or transaction's transparency include:
 - a) To what extent do products or services facilitate or allow anonymity or opacity of customer, ownership or beneficiary structures, for example

certain pooled accounts, bearer shares, fiduciary deposits, offshore and certain onshore trusts and dealings with shell companies?

- b) To what extent is it possible for a third party that is not part of the business relationship to give instructions, e.g. certain correspondent banking relationships?

- Risk factors that may be relevant when considering the risk associated with a product, service or transaction's complexity include:
 - a) To what extent is the transaction complex and involves multiple parties or multiple jurisdictions, for example certain trade finance transactions? Are transactions straightforward, for example regular payments into a pension fund?
 - b) To what extent do products or services allow payments from third parties or accept overpayments where this is not normally foreseen, e.g. certain mortgage, pension or life insurance products? Where third party payments are foreseen, does the firm know the third party's identity, for example a state benefit authority or a guarantor? Or are products and services funded exclusively by fund transfers from the customer's own account at another financial institution that is subject to AML/CTF standards and oversight that are comparable to those required under Directive (EU) 2015/849?
 - c) Does the firm understand the risks associated with its new or innovative product or service, in particular where this involves the use of new technologies or payment methods?

- Risk factors that may be relevant when considering the risk associated with a product, service or transaction's value or size include:
 - a) To what extent are products or services cash intensive, such as many payment services but also certain current accounts?
 - b) To what extent do products or services facilitate or encourage high value transactions? Are there any caps on transaction values or levels of premium that could limit the use of the product or service for money laundering or TF purposes?

Delivery channel risk factors

- When identifying the risk associated with the way the customer obtains the products or services they require, firms should consider the risk related to:
 - a) the extent to which the business relationship is conducted on a non-face to face basis; and
 - b) any introducers or intermediaries the firm might use and the nature of their relationship to the firm.

- When assessing the risk associated with the way the customer obtains the product or services, firms should consider a number of factors including:
 - a) Is the customer physically present for identification purposes? If they are not, has the firm used a reliable form of non-face to face CDD? Has it taken steps to prevent impersonation or identity fraud?
 - b) Has the customer been introduced from other parts of the same financial group and if so, to what extent can the firm rely on this introduction as reassurance that the customer will not expose the firm to excessive ML/TF risk? What has the firm done to satisfy itself that the group entity applies CDD measures to European Economic Area (EEA) standards in line with Article 28 of Directive (EU) 2015/849, for example has it considered the findings of relevant internal audit reports?
 - c) Has the customer been introduced from a third party, for example an independent agent and is the third party a financial institution or is their main business activity unrelated to financial service provision? What has the firm done to be satisfied that:
 - i. the third party applies CDD measures and keeps records to EEA standards and that it is supervised for compliance with comparable AML/CTF obligations in line with Article 26 of Directive (EU) 2015/849;
 - ii. the third party will provide, immediately upon request, relevant copies of identification and verification data, among others in line with Article 27 of Directive (EU) 2015/849; and
 - iii. the quality of the third party's CDD measures is such that it can be relied upon?
 - d) Has the customer been introduced through a tied agent, i.e. without direct firm contact? To what extent can the firm be satisfied that the agent has obtained

enough information so that the firm knows its customer and the level of risk associated with the business relationship?

- e) If independent or tied agents are used, to what extent are they involved on an ongoing basis in the conduct of business? How does this affect the firm's knowledge of the customer and ongoing risk management?
- f) Where a firm uses an intermediary, are they:
 - i. a regulated person subject to AML obligations that are consistent with those of the Directive (EU) 2015/849?
 - ii. subject to effective AML supervision? Are there any indications that the intermediary's level of compliance with applicable AML legislation or regulation is inadequate, for example because the intermediary has been sanctioned for breaches of AML/CTF obligations?
 - iii. based in a high-risk jurisdiction?

Sectoral guidelines for investment managers

Investment management is the management of an investor's assets to achieve specific investment goals. It includes both discretionary investment management, where investment managers take investment decisions on their customers' behalf, and advisory investment management, where investment managers advise their customers on which investments to make but do not execute transactions on the customers' behalf. Investment managers usually have a limited number of private or institutional customers many of which are wealthy, for example high net worth individuals, trusts, companies, government agencies and other investment vehicles. The customers' funds are often handled by a local custodian, rather than the investment manager. The ML/TF risk associated with investment management is therefore driven primarily by the risk associated with the type of customers investment managers serve. Firms in this sector should consider the following risk factors and measures alongside those set out in Title II of these guidelines. The sectoral guidelines in Title III Chapter 5 (wealth management) may also be relevant in this context.

Product, service or transaction risk factors

- The following factors may indicate higher risk:
 - a) transactions are unusually large;
 - b) third party payments are possible

Customer or investor risk factors

- The following factors may indicate higher risk:
 - a) the customer's behavior, for example:
 - i. repurchasing or redeeming a long-term investment within a short period after the initial investment or before the payout date, in particular where this results in financial loss or payment of high transaction fees;
 - ii. the repeated purchase and sale of shares within a short period of time without an obvious strategy or economic rationale;
 - iii. refusal or unwillingness to provide CDD information;
 - iv. frequent changes to CDD information or payment details;
 - v. the customer transfers funds in excess of those required for the investment and asks for surplus amounts to be reimbursed;
 - vi. the circumstances in which the customer makes use of the "cooling off" period gives rise to suspicion;
 - vii. using multiple accounts without previous notification, especially when these accounts are held in multiple or high risk jurisdictions
 - b) the customer's behavior, for example:
 - i. the customer is an offshore company or trust;
 - ii. the customer is an unregulated fund who carries out little or no due diligence on its underlying investors;
 - iii. the customer is an unregulated third party investment vehicle, for example a hedge fund;
 - iv. the customer's ownership and control structure is opaque;
 - v. the customer is a PEP or otherwise influential individual.
 - c) the customer's business, for example the customer's funds are derived from business in sectors that are associated with higher financial crime risk.

- The following factors may indicate lower risk:
 - a) the customer is an institutional investor whose status has been verified by an EEA government agency, e.g. a government-approved pensions scheme;
 - b) the customer is a government body from an EEA jurisdiction.

Country or geographic risk factors

- The following factors may indicate higher risk:
 - a) the investor or their custodian is based in a high risk jurisdiction, including off-shore jurisdictions;
 - b) the funds come from a high risk jurisdiction, including off-shore jurisdictions

Measures

Investment managers typically need to develop a good understanding of their customer, their customer's circumstances and anticipated levels of transactions to help them identify suitable investment portfolios. This information will be similar to that firms will obtain for AML/CTF purposes.

Firms should follow the Enhanced Due Diligence (EDD) guidelines in Title II in higher risk situations. In addition, where the risk associated with a business relationship is increased, firms should:

- identify and, where necessary, verify the identity of underlying investors where the customer is an unregulated third party investment vehicle;
- understand the reason for any payment or transfer to or from an unverified third party, in particular where the firm provides custody services.

To the extent permitted by national legislation, investment managers may apply the guidelines on Simplified Due Diligence (SDD) in Title II in low risk situations.

Sectoral guidelines for providers of investment funds

The provision of investment funds can involve multiple parties, such as the ManCo, depositary bank, registrars, platforms, investment managers and financial advisors. The type and number of parties involved in the provision of investment funds depends on the nature of the investment and will affect how much the firm knows about their customer and investors.

Investment funds can be abused for ML/TF purposes. Retail funds are often conducted on a non-face to face basis; access to such funds is often easy and holdings of investment funds can easily be transferred between different parties. However, the medium- to long term nature of the investment can contribute to limiting the attractiveness of these products for money launderers. Institutional funds are exposed to similar risks, though these risks may be reduced where such funds are open only to a small number of investors.

Firms in this sector should consider the following risk factors and measures alongside those set out in Title II of these guidelines. The sectoral guidelines in Title III Chapter 7 (life insurance undertakings) and Title III Chapter 8 (investment management) may also be relevant in this context.

Product, service or transaction risk factors

- The following factors may indicate higher risk:
 - a) the transaction involves third party subscribers or payees, in particular where this is unexpected;
 - b) the transaction involves accounts or third parties in multiple jurisdictions, in particular where these jurisdictions are associated with a high ML/TF risk.

- The following factors may indicate lower risk:
 - a) third party payments are not allowed.

Customer or investor risk factors

- The following factors may indicate higher risk:
 - a) the customer or investor's behavior, for example:

- vi. repurchasing or redeeming a long-term investment within a short period after the initial investment or before the payout date, in particular where this results in financial loss or payment of high transaction fees;
 - vii. the repeated purchase and sale of shares within a short period of time without an obvious strategy or economic rationale;
 - viii. refusal or unwillingness to provide CDD information;
 - ix. frequent changes to CDD information or payment details;
 - x. the customer transfers funds in excess of those required for the investment and asks for surplus amounts to be reimbursed;
 - xi. the circumstances in which the customer makes use of the “cooling off” period gives rise to suspicion;
 - xii. using multiple accounts without previous notification, especially when these accounts are held in multiple or high risk jurisdictions;
 - xiii. sudden change in clearing and settlement location without rationale related to any change in the country residence of the client.
- b) the customer or investor’s nature, for example making investments that are inconsistent with the customer’s nature or overall financial situation.
- The following factors may indicate lower risk:
 - a) the customer is an institutional investor whose status has been verified by an EEA government agency, e.g. a government-approved pensions scheme;
 - b) the customer or investor is a regulated financial intermediary in an EEA country.

Distribution channel risk factors

- The following factors may indicate higher risk:
 - a) the fund admits a wide, or unrestricted, range of investors;
 - b) multiple relationships, which limits firms’ oversight of its business relationships and restricts their ability to monitor transactions.
- The following factors may indicate lower risk:
 - a) the fund admits only a specific type of low-risk investors;

- b) the fund can be accessed only through regulated financial intermediaries in EEA countries, who are within scope of their national AML/CTF legislation.

Country or geographic risk factors

- The following factors may indicate higher risk:
 - a) investors' funds have been generated in high risk jurisdictions, in particular those associated with higher levels of predicate offences to money laundering.

Measures

Enhanced customer due diligence measures

- Examples of EDD measures firms should apply in a high risk situation include:
 - a) obtaining additional customer information during identification, such as occupation, level of assets, information available in public databases, the Internet, background and business objectives, information on the reasons for the proposed transactions;
 - b) taking additional steps to verify the documents obtained;
 - c) obtaining information on the source of funds and/or the customer's financial assets;
 - d) requiring that the redemption payment is made through the initial account used for investment;
 - e) establishing limits on number and/or amount of transactions;
 - f) requiring that the first payment is made through an account in the name of the customer with a bank subject to equivalent AML/CTF standards;
 - g) obtaining approval from senior management at the time of the transaction when a customer uses a product or service for the first time;
 - h) applying enhanced monitoring of the customer relationship and individual transactions;
 - i) using anti-impersonation fraud checks to mitigate the risk of impersonation fraud where the relationship is conducted on a non-face to face basis. Examples include sending a letter to the customer's address or applying additional verification measures (such as checking against online databases) to verify the existence of the purported identity.

Simplified customer due diligence

To the extent permitted by national legislation and provided that the funds are being transferred to or from an account held in the customer's name at an EEA credit institution, examples of SDD measures firms may apply include using the source of funds or the destination of funds to meet some of the CDD requirements.

Intermediaries

Where a firm uses a financial intermediary to distribute fund shares, for example a regulated platform, a bank or a financial adviser, that intermediary may be regarded as the firm's customer provided that the intermediary acts on its own account as the direct counterparty of the firm. This could be the case, for example, where the intermediary receives from its customer a mandate to manage their assets or carry out one or more investment transactions. In those situations, the firm should treat the intermediary's customers as the fund's beneficial owners.

- In those situations, the firm may apply SDD measures provided that:
 - a) the financial intermediary is subject to AML/CTF obligations in an EEA jurisdiction;
 - b) the ML/TF risk associated with the business relationship is low, based on the firm's assessment of the financial intermediary's business, the types of clients the intermediary's business serves and the jurisdictions the intermediary's business is exposed to, among others; and
 - c) the firm is satisfied that the intermediary applies robust and risk-sensitive CDD measures to their own clients and their clients' beneficial owners. It may be appropriate for the firm to take risk-sensitive measures to assess the adequacy of its intermediary's CDD policies and procedures, for example by referring to publicly available information about the intermediary's compliance record, liaising directly with the intermediary or by sample-testing the intermediary's ability to provide CDD information upon request.

- Where those conditions are met, and subject to applicable national legislation permitting this, SDD may consist of the firm:
 - a) identifying and verifying the identity of its intermediary, including the intermediary's beneficial owners;;

- b) assessing the purpose and intended nature of the business relationship;
 - c) conducting ongoing monitoring of the business relationship; and
 - d) Establishing that the intermediary will provide upon request relevant information on their clients, who invested in the fund and who are the fund's beneficial owners.
- Where the financial intermediary is established in a third country, or where there are indications that the risk associated with the business relationship may not be low, firms should apply full CDD, including reliance as per Article 25 of Directive (EU) 2015/849 or EDD measures as appropriate.

Annex IV – Interviews

Interview I

AD- Question 1: Please describe yourself, your background and your role in the company - including your daily/regular contact points with the Luxembourg AML/CTF Regulation in the fund industry?

INTERVIEWEE I- Answer 1: MLRO and PAMLO, daily contact via KYC enquiries and review of higher risk clients, advisory and monitoring, filing of STRs. In addition Chairman of the ALFI AML working group and member of the CSSF AML-Committee.

AD- Question 2: In general, do you think that the Luxembourg Fund Industry is highly exposed to the risk of being used for ML/TF and could you name the activity which poses the bigger threat to the fund industry and explain why?

INTERVIEWEE I- Answer 2: Investment fund is one amongst many financial products purchased and sold by clients. Monetary flows go through the banking system first, meaning that if laundering takes place, it starts at a much earlier stage. Intermediation of fund sales constitutes a potential threat in that it may create a level of opacity. Best measure to mitigate this risk is to (i) only open omnibus/nominee accounts for regulated and supervised financial actors who are themselves subject to equivalent AML/CTF standards and to (ii) perform enhanced due diligence on these financial intermediaries.

AD- Question 3: Regarding the three stages of ML, placement, layering and integration, for which one/ones could the fund industry being used for most likely and why?

INTERVIEWEE I- Answer 3: Placement: not possible, as investment funds do not accept any cash proceeds

Layering: possible and most likely, if prior AML controls by financial institutions are deficient

Integration: investment funds can be used for reintegration purposes, just as any other assets used for investment

AD- Question 4: Within an investment fund structure, there are several different cash flows taking place, where within a fund structure do you see the biggest threat of ML/TF?

INTERVIEWEE I- Answer 4: Money received on fund cash collection accounts

- a) from direct investors (verification of origin of funds) or
- b) from intermediaries (verification of origin of funds not possible by the investment funds, but it must be ascertained that it takes place at the intermediary level).

Payout of redemption proceeds and need to verify against sanction lists. Avoidance of third party payments.

Investments performed by the fund on less liquid / difficult to value assets (e.g. private equity, property). Please consider that the screening of investments is not covered by the AML Law, with the “implicit” exception of the financing of cluster munitions, being a predicate offence.

AD- Question 5: Do you think the fact that an investment fund has outsourced several tasks to different providers makes it more vulnerable to AML/CTF risks?

INTERVIEWEE I- Answer 5: The fund is ultimately responsible for delegating AML/CTF controls to third parties. The best risk mitigation is for the fund to

(i) be very clear on what is outsourced and on the related roles and responsibilities and to

(ii) perform oversight over the outsourced activities.

AD- Question 6: In the Luxembourg Fund Market there is a variety of Investment Products available. Where do you see the biggest risk exposure to ML/TF in regards to:

- a) Fund Regimes: UCITS vs. AIFMD
- b) Investment Strategies: tradable securities on stock market vs. real estate/private equity or microfinance
- c) Investor Side: retail vs. corporate

INTERVIEWEE I- Answer 6: Risk mainly depends on type of clients, countries and distribution channels. For daily valued funds, the risk should be lower, especially if those funds monitor frequent trading.

Difficult-to-value funds may be more attractive to launderers. Therefore it is important to consider the fund's investment policy, including target countries, as part of the initial risk assessment.

Concerning the type of client, it depends. As launderers seek anonymity, I would have thought that legal entities are more attractive for laundering money.

AD- Question 7: There are trends in the fund sector visible, e.g. dedicated funds especially for High Net Worth Individuals, sharia compliant investment funds or rent a sub-fund models. How do these trends affect the risk exposure of the investment fund to ML, especially self-laundering and TF?

INTERVIEWEE I- Answer 7: If funds are used exclusively for dedicated asset management for the benefit of a limited number of investors, such as family offices operating SIFs, the laundering risk is identical to wealth management activities. On the other hand, the fact of having beneficial owners behind these structures does oblige the investment fund to identify them and verify their identity as well as the source of funds. The best way to mitigate the associated risk is to impose a look-through of omnibus account positions.

The fact of renting sub-fund models takes to some extent away the concept of "promotor ownership". Therefore, companies renting these structures must ensure proper due diligence on the investment funds and all related parties.

AD- Question 8: Most funds incorporated in Luxembourg can benefit from an EU passport for distribution within the EU. Which impact does it have that the local AML/CTF Laws in the EU differ in every member state for the distribution via local distributors?

INTERVIEWEE I- Answer 8: I think that the '4th AML-Directive' on AML will provide better harmonization of laws in Europe, considering the detailed content of the Directive and the proposed KYC standards, which will be published by the ESAs. Therefore I am not really concerned about EU passporting. However, your question will remain valid for distributors appointed outside the EU for which a detailed country/distributor risk assessment needs to be performed.

AD- Question 9: Would it be feasible from the fund industry perspective to tackle ML/TF with the same measures as currently requested by legislation; can the same measures actually be used or are different or additional controls necessary?

INTERVIEWEE I- Answer 9: I do not see how the fund industry would be permitted to adopt measures which are different from those requested by legislation. The KYC guidelines, which will be published by the ESAs will provide information on standards to be applied by sector, including providers of services for investment funds. This means that regulators have considered the special nature of investment funds for which

(i) the basic AML legislation will remain the same as for any other person subject to that legislation and

(ii) the handling of omnibus/nominee accounts needs to be subject to additional scrutiny.

AD- Question 10: Is the current risk based approach sufficient to effectively detect ML/TF within a fund, e.g. in regards to nominee investors, distribution channels and fund platforms? Where would you see needs for improvement?

INTERVIEWEE I- Answer 10: The concept of correspondent relationships has been clarified in article 3 of CSSF regulation 12-02. In my view, further improvements are necessary at investment fund level to ensure proper enhanced due diligence on their distribution network, as third party TAs cannot really cover this aspect. Investment funds must clearly understand:

(i) their distribution network,

(ii) the operation of nominee investors and the risks associated with them, and perform

(iii) ongoing oversight. One concern I have is that some fund providers may think that, when delegating tasks, they delegate responsibility, which is clearly not true.

AD- Question 11: Do you think that the new regulations such as UCITS V, AIFMD or the stricter requirements in the Custodian Business could also help to detect or prevent ML/TF even they are not intended for this purpose?

INTERVIEWEE I- Answer 11: Additional controls are imposed by these regulations, such as cash flow monitoring, review of asset valuation, monitoring of frequent trading/market timing. These measures contribute to a solid AML framework.

AD- Question 12: According to your opinion, which are the most important criteria to consider for a ML/TF risk assessment for a fund?

INTERVIEWEE I- Answer 12: Type of client, country, distribution channels and possibility to sub-distribute, investment policy.

AD- Question 13: Do you think that increasing pressure to create revenue influences the enforcement of the AML/CTF Laws in the local fund industry?

INTERVIEWEE I- Answer 13: No, as financial actors have seen the cost of non-complying.

Interview II

AD- Question 1: Please describe yourself, your background and your role in the company - including your daily/regular contact points with the Luxembourg AML/CTF Regulation in the fund industry?

INTERVIEWEE II- Answer 1: I am the Compliance and Conducting Officer of the company here in Luxembourg. I have been with the enterprise for four and half years. My exposure to AML started when I inherited the position of MLRO, in 2012 when the CSSF regulation 12-02 was published. In addition I am also responsible for other compliance tasks because my MLRO role is not a fulltime position. This role is complemented by my prior knowledge of the financial industry. Initially I worked in product related fields such as investment compliance, accounting, marketing, product development and risk management. When I entered the field of AML, as matter of fact I did not approach my new assignment by regarding the established practices as the norm or being fully satisfying. Taking my further knowledge and experience in the financial industry into consideration and listening to remarks of different people on AML I tried combine both and realized that there is a lot more to look into in the field of AML. At this point I started to deeply analyze the topic. As a fundamental, and one think that one needs to bear in mind, in terms of the approach is to think of the overall wider picture. That means firstly funds are a financial instrument like other financial instruments such as shares, bonds, future derivatives etc. when holding a share/unit of a fund. Secondly in most cases it is a savings instrument e.g. like a life insurance. In my point of view these are two fundamentals that are usually forgotten when considering the landscape we are in. When considering funds as financial instruments and in particular why the funds are more risky or not, more complex or not or more or less efficient, we always have to look to

what funds are compared to. Therefore the two characteristics of fund shares/units being a financial as well as savings instrument need to be considered when establishing a framework. In practice funds may be treated in a different manner when looking on the Luxembourg Market there is the retail landscape and the alternative one, but looking into other countries like France or Ireland there are also exchange traded funds (ETFs), which work completely different from a retail fund, but also considered as funds and belonging to the framework. When looking at the spectrum of the fund landscape you have ETFs, being listed on the stock exchange with a certain operating model, the retail/UCITS funds, having a global distribution which the Luxembourg Fund Industry is quite familiar with, but there are also the private placement structures, dedicated products, alternative products etc. All these different types have to fit into the wider picture of the financial instrument and saving or long-term investment product. For me these are two fundamentals in the landscape and there might be one simple question to ask yourself. If you take the biggest Asset Manager being your client and consider the Assets under Management and compare the total market value of this fund with the market value of a listed company, ask yourself is it easier to buy a share in listed companies like Deutsche Bank or Volkswagen to launder money. What is actually the difference? This is important to keep in mind in practice.

AD- Question 2: Within an Investment fund structure, there are several different cash flows taking place, where within a fund structure do you see the biggest threat of ML/TF, taken into consideration the ML Cycle as well as inflows and outflows? And where do you think the regulatory framework should be focusing on?

INTERVIEWEE II- Answer 2: In practice I do not think about placement exposure unless you have a third party payment taking place. When sending back the money to your customer, from whom you received the money, the risk is quite contained. The most challenging one is layering, that is where you have the main challenges to prevent and detect ML.

Potentially there is also integration, maybe not at the first level, but at the second or third level. Integration, investing or spending the money that now appears to be clean, is in most people's minds often connected with the purchase of luxury goods such as cars or real estate. But the fact is that not only cars and real estate is bought with laundered funds. There is also the option to invest in financial products. In this

case the launderer has to decide in which financial product the launderer wants to invest and might end up with a long-term savings product such as fund.

From my point of view the higher risk exposure for funds is to be used for layering activities, but the risk being used for integration also exists. However it is a lot harder to identify because in the majority of cases integration cannot be detected anymore. Whereas in the layering phase you might be able to identify such an activity, because you have indicators that can be used, e.g. the new circular released on Friday by the CSSF on tax crimes, that is something new to consider. In addition there is the question of the origin and the source of the funds, which are considered the most critical one from my point of view. The approach to look at it is quite a simple one. The main questions to properly answer are: who the customer is, where the money comes from and how it is transferred to the fund's account? To answer these questions properly presents the main challenge in the layering phase. The general answer to these questions need to contain answers to more particular question e.g. if the fund is really dealing with this specific client (investor), who is the real beneficial owner, where does the money come from and how it is exactly transited to the different vehicles or channels.

Summarized the challenges lie in preventing placement by preventing third party payments, detecting the different layering schemes, which in my point of view pose the biggest treat and can still be detected and of course prevent potential integration however this being very difficult to detect.

AD- Question 3: Taking your previous statements into consideration, form your point of view, which offence; ML or TF, poses the bigger threat to the Luxembourg Fund Industry in general?

INTERVIEWEE II- Answer 3: I would consider ML the bigger threat. The cash flow of TF is a transitory one and this might not take place in a fund. But some of the laundered money has already found its way to Luxembourg and is in the country and therefore the layering activities should be considered as the main threat. This does not mean that the threat of TF and its consequences shall not be considered. However transit payments in a fund are very uncommon and hard to implement. This threat concerns more the retail or private banking sector than the fund industry, because of the corresponding banking activities in this part of the financial sector. Normally when TF is concerned the money needs to quickly transit through, while

money in the layering phase usually remains longer in one place to not raise any suspicion.

AD- Question 4: With reference to your introduction statement concerning the risk exposure of the different investment fund products, where do you believe is the highest risk exposure especially taken the following factors into account: UCITS, funds vehicles under AIFMD and private placement structures?

INTERVIEWEE II- Answer 4: From the fundamentals I do not see much differences. Taken the ETF structures e.g., you are free to buy or sell it daily, but can also keep it for a while, the same accounts for retail and private placement funds. This leads back to the common denominators of funds first being a financial instrument and second being a savings and long-term investment. They have the same kind of fundamental characteristics, even though they operate differently. From my point of view, the risk exposure is determined by the intermediation, the different ways an investor can participate into a fund. It is not possible to fully control the intermediation at any time especially when having ETFs, where all deals go through market makers. Compared the more dedicated products, the notion of a distribution network in which the parties distribution the fund are well known and usually being limited, or even is missing. Of course if the wrong distribution network e.g. with a lack of sophisticated controls is present, that will increase the structure's risk exposure. In terms of concentration of the risk, in case of a smaller distribution network it will be more concentrated in smaller or private vehicles when one or more poor distributors are included in the network. It is more diluted in retail funds with a bigger distribution network, because most money invested will come from private investors and being well earned from legitimate sources. Therefore the proportion might be smaller but the risk is still there.

AD- Question 5: Speaking of new products on the Luxembourg Fund Market, such as ETFs, dedicated funds especially for high net worth individuals, sharia compliant investment funds or rent a sub-fund structures. Do you think that these trends will change the risk exposure of the Luxembourg Fund Industry?

INTERVIEWEE II- Answer 5: In my point of view it is more a question of concentration. If you look at a retail fund, being a product set up for the mass, you design the product for this specific purpose. Therefore it is more the concentration

on the actual beneficial owners/the controlling persons, the person who is providing the funds and the person who is dictating the investment strategy in the end, what is prevailing more than somebody who wants to have an exposure to European equity, U.S. bonds or similar products normally used as investments in retail funds. For me this is the only characteristic. The bottom line stays the same, it is only a matter of concentration on the controller and the source or origin of the funds.

AD- Question 6: To summarize your above statement, the risk is mainly situated around the execution of sophisticated controls and not having the insights on the distribution network of the vehicle.

INTERVIEWEE II- Answer 6: Being a dedicated fund I would not set the focus on the distribution network as this is usually very small or not existent at all, but more the concentration on the beneficial owner/s, the person setting up the structure and the purpose behind it. In a dedicated fund the origin of the funds is limited to certain sources and therefore more concentrated than in a mass retail fund.

AD- Question 7: Most funds incorporated in Luxembourg can benefit from an EU passport for distribution within the EU. Which impact does it have that the local AML/CTF Laws in the EU differ in every member state for the distribution via local distributors? As an example Italy or Poland can be named where the responsible for the AML-checks lays with other parties of the fund structure compared to Luxembourg?

INTERVIEWEE II- Answer 7: The funds we administrate are registered in 38 countries, that means the distribution network is not only limited EU in our case. Subsequently this question needs to be regarded in a worldwide context. This question is tricky, because it is true that there is risk. From my point of view, if a distributor is located farer away does not necessarily mean it will automatically pose a higher risk of not fulfilling the relevant AML-controls. A local one can also have lacks in its AML-controls. Our company's distribution model, e.g. is appointing one global/principle distributor, who then appoints all sub-distributors, meaning that there is an additional level between the final distributor and the ManCo. In this case the reputational risk is highly concentrated on the principle distributor in particular on him having the sophisticated AML-Framework in place and on performing the right controls on its sub-distribution network. Other market players have set up their

distribution network differently. This is due to different risk appetites and internal organizational structures of each company.

AD- Question 8: If you take the about question in the context of the '4th AML-Directive' further harmonizing the framework and setting minimum standards will make cross border distribution less risky?

INTERVIEWEE II- Answer 8: Indeed, there are some differences today. Having mentioned Poland as an example there a 'national' PEP is not considered as PEP according to the Polish Law. This leads to the questions if this fact increases the concentration of risk? In Poland omnibus accounts are prohibited and therefore a look through on the final investor is the norm. The underlying investor would be identified having a political exposure during the onboarding process, but the risk would be determined by the amount the person wants to invest being in line with their background and activity, the specific political function, the source of funds needing to be from the PEPs home country and from an account in the PEPs own name. If the money is not received from the PEP itself and not from the PEPs home country, the PEP can be regarded similar to an offshore structure and in this case a higher risk of ML is present.

AD- Question 9: Would it be feasible from the fund industry's perspective to tackle ML/TF with the same measures as currently requested by legislation; can the same measures actually be used or are different or additional controls necessary?

INTERVIEWEE II- Answer 9: This questions leads back to the initial one and from my point of view it is not going to work, because a fund is a financial and a savings instrument therefore a different model. As long as the framework tries to implement private banking rules within the fund industry it will not work effectively. There are already voices on the market that local AML-Framework concentrates very much on private banking. My opinion on this matter is that the framework is well written, and the fund industry has taken on bad habits of complaining. But by inverting the question, it needs to be said, that the fund industry has not yet been able to deliver a proper AML-Framework or guidance suitable to its business activities.

AD- Question 10: From your personal point of view do you think that the current risk based approach is sufficient to effectively detect ML/TF within a fund as the measures can to an extent be determined by the funds themselves?

INTERVIEWEE II- Answer 10: This goes back to a specific detail of the regulation that has to be kept in mind. The framework refers to the prevention of ML/TF. Subsequently the risk is always linked to the activity of the party, with whom the party is dealing, the setup of structures and the distribution channels. The risk-based approach is the only way to prevent ML. If a rule-based approach had been put place it would have been circumvented by the launderers very quickly.

AD- Question 11: Do you think that the new regulations such as UCITS V, AIFMD or the stricter requirements in the custodian banking business e.g. to verify the economical background of transactions could also help to detect or prevent ML/TF or are they strictly intended for the purpose of customer protection?

INTERVIEWEE II- Answer 11: From my point of view the purpose of customer protection is already to be questioned. Personally, I doubt that a custodian will add a lot in terms to the protection of the financial market. Regarding the controls and where they are implemented in the payment chain, the custodian is already one step behind on the knowledge of the customer. Therefore they do not manage any kind of AML risk. The same accounts for the Transfer Agents being part of a chain to optimize or to regroup the collection of documents. This leads back to questions of the scope of the regulation. If it always the fund's ManCo managing the risk and does that mean it has to manage the risk of any single investor that has been invested through the distribution network? Referring back to the initial statement a fund being a financial instrument the scope of the regulation is not optimal. From a personal point of view I am not convinced that this works effectively. In particular not in large retail or mass structures, normally being highly intermediated funds, a true visibility on the end investor is not provided in most cases. It works well in more dedicated funds similar to a private banking relationship where face-to face relationships are present and deeper analysis on each single investor is performed. To summarize it is the intermediation risk, which changes completely the risk landscape within an investment fund.

AD- Question 12: According to your opinion, which are the most important risk factors or variables to prevent or detect ML/FT in a fund used in your risk assessment?

INTERVIEWEE II- Answer 12: In the current situation the intermediation risk should be named as the most important risk factor. It is of high importance to have a sophisticated partner in the first layer of the distribution network and having particular knowledge in which manner its employees conduct their activity. A failure on the intermediary side to perform the AML controls properly will result in the acceptance of clients that are not in the risk appetite of the fund. Therefore it is best to partner with your distributor and build up partnership rather than a delegation. This will not in any case prevent the acceptance of fraudulent investors in a fund. The question in this case to ask is: was this done due a single error within the control process and the distributor was maybe abused or was the distributor willingly to accept this client and playing the role of an accomplice. In terms of our activity mostly being set around mass retail funds this is where the biggest risk is situated. In addition it is also the quality of the work performed by the people involved. Running fast and inefficient through the look through questions and the determination of the source of funds poses another threat of being abused for ML.

AD- Question 13: Do you think that increasing pressure to create revenue influences the enforcement of the AML/CTF Laws in the local fund industry? Please provide your personal opinion.

INTERVIEWEE II- Answer 13: Personally I do not really see this. The reputational risk is the risk the fund industry is quite keen on and considered as key factor for success. The challenge is where you want to distribute even further, how to manage the local risk where you commercialize the product. Do you select key market players or do you want to have anybody and everybody investing into your fund. The manner the local relationship manager handles its market plays also an important role. This needs to be considered the main risk drivers and not the reinforcement of rules and revenues.

AD: This was the last question. Thank you for taking the time to provide your insights on the Luxembourg Fund Industry to contribute to my thesis.

INTERVIEWEE II: You are welcome. I hope my answers are helpful.

AD: Yes very helpful.

Interview III

AD- Question 1: Please describe yourself, your background and your role in the company - including your daily/regular contact points with the Luxembourg AML/CTF Regulation in the fund industry?

A- Answer 1: I have been working in the area of AML since the mid of 2000, in various functions. At the time I started in the field of AML as the branch manager of the Cayman Islands branch of a well-known German based financial institution, when the first OECD tax haven initiative took place. The measures of the initiative lead in particular to a reinforcement of KYC requirements in Cayman Islands. This was my first contact with the field of AML. In 2003 I transferred to the company's headquarters in Frankfurt where I was involved in all facets of the AML topic, mainly responsible for foreign trade law, sanctions and embargos. In my position as the group's deputy MLRO the supervision and support of the international units of the group were part of my duty. Holding this position, I was responsible for conducting the first enterprise wide "Geldwäschegefährdungsanalyse" (ML threat/risk analyses). In 2006 I transferred to the Luxembourg subsidiary of the company to be closer to the business. Between 2008 and 2010 I was the group MLRO of a German Private Bank conducting this position out of Luxembourg. In 2010 I started working as Chief Compliance Officer Luxembourg for my current employer. From a regulatory perspective I was primary responsible for the Wealth Management business. Holding the role as Country Head as well, included the comprehensive responsibility for the Compliance Function of all Luxembourg based group units, being three fund management companies and a transfer agent. Since December 2016 I am the European Head of Financial Crime of our newly created European entity and responsible for the enterprise wide Financial Crime unit..

AD- Question 2: The first question relates to ML/TF in the fund industry in general. What is your general point of view and which of the two activities ML/TF poses in your opinion the bigger risk exposure to the local fund industry?

A- Answer 2: I am going to answer this question from an academic point of view, following the approach taken when performing a ML/TF risk analyses. In a first step, the conceptional/inherent risk is considered. In the next step, the risk mitigating measures are taken into consideration to determine the final, residual risk. When considering the risk exposure I can only recommend using this approach, otherwise

it is very likely, that out of self-interest, it might be quickly concluded that there is no risk present or the present risk is minimal and/or easily controllable. Speaking of the conceptional risk in general, a fund structure is suitable to be used to hide assets of any kind acquired by criminal means. In terms of the three money-laundering phases, the placement is the one quite unlikely to happen within a fund structure. The contribution of assets in kind or physical assets is not the norm when founding or subscribing into an investment fund. Normally subscriptions are made by the means of assets that already have taken the form of book money or financial assets. Looking at the alternative fund market placement could be possible there if physical assets such as art or jewelry can be contributed to the fund's assets or being part of the targeted investment. Considering the previous it can be stated that the fund industry is exposed to the risk of being used for ML. In fact I would consider the risk medium to high if I had to put in on scale, which will probably be deeper discussed in the course of the interview. I must admit the question of funds being used for or involved in TF is a lot harder to judge, due to the lack of empirical values. Experience has shown that TF aims at providing the funding for terrorist activities on a short term or maybe mid-term basis. Subsequently it seems logical that terrorists would prefer more liquid financial instruments. Nevertheless it cannot be excluded that funds are targeted as investment forms as well. From my point of view, at present empirical values do not point in this direction, therefore I can only provide this evolution based on the experience drawn from the scanty results of the criminal investigations so far performed and published. Consequently a concrete evaluation is very difficult at present.

AD- Question 3: Having already mentioned the placement being the first of the three stages of ML, how do you consider the risk exposure in terms of layering and integration within the local fund sector?

A- Answer 3: As already mentioned, placement cannot be unequivocally ruled out, but primary financial assets are less susceptible to the placement risk. To mitigate the risk even further the company has ceased to execute cash transaction, inflows as well as outflows a while ago. Other banks in the market might continue this practice due to their underlying business model and subsequently might be exposed to the placement risk. The Luxembourg Fund Industry, being one of the most sought of the EU countries for setting up investment funds and fund management

companies and a financial market on which mainly cross-border business takes place, has a strong exposure to the layering risk as well as to the integration risk.

AD- Question 4: Considering only the cash flows taking place within a fund structure where would you see the bigger or more possible threat a structure is exposed to: ML or TF?

A- Answer 4: As already stated above, in my opinion, ML poses the bigger risk exposure to the local fund industry, amongst other considering countries of distribution and distribution channels.

AD- Question 5: Is this due to the fact that the TF cash flow is a transitory one, ensuring the money is transferred from A to B?

A- Answer 5: This is one factor playing a role in my evaluation, even though it needs to be considered that these cash flows will also probably pass through different entities in several locations. In addition I think that the level of criminal maturity is more pronounced in the field of ML than in TF, if separate groups perform the deeds. Subsequently the level of sophistication is higher in the field of ML.

AD- Question 6: Taken the interim results of my thesis already into consideration, terrorists use criminal activities considered as predicate offence for ML to earn money to finance their attacks and/or structures. Can this statement be confirmed from your point of view?

A- Answer 6: That is indeed the case. In terms of exchange of experience between the local MLROs/Compliance Officers and to inform the later about the latest findings in the criminal investigations of the FIU, it took measures to foster this exchange last year. Within this exchange, it became obvious that the events connected to the recent terrorist attacks in Europe, can possibly not be analyzed in such details that sustainable patterns can be uncovered. At least, no patterns similar to the ones known used in ML activities. But indeed there is a blending of both activities especially considering that TF is not only done using clean money, but also involving money from criminal activities.

AD- Question 7: The next question relates to the possibility to delegate certain tasks within a fund structure. Even though they are CSSF circulars providing legal

requirements. Do you think the fact that a fund has outsourced several tasks to different service providers makes it more vulnerable to AML/CTF risks?

A- Answer 7: In principal: yes. The more the processes involved in AML/CTF are fragmented and the stronger the perception of each single party is focused only on the fragmented part it performs, the higher is the inherent risk not being able to recognize ML and/or TF. Having several providers within a fund structure a Management Company's only mitigating risk measure is to ensure to provide clear guidance on the processing of the delegated tasks and not to rely on the internal processes of the party the tasks are delegated to, e.g. on the risk classification such as the criteria of the risk classification and how they should be interpreted. This is clearly the main risk evolving when delegating tasks to third parties is involved. Even though the whole fund market is working on the same regulatory framework, its interpretation differs slightly among the participants of the fund market due to their origin and experience in the market or where the law consciously leaves spaces for own interpretation. The risk level is determined by how good the supervision of the delegated processes is put in place and being executed in line with the risk appetite of the entity and to which extent it is able to force its own processes on the service provider. Another point to be considered is that delegation can be done intentionally in order not to take care of certain issues in detail, as long as their dealt with in line with legal and regulatory requirements. In general the level of risk related to delegation is determined by the definition of the risk appetite of the delegating company. Some comfort is also provided by the fact that you can only delegate to entities that are subject to equivalent standards regarding the combat of ML/TF.

AD- Question 8: The next part of my research was related to funds being investment products themselves. On the local fund market there is a variety of different investment products available, which can inter alia be differentiated by their the fund regimes (UCITS vs. AIFMD), their investment strategies, e.g. tradable securities on stock market vs. real estate/private equity or microfinance and by the investor group they are targeting (retail vs. corporate). Considering the above mentioned criteria, for which structures or in which areas do you see the biggest risk exposure to ML/TF?

A- Answer 8: There I would like to make a short digression. Earlier this month PWC presented a case study based on true facts, which in summary highlighted that years ago, funds originating from criminal activities have been placed in certificates of

deposits in Luxembourg. This statement is not in line with the common inherent risk assessment of a certification of deposit, which normally is assessed being a product with low or maybe at utmost medium risk exposure. It is generally classified as a deposit or savings product, maybe depending on its structuring, it is directly transferrable. The more fungible it is, the higher is the risk associated with the certificates, in particular when it can be transferred anonymous in the form of bearer certificates. The statement is objecting entirely to the evaluation of the inherent risk assessment on this product.

The digression clearly illustrates that the risk exposure of products to ML is also determined by the ML phase in which it is used. ML as well as TF are internationally or at least cross-border structured activities, meaning that only part of the activities will take place in Luxembourg. Is the money only parked here or will a cross-border financial market like Luxembourg be used to perform the layering? This leads to the conclusion that it is not possible to precisely exclude any activity, phase or product. The above stated example provides very good evidence for this statement. When I first looked your interview questions, before visiting the PWC event, my original thoughts on UCITS were the following. Within a UCITS usually dominated on the assets side by fungible and liquid assets, being traded on differently regulated, but regulated markets the risk might be lower than with an AIF structure where the questions of how to value the actual market price of an asset is predominant. Within an AIF the possibility to use evaluation margins to move money is also existent, e.g. overpricing or over invoicing. In general the market tendency is to classify the UCITS as less risky than an AIF in terms of investments. Maybe, but this is only a personal assumption on my side, the fact that it is harder to recognize ML/TF within a UCITS structure has also an influence on this perception of the risks involved.

AD- Question 9: Not having attended the PWC event, I assume from your above description, that the certificates of deposits were purchased in the integration phase substituting the investments like real estate, jewelry, luxury car and goods typically associated with the integration phase in literature?

A- Answer 9: Yes this was the case.

This also accounts for mutual funds being widely distributed. I am not able to rule out entirely the possibility to have incriminated monies in the funds. When taking the view of a financial service provider, selling or distributing a mutual fund via a third party, depending on the fund structure's setup (labeling or distribution of own funds), the

service provider analysis the AML/CTF policies and procedures of the third party as well as their effectively enforcement. If the analysis turns out satisfying the third party will become part of the distribution network. While when having a smaller circle of investors the service provider takes a closer look at each single investor.

In addition the impact of the reputational risk has to be considered as well. The failure of not having identified one criminal, amongst the mass of investors in a mutual fund would potentially not pose a high severe reputational risk. While a failure, regardless of your regulatory duties, to identify a criminal within a fund of 15 investors will always be hold against the company as failure, which they could have been able to prevent and therefor presenting a high reputational risk exposure. In such cases the materialization of the risk, in the unlikely event the worst-case scenario happens, is a lot higher. Consequently according to the risk appetite of the service provider additional measures and closer investigation on the investors of smaller funds are performed.

AD- Question 10: In terms of risk exposure, which is your position concerning new trends in the fund sector visible e.g. dedicated funds especially for high net worth individuals, sharia compliant investment funds or rent a sub-fund models. Also taken the latest CSSF circular 17/650 regarding tax crimes into consideration?

A- Answer 10: In general we do not advice our clients on the setup or the choice of specific structures or investment strategies for their investments, we solely provide the services associated with the structures. The client approaches us with already having a proposal for its structure in place. We do provide services for dedicated funds for high network individuals. Our product line does not include the setup sharia compliant or rent a sub-funds models and we do not offer the service to take promoter ship in a fund. These products are not in line with our risk appetite. We offer the financial services for existing structures, which the client has to set up himself.

AD- Question 11: Only to clarify my understanding, the structuring needs to be done by the client?

A- Answer 11: Absolutely, in a case where a client explicitly wishes our company to structure a product, a dedicated team, being aware of all aspects to be considered, will take care of this request in line with the regulatory framework. Meaning that e.g.

tax advice will not be provided and left to tax professionals. The risks associated with tax advisory are out of our risk appetite.

From a service provider's perspective the tax situation is very complex, especially in terms of classifying if the product is related to tax evasion or tax fraud or if it is legal tax planning or tax organization. Consequently a while ago we decided to not only rely on the abstract comfort of the tax compliance provided by our clients and put measures in place to document the tax compliance of our clients. Therefore from our point view the CSSF circular does not pose any additional risk exposure to our company, but I cannot speak for other service provides.

The political motivated trend to label tax planning or tax organization as improper or scandalous and maybe the need to prevent in the future might have an influence on the regulatory framework of the local financial market. The development of this situation and its impacts cannot be fully anticipated. It is difficult to put the changing standards into practice upfront. Consequently the developments of such trends have to be monitored closely.

They can be compared to long-term client relationships, which started 30 years ago. During the client relationship the client has been evaluated differently due to the changing regulatory requirements over the years, in particular in regards to the AML Framework. An example of the changes in terms of ML is the constant extension of the predicate offences over the years. When at the time of the setup of a structure the offence, which it is exposed to now, was not considered as an offence at all or not named as predicate offence for ML, but became one lately, the question is how to handle this situation under the current given circumstances. This is a tricky situation and therefore on the product side it needs to be verifiable that the purpose of the structure is plausible, is matching the background of the client, is excluding tax related issues and predicate offences and that the use of the structure is legally unobjectionable. All the mentioned factors must be considered taken the specific risk appetite of the relevant service provider into consideration.

AD- Question 12: Summarizing your statements in terms of services provided to HNWI and dedicated funds the risk approach is the same as for any other product. The products provided have to be assessed in terms of the risk they pose the company, the product related risk factors have to be identified and risk mitigating measures if existent have to be put and place or be development. The main issue is

to identify the relevant risk factors and the mitigating measures to lower the risk exposure. Otherwise those products might pose a higher risk exposure.

A- Answer 12: Yes, indeed. This is also reflected in our risk-based approach. As a risk mitigation measure the involvement of Compliance in the on boarding process of a fund structure is always necessary. Whereas for other products or clients presenting after the risk rating a low or medium risk exposure it is not necessary to involve the Compliance Function. Of course in case of doubts or unusual factors identified Compliance can be involved at any time in the process.

AD- Question 13: Further taking the benefit of the EU passport, namely EU wide distribution without local registration into consideration, established under the 3rd AML-Directive not providing minimum AML standards for all member states. From your point of view as a Luxembourg based service provider which consequences does the above have in terms of cross boarder distributing of funds.

A- Answer 13: The trend observed over the last years was that clients, having set up their fund structures in 'real' offshore locations, being jurisdictions regarded as very moderately regulated, transferred their structures to Luxembourg. The good international reputation of the local fund market and being within the EU is regarded as label for quality and high service standards and enhanced the integrity of the fund structure. In addition the EU passport lightens the cross-border distribution. The point, which you have addressed, makes reality not as easy as it seems at first, because each country has slightly different requests in regards to AML/KYC documentations and tasks. In a worst case of doubt you have a different product that you distributing in the other country. The fully harmonization of the AML/KYC requirements and approaches has not taken place within the third directive. The questions leads back to the initial ML risk to understand, who the ultimate investor is, which monies the investor contributes to the fund and where these monies come from. In this case the location of incorporation is relevant but the setup of the distribution network needs to be regarded in detail.

In particular regarding the concept of the nominee investor being an equivalent regulated financial institution. On the one hand the concept is the condition that distribution works as it does today, including the aspect of pass porting. On the other hand it is not sufficient to make the statement that a nominee Investor always equals a higher risk the overall situation of each specific case has to be taken into account.

This involves analyzing the fund-structure, the distribution network, the investments as well as the investors. However the nominee investors are those ones that are posing the biggest challenges to the involved parties. Directly linked to this kind of investment in a fund is the investment through fund platforms. Usually a fund being distributed via a fund platform does not imply that the platform is performing the relevant customer due diligence on the underlying investors investing through it. This brings back the importance of the sound knowledge on the distribution channels of the fund as well as what has been already been stated in terms of delegation of tasks to several parties. The risk is always be determined by of the above factors no matter if they multiply each other or if they raise the risk exponentially.

In terms of guidelines, there are no too precise guidelines for the fund sector available describing the risk and risk mitigating measures in particular situations. The existing ones – the guidelines issued by ALFI/ALCO/ABBL – are consciousness kept general to provide the most guidance possible but due to the diversity of structures cannot take every particular one into consideration.

An interesting point to be considered on the views on nominees is, that regulators of other states might consider the concept of nominees differently. The statement that, acting on the initiative of someone else does not facilitate the application of simplified customer due diligence measures. Meaning that not identifying the economic beneficiary is only possible in the cases of ownership and control, but not in the case when acting on the initiative of a third party. This might not be the case for mutual funds but for nominees in other structures. Consequently the acceptance of a nominee investor is questioned by this statement.

It also needs to be kept in mind that identification requirement for the economic beneficiary when having 25% or more ownership, is a minimum requirement. The conclusion should not be drawn that below this threshold there is no economic beneficiary. Subsequently a financial institution can set lower thresholds in line with its risk appetite.

AD- Question 14: My next question evolves around the regulatory environment. Currently ML/TF are put under the same regulations and combated with the same measures. From a fund industry perspective do you think it is feasible or should the measures be tailor made for the financial service providers according to their business activity?

A- Answer 14: This is a question on how the framework is designed. Here in Luxembourg the framework is originally politically orientated and motivated, which needs to be accepted to a certain point. The framework could be possibly enhanced, by providing precise instructions on the implementation of the measures. To make differences from a regulatory framework would not have any additional value. The existence of one legal foundation is a good basis. The matter to be considered is the implementation of a meaningful risk based approach in the different activities of the financial institution. A good instrument to do so would be the establishment of more specific guidelines with a normative character. Germany e.g. publishes the 'Auslegungs- und Anwendungshinweise' specific papers providing guidance on the implementation of the regulations. On the one hand they leave certain space for the institution's risk based approach, on the other hand, especially for the retail business, they provide concrete specifications, which are aligned with the regulator and regarded as administrative practice. This provides a higher level of security and a better framework. For Luxembourg such guidelines could ease the discussions and answer questions on the interpretation of the legislative texts. In addition changes in standards could be communicated more effectively and efficiently to all market members. The different interpretation by local market participants including the advisory sector leads to confusion within the customer base and does not establish a coherent overall picture of the Luxembourg Fund Market.

AD- Question 15: On my last question I would appreciate your honest personal view. Do you think that increasing pressure to create revenue influences the enforcement of the AML/CTF Laws in the local fund industry?

A- Answer 15: I can only speak for myself and from my experience and can deny this question. Generally speaking in a free market economy standards can be applied differently. This questions needs to be considered under the individual risk appetite of each institution and under the reputational risk factor.

If this question is considered in the setting of the political changes in the US, it becomes clear that this matter is also driven by politics. Therefore the development of this trend needs to be monitored, taken in to consideration that not only combatting ML and crime, but also the fair treatment of customers is concerned.

AD: This was the last the question on my side. If you would like to add any comments or remarks from your side, please feel free to do so.

A: No.

AD: Thank you for your time.

Bibliography

- Acharya, A. (2009). *Targeting Terrorist Financing: International Cooperation and New Regimes*. Abingdon, UK: Routledge.
- Baker, R. (2005). *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System*. Hoboken, USA: John Wiley & Sons Inc.
- Baxter, R. R. (1974). A Skeptical Look At The Concept of Terrorism. *Akron Law Review*, 7(3), 380.
- Beare, M. E. (2007). *Money Laundering in Canada: Chasing Dirty and Dangerous Dollars*. Toronto, CA: University of Toronto Press Incorporated.
- Cox, D. (2014). *Handbook of Anti-Money Laundering*. Chichester, UK: John Wiley & Sons, Ltd.
- Dembowski, A. (2012). *Profi-Handbuch Investmentfonds: Grundlagen - Auswahl - Anlagestrategien*. Regensburg, DE: Walhalla u. Praetoria Verlag GmbH & Co. KG.
- EY. (2015). *Investment Funds in Luxembourg - A technical guide*. Luxembourg, LU: Ernst & Young S.A.
- EY. (2016). *Investment Funds in Luxembourg - A technical guide*. Luxembourg, LU: Ernst & Young S.A.
- Financial Action Task Force (b). (2016). *INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION - The FATF Recommendations*. Paris, FR: FATF/OECD.
- Financial Action Task Force (c). (2008). *TERRORIST FINANCING*. Paris: FATF/OECD.
- Financial Action Task Force (d). (2015). *Money Laundering Through the Physical Transportation of Cash*. Paris, FR: FAFT/OECD and MENAFATF.
- Financial Action Task Force (e). (2010). *Global Money Laundering & Terrorist Financing Threat Assessment*. Paris, France: FATF/OECD.
- Freeman, M. (2016). *Financing Terrorism: Case Studies*. Abingdon, UK: Routledge.

- Grosse, R. E. (2001). *Drugs and Money: Laundering Latin America's Cocaine Dollars*. Westport, US: Praeger Publishers.
- Gurulé, J. (2008). *Unfunding Terror: The Legal Response to the Financing of Global Terrorism*. Cheltenham, UK: Edward Elgar Publishing Limited.
- Higgins, R. (1997). The general international law of terrorism. In M. Flory, & R. Higgins, *Terrorism and International Law* (p. 28). London, UK: Routledge.
- Hopton, D. (2016). *Money Laundering: A Concise Guide for All Business*. New York, NY, US: Routledge.
- International Monetary Fund (a). (2004). *Luxembourg: Detailed Assessment of Observance of Standards and Codes-FATF - Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*. Washington D.C.: International Monetary Fund Publication Services.
- Koh, J.-M. (2006). *Suppressing Terrorist Financing and Money Laundering*. Berlin - Heidelberg, DE: Springer.
- Levy, S. M. (2016). *Federal Money Laundering Regulation: Banking, Corporate and Securities Compliance*. New York: Wolters Kluwer.
- Madinger, J. (2012). *Money Laundering: A Guide for Criminal Investigators, Third Edition*. Boca Raton, US: Taylor & Francis Group LLC.
- Maylam, S. (2003, April 01st). Prosecution for money laundering in the UK. *Journal of Financial Crime*, pp. 157-158.
- Mugarura, N. (2016). *The Global Anti-Money Laundering Regulatory Landscape in Less Developed*. New York: Routledge.
- Norwitz, J. H. (2009). *Pirates, Terrorists, and Warlords: The History, Influence, and Future of Armed Groups Around the World*. New York, US: Skyhorse Publishing.
- OECD - Organisation for Economic Co-operation and Development. (2009). *Money Laundering Awareness Handbook for Tax Examiners and Tax Auditors*. Paris, FR: OECD - Organisation for Economic Co-operation and Development.

- Richards, J. R. (1999). *Transnational Criminal Organizations, Cybercrime, and Money Laundering: A Handbook for Law Enforcement Officers, Auditors, and Financial Investigators*. Boca Rota: CRC Press LLC.
- Ryder, N. (2015). *The Financial War on Terrorism: A review of counter-terrorist financing strategies*. New York, NY, US: Routledge.
- Schikora, L. (2012). *Eine kritische Analyse der Geldwäscheproblematik mit aktuellem Bezug zum polnischen Recht*. Hamburg, DE: Diplomica Verlag GmbH.
- Schmid, A. P., & Jongman, A. J. (1988). *Political Terrorism: A New Guide To Actors, Authors, Concepts, Data Bases, Theories & Literature*. London, UK: Transaction Publishers.
- Steiner, A. (2010). *Investmentfonds oder Lebensversicherung*. Hamburg, DE: Diplomica Verlag GmbH.
- The Stationery Office, London. (2006). *Report of the Official Account of the Bombings in London on 7th July 2005*. House of Commons, London.
- Thony, J.-F. (2005). Money Laundering and Terrorism Financing: An Overview. In I. M. Fund, *Current Developments in Monetary and Financial Law* (pp. 241-255). Washington, D.C., US: International Monetary Fund, Publications Services.
- Turner, J. (2011). *Money Laundering Prevention: Deterring, Detecting, and Resolving Financial Fraud*. Hoboken, NJ, US: John Wiley & Sons.
- Unger, B., & Busuioc, E. M. (2007). *The Scale and Impacts of Money Laundering*. Cheltenham, UK: Edward Elgar Publishing Limited.
- Unger, B., & van der Linde, D. (2013). *Research Handbook on Money Laundering*. Cheltenham: Edward Elgar Publishing Limited.
- United Nations Security Council. (2004). *First report of the Analytical Support and Sanctions Monitoring Team appointed pursuant to resolution 1526 (2004) concerning Al-Qaida and the Taliban and associated individuals and entities - S/2004/679*. United Nations . United Nations.
- United States General Accounting Office. (2010). *TERRORIST FINANCING U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms*. In K. E. Boon,, A. Huq, & D. C. Lovelace, Jr.,

Terrorist Financing and Money-laundering (pp. 197-244). New York, US: Oxford University Press Inc.

World Bank. (2009). *Combating Money Laundering and the Financing of Terrorism - A Comprehensive Training Guide*. Washington DC, US: The International Bank for Reconstruction and Development/The World Bank.

Internet Sources

2016/0208 (COD) DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC. (2016, July 05th). Retrieved December 07th, 2016, from http://ec.europa.eu/justice/criminal/document/files/aml-directive_en.pdf

ALFI - Association of the Luxembourg Fund Industry (a). (2013, July). *alfi*. Retrieved January 13th, 2017, from Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg Fund Industry- Guidelines: <http://www.alfi.lu/sites/alfi.lu/files/files/Alfi%20guidelines%20and%20recommendations/Guidelines-ABBL-ALCO-ALRIM-final.pdf>

ALFI - Association of the Luxembourg Fund Industry (b). (January, 30th 2012). *alfi*. Retrieved January 15th, 2017, from characteristics of an investment fund: <http://www.alfi.lu/investor-centre/how-do-ucits-investment-funds-work/characteristics-investment-fund>

ALFI - Association of the Luxembourg Fund Industry (c). (2017, January 13th). *ALFI - Statistic and Figures*. Retrieved January 18th, 2017, from Net assets under management in Luxembourg funds: http://www.alfi.lu/sites/alfi.lu/files/files/Statistics/Luxembourg/ouverture_section_statistique_chiffres_du_mois.pdf

ALFI - Association of the Luxembourg Fund Industry (d). (2017, January 13th). *alfi - Statistics & Figures - luxembourg*. Retrieved January 19th, 2017, from <http://www.alfi.lu/statistics-figures/luxembourg>

- ALFI - Association of the Luxembourg Fund Industry (e). (2013, April). *Alfi - Why Luxembourg? Luxembourg: The Global Fund Center*. Retrieved January 19th, 2017, from http://www.alfi.lu/sites/alfi.lu/files/files/Publications_Statements/Brochures/Luxembourg-the-global-funds-centre.pdf
- ALFI - Association of the Luxembourg Fund Industry (f). (2017, January 06th). *alfi - setting up in Luxembourg - UCITS*. Retrieved February 22nd, 2017, from basic information: <http://www.alfi.lu/setting-luxembourg/ucits/basic-information>
- ALFI - Association of the Luxembourg Fund Industry (g). (2012, March 12th). *alfi - how ucits funds protect investors*. Retrieved February 18th, 2017, from <http://www.alfi.lu/investor-centre/investor-protection/how-ucits-funds-protect-investors>
- ALFI - Association of the Luxembourg Fund Industry (h). (2017, January 06th). *setting up in luxembourg- alternative investment funds -sif - specialised investment funds*. Retrieved February 19th, 2017, from <http://www.alfi.lu/setting-luxembourg/alternative-investment-funds/sif>
- ALFI - Association of the Luxembourg Fund Industry (i). (2017, January 10th). *setting up in luxembourg- alternative investment fund - sicar - investment company in risk capital*. Retrieved February 21st, 2017, from <http://www.alfi.lu/setting-luxembourg/alternative-investment-funds/sicar>
- ALFI - Association of the Luxembourg Fund Industry (j). (2017, January 10th). *setting up in luxembourg- alternative investment fund - uci - undertakings for collective investment established under part 2 of the law of 2010*. Retrieved February 21st, 2017, from <http://www.alfi.lu/setting-luxembourg/alternative-investment-funds/uci>
- Allen & Overy. (2016, December). *European Finance Litigation Review - Auto-laundering: Luxleaks impact on suspicious transaction reporting*. Retrieved January 20th, 2017, from <http://www.allenoverly.com/publications/en-gb/european-finance-litigation-review/Documents/EFLR%20Dec16.PDF/european-finance-litigation-review/western-europe/Pages/Auto-laundering-Luxleaks-impact-on-suspicious-transaction-reporting.aspx>

- Arendt & Medernach. (2013, February). *investment management*. Retrieved February 25th, 2017, from <http://www.arendt.com/publications/documents/brochures/im-ucits%2002.2013.pdf>
- Aufhauser, D. (2003, June 26th). *AIR UNIVERSITY - The Threat of Terrorist Financing*. Retrieved January 10th, 2017, from http://www.au.af.mil/au/awc/awcgate/congress/terrorist_financing.htm
- Brisard, J.-C. (2002, December 19th). *TERRORISM FINANCING - Roots and trends of Saudi terrorism financing*. Retrieved December 8th, 2016, from <http://www.investigativeproject.org/documents/testimony/22.pdf>
- Bureau for International Narcotics and Law Enforcement Affairs, U.S. Department of State. (1998, March). *Hellenic Resources Network*. Retrieved December 04th, 2016, from U.S. Department of State 1997 International Narcotics Control Strategy Report: <http://www.hri.org/docs/USSD-INCSR/97/Financial.html>
- Bureau of International Narcotics and Law Enforcement Affairs. (2004, March). *U.S. Department of State - Money Laundering and Terrorist Financing: A Global Threat*. Retrieved January 11th, 2017, from <https://www.state.gov/j/inl/rls/nrcrpt/2003/vol2/html/29843.htm>
- BVI Bundesverband Investment und Asset Management e.V. BVI - Deutscher Fondsverband. (2014, April). *OFFENE INVESTMENTFONDS FLEXIBEL UND VOR INSOLVENZ GESCHÜTZT*. Retrieved January 15th, 2017, from https://www.bvi.de/fileadmin/user_upload/Bestellcenter/BVI_2014_Offene_Investmentfonds_.pdf
- Carne Group. (2014). *UCITS Guide for Investment Managers - A guide for investment managers, promoters and distributors to establishing UCITS funds*. Retrieved February 22nd, 2017, from <http://www.carnegroup.com/wp-content/uploads/2014/08/UCITS-Guide-for-Investment-Managers-August-2014.pdf>
- Code Pénal. (2016, July 10th). Retrieved January 19th, 2017, from <http://legilux.public.lu/eli/etat/leg/code/penal/20160710#>

- Council of Europe. (1990, November 08th). *Treaty Office - Details of Treaty No.141 - Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime*. Retrieved December 04th, 2016, from https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/141?_coeconventions_WAR_coeconventionsportlet_languageId=en_GB
- CSSF - Commission de Surveillance du Secteur Financier (a). (2016, July 15th). *Anti-money laundering and counter-terrorist financing: Laws, regulations and other texts*. Retrieved January 13th, 2017, from <https://www.cssf.lu/en/supervision/financial-crime/aml-ctf/laws-regulations-and-other-texts/>
- CSSF - Commission de Surveillance du Secteur Financier (b). (n.d.). *Net assets of UCIs*. Retrieved February 24th, 2017, from <http://www.cssf.lu/en/supervision/ivm/ucits/statistics/monthly-statistics/net-assets-of-ucis/>
- CSSF - Commission de Surveillance du Secteur Financier (c). (2017, January 26th). *GLOBAL SITUATION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT AND SPECIALISED INVESTMENT FUNDS AT THE END OF NOVEMBER 2016*. Retrieved February 23rd, 2017, from http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués_2017/PR1705_uci_250117.pdf
- CSSF - Commission de Surveillance du Secteur Financier (d). (n.d.). *Investment policy of UCIs - Breakdown according to investment policy*. Retrieved February 22nd, 2017, from <http://www.cssf.lu/en/supervision/ivm/ucits/statistics/monthly-statistics/investment-policy-of-ucis/>
- CSSF - Commission de Surveillance du Secteur Financier (e). (n.d.). *Marketing of units/shares of a Luxembourg UCITS in the EU*. Retrieved February 18th, 2017, from <http://www.cssf.lu/en/supervision/ivm/ucits/marketing-shares-units-ucits/marketing-lux-eu-notification/>
- CSSF - Commission de Surveillance du Secteur Financier (f). (n.d.). *Commission de Surveillance du Secteur Financier - ANNUAL REPORT 2015*. Retrieved February 25th, 2015, from

https://www.cssf.lu/fileadmin/files/Publications/Rapports_annuels/Rapport_2015/RA_2015_EN_full_version.pdf

CSSF Regulation N° 12-02 of 14 December 2012 on the fight against money laundering. (2012). Retrieved March 04th, 2017, from http://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/RG_CSSF/RCSF_No12-02eng.pdf

Debroise, F. (2015, May 12th). *Anti money laundering - Look through, behind and beyond: Seek and find the beneficial owner - a Luxembourg perspective*. Retrieved March 04th, 2017, from <https://ogier.com/publications/anti-money-laundering-look-through-behind-and-beyond-seek-and-find-the-beneficial>

Delbecque, B., & Carroll, A. (2016, December). *Efama - Quarterly Statistical Release*. Retrieved January 15th, 2017, from Trends in the European Investment Fund Industry in the Third Quarter of 2016: http://www.efama.org/Publications/Statistics/Quarterly/Quarterly%20Statistical%20Reports/161212_Quarterly%20Statistical%20Release%20Q3%202016.pdf

Dillon Eustace. (2008). *A Guide to UCITS in Ireland*. Retrieved January 18th, 2017, from <http://www.dilloneustace.ie/download/1/DE%20UCITS%20Brochure%20FA%20Web.pdf>

DZ PRIVATBANK S.A. (2017). *FONDSKONSTRUKTIONEN: DER WEG ZUM INDIVIDUELLEN FONDSKONZEPT*. Retrieved February 21st, 2017, from <https://www.dz-privatbank.com/dzpb/de/fondskonstruktionen.html>

EU DIRECTIVE 2005/60/EC of 26 October 2005. (2005, November 25th). Retrieved January 19th, 2017, from <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32005L0060&from=en>

European Commission (a). (2017, January 10th). *MIGRATION AND HOME AFFAIRS - Financing*. Retrieved January 10th, 2017, from https://ec.europa.eu/home-affairs/what-we-do/policies/crisis-and-terrorism/financing_en

European Commission (b). (2012, April 11th). *European Commission - Press Release Data Base*. Retrieved January 13th, 2017, from European

Commission report on the application of the Third Anti-Money Laundering Directive - Frequently asked questions: http://europa.eu/rapid/press-release_MEMO-12-246_de.htm?locale=en

European Union. (2015, August 30th). *EUR-Lex - Access to European Union*. Retrieved January 17th, 2017, from <http://eur-lex.europa.eu/legal-content/EN-DE/TXT/?uri=URISERV:l14527&from=DE>

Financial Action Task Force (a). (2016). *Money Laundering - Financial Action Task Force*. (F. A. Force, Ed.) Retrieved December 05th, 2016, from <http://www.fatf-gafi.org/faq/moneylaundering/>

Financial Action Task Force (f). (2017). *Money laundering and terrorist financing risks*. Retrieved March 07th, 2017, from <http://www.fatf-gafi.org/publications/methodsandtrends/documents/ml-tf-risks.html>

Financial Crimes Enforcement Network. (n.d.). *Money Services Business Definition*. Retrieved January 10th, 2017, from <https://www.fincen.gov/money-services-business-definition>

Financial Markets Limited. (2009). *finmarkfx.com*. Retrieved January 01st, 2017, from https://finmarkfx.com/en/docs/Anti_Money_Laundering.pdf

Financial Transactions and Reports Analysis Centre of Canada. (2015, May 30th). *What is terrorist financing?* Retrieved January 10th, 2017, from <http://www.fintrac-canafe.gc.ca/fintrac-canafe/definitions/terrorist-terroriste-eng.asp>

Freeman, M., & Ruehsen, M. (2013, August). Terrorism Financing Methods: An Overview. *Perspectives on Terrorism*, 7(4), 5-27. Retrieved January 03rd, 2017, from <http://www.terrorismanalysts.com/pt/index.php/pot/article/view/279/html>.

Grand-ducal Regulation of 1 February 2010 providing details on certain provisions of the amended law of 12 November 2004 on the fight against money laundering and terrorist financing. (2015, January 01st). Retrieved March 05th, 2017, from http://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/RG_NAT/gdr_aml_ft_01022010_upd050815_eng.pdf

- HM Treasury. (2016, October 31st). *GOV.UK - Consultation outcome Amendments to the UCITS Directive (UCITS V)*. Retrieved February 28th, 2017, from <https://www.gov.uk/government/consultations/consultation-on-amendments-to-the-ucits-directive-ucits-v/amendments-to-the-ucits-directive-ucits-v>
- International Bar Association. (2015, March 03rd). *Anti-Money Laundering Forum - Luxembourg*. Retrieved January 13th, 2017, from <http://www.anti-moneylaundering.org/europe/luxembourg.aspx>
- International Monetary Fund (b). (1998, February 10th). *Speech: Money Laundering: the Importance of International Countermeasures--Address by Michel Camdessus*. Retrieved December 04th, 2016, from <http://www.imf.org/external/np/speeches/1998/021098.htm>
- IRS - Internal Revenue Service. (2016, April 29th). *Overview - Money Laundering*. (IRS - Internal Revenue Service) Retrieved December 05th, 2016, from <https://www.irs.gov/uac/overview-money-laundering>
- Joint Committee of the European Supervisory Authorities. (2015, October 21st). *Joint Consultation Paper - The Risk Factors Guidelines*. Retrieved March 05th, 2017, from [file:///M:/MBA%20-%20Masterthesis/JC%202015%20061%20\(Joint%20Draft%20Guidelines%20on%20AML_CFT%20RFWG%20Art%2017%20and%2018\).pdf](file:///M:/MBA%20-%20Masterthesis/JC%202015%20061%20(Joint%20Draft%20Guidelines%20on%20AML_CFT%20RFWG%20Art%2017%20and%2018).pdf)
- King, C. (2010, October 18th). *The Economic Crime and Cybersecurity Institute of Utica College*. Retrieved December 30th, 2016, from TEAMING TO FIND THE FRAUDSTER: MONEY LAUNDERING DETECTION AND INVESTIGATION: <http://www.ecii.edu/conferences/2010-conference-presentations/>
- Knoema (a). (2016, October 07th). *GDP Statistics from the World Bank*. Retrieved December 04th, 2016, from <https://knoema.com/mhrzolg/gdp-statistics-from-the-world-bank?country=World>
- Knoema (b). (2016, March 25th). *GDP by Country, 1980-2015*. Retrieved December 05th, 2016, from <https://knoema.com/tbocwag/gdp-by-country-1980-2015?subject=U.S.%20dollars&country=Canada>

- Knoema (c). (2016, May 25th). *GDP by Country, 1980-2015*. Retrieved December 04th, 2016, from <https://knoema.com/tbocwag/gdp-by-country-1980-2015?subject=U.S.%20dollars&country=Germany>
- KPMG. (2016, September). *Luxembourg Investment Vehicles - An overview of the legal and regulatory requirements*. Retrieved January 19th, 2017, from <https://home.kpmg.com/content/dam/kpmg/lu/pdf/lu-en-brochure-regulated-investment-vehicles-2016-spread-web.pdf>
- LaHood, M.-J. (n.d.). *ACAMS The money service business in the USA*. Retrieved January 10th, 2017, from <http://www.acams.org/wp-content/uploads/2015/08/The-Money-Service-Business-in-the-USA-How-to-Comply-with-Federal-and-State-Laws-Regu.pdf>
- Law of 12 November 2004. (2015, July 24th). Retrieved January 13th, 2017, from https://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/Lois/L_121104_AML_upd240715_eng.pdf
- Law of 17 December 2010. (2016, March 15th). Retrieved February 21st, 2017, from https://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/Lois/L_171210_UCI_upd150316.pdf
- LCG International AG. (2013, September). *Investmentfonds SICAV/SICAF Luxembourg*. Retrieved February 25th, 2017, from <http://www.firmengruendung-luxemburg.com/pdf/Investmentfonds-SICAV-SICAF-Luxemburg.pdf>
- Luxembourg for Finance - Agency for the Development of the Financial Centre (a). (n.d.). *FUND STRUCTURING*. Retrieved January 21st, 2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-funds>
- Luxembourg for Finance - Agency for the Development of the Financial Centre (b). (n.d.). *INVESTMENT FUNDS*. Retrieved January 19th, 2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-funds/fund-structuring>
- Luxembourg for Finance - Agency for the Development of the Financial Centre (c). (n.d.). *ALTERNATIVE INVESTMENT FUNDS*. Retrieved February 23rd,

2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-vehicles/alternative-investment-funds>

Luxembourg for Finance - Agency for the Development of the Financial Centre (d). (2015, May). *HOW TO SET UP A NON-UCITS ("PART II") FUND*. Retrieved February 26th, 2017, from http://www.luxembourgforfinance.com/sites/luxembourgforfinance/files/lff_how_to_set_up_non_ucits_fund.pdf

Luxembourg for Finance - Agency for the Development of the Financial Centre (e). (n.d.). *INVESTMENT FUND MANAGEMENT COMPANIES*. Retrieved February 27th, 2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-vehicles/investment-fund-management-companies>

Luxembourg for Finance - Agency for the Development of the Financial Centre (f). (n.d.). *FUND ADMINISTRATION*. Retrieved February 26th, 2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-funds/fund-administration>

Luxembourg for Finance - Agency for the Development of the Financial Centre (g). (n.d.). *SOPARFI*. Retrieved March 16th, 2017, from <http://www.luxembourgforfinance.com/en/products-services/investment-vehicles/soparfi>

Mardinger, J., Doyle, G., & Ferrara, A. (n.d.). *How much does money laundering cost?* Retrieved March 12th, 2017, from <https://www.quora.com/How-much-does-money-laundering-cost>

Money Laundering Threat Assessment Working Group. (2005, December). *U. S. Money Laundering Threat Assessment -December 2005*. Retrieved January 10th, 2017, from <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/mlta.pdf>

Parquet du tribunal d'arrondissement de Luxembourg - Cellule de renseignement financier (CRF). (2016, October). *Lutte anti-blanchiment - Cellule de renseignement financier (CRF)*. Retrieved December 06th, 2016, from <http://www.justice.public.lu/fr/publications/rapport-activites-crf/rapport-crf-2015.pdf>

- PwC - PricewaterhouseCoopers. (2015). *Securitisation in Luxembourg*. Retrieved January 19th, 2017, from <http://www.pwc.lu/en/securitisation/docs/pwc-securitisation.pdf>
- PWC. (2016, January). *Know Your Customer: Quick Reference Guide*. Retrieved January 13th, 2017, from <https://www.pwc.com/gx/en/financial-services/publications/assets/pwc-anti-money-laundering-2016.pdf>
- Reckinger, P. (n.d.). *Elvinger, Hoss & Prussen*. Retrieved December 04th, 2016, from Anti-money laundering in Luxembourg: <http://www.ehp.lu/uploads/media/AntimoneylaunderingLuxembourg.pdf>
- Richards, James R. for Association of Certified Anti-Money Laundering Specialists. (2012). *ACAMS - Advanced Financial Crime Professionals World Wide*. (A. o.-M. Specialists, Ed.) Retrieved January 02nd, 2017, from <http://www.acams.org/cams-english-study-guide/>
- SEI Global Asset Management Product Guide. (2012). *Luxembourg SICAV/SICAF*. Retrieved February 19th, 2017, from https://www.seic.com/IMS/SEI_Lux_SICAV_EU.pdf
- Stelzel, K. (2016). *KrimLEX*. (P. D. Feltes, Producer) Retrieved December 26th, 2016, from http://www.krimlex.de/artikel.php?BUCHSTABE=&KL_ID=28
- UNODC - United Nations Office on Drugs and Crime (a). (2016). *Introduction to money-laundering*. (United Nations Office on Drugs and Crime) Retrieved December 05th, 2016, from <https://www.unodc.org/unodc/en/money-laundering/introduction.html>
- UNODC - United Nations Office on Drugs and Crime (b). (2011, October 25th). *Illicit money: how much is out there?* Retrieved December 04th, 2016, from http://www.unodc.org/unodc/en/frontpage/2011/October/illicit-money_-how-much-is-out-there.html
- UNODC - United Nations Office on Drugs and Crime (c). (2016). *The Money-Laundering Cycle*. Retrieved December 18th, 2016, from <https://www.unodc.org/unodc/en/money-laundering/laundrycycle.html>
- Walker, J. (1998, November 30th). *Modelling Global Money Laundering Flows - some findings*. Retrieved December 04th, 2016, from <http://www.johnwalkercrimetrendsanalysis.com.au/ML%20method.htm>

WebFinance Inc. (2017). *BunsineesDictionary - Expert*. Retrieved March 08th, 2017, from <http://www.businessdictionary.com/definition/expert.html>

EIKV-Schriftenreihe zum Wissens- und Wertemanagement

Bereits erschienen

2015	Francesca Schmitt	Intellectual Property and Investment Funds	Band 1
2016	Sebastian Fontaine	The electricity market reinvention by regional renewal	Band 2
2016	Tim Karius	Intellectual Property and Intangible Assets - Alternative valuation and financing approaches for the knowledge economy in Luxembourg	Band 3
2016	Irena Hank	Emotionale Intelligenz und optimales Teaming – eine empirische Untersuchung	Band 4
2016	Pascal Berg	European Market Infrastructure Regulation (EMIR)	Band 5
2016	Dr. Sverre Klemp	Die Angemessenheit der Vergütung nach § 32 UrhG für wissenschaftliche Werke im STM-Bereich	Band 6
2016	Lars Heyne	Immaterialgüterrechte und Objektreplication: Juristische Risiken und Lösungsmöglichkeiten bei der Vermarktung von 3D-Druckvorlagen	Band 7
2016	Torsten Hotop	Äquivalenzinteresse im Erfinderrecht	Band 8
2016	Christian Wolf	Zur Eintragungsfähigkeit von Geruchs- und Hörmarken	Band 9
2016	Nadine Jneidi	Risikofaktor Pflichtteil - Grundlagen und Grenzen der Regelungs- und Gestaltungsmöglichkeiten von Pflichtteilsansprüchen bei der Nachfolge in Personengesellschaften	Band 10
2016	Meika Schuster	Ursachen und Folgen von Ausbildungsabbrüchen	Band 11
2016	Julie Wing Yan Chow	Activity Based Costing - A case study of Raiffeisen Bank of Luxembourg	Band 12
2016	Peter Koster	Luxembourg as an aspiring platform for the aircraft engine industry	Band 13
2016	Stefanie Roth	The Middle Management – new awareness needed in the current information society?	Band 14
2016	Alexander Fey	Warum Immaterielle Wirtschaftsgüter und Intellectual Property die Quantenteilchen der Ökonomie sind	Band 15

EIKV-Schriftenreihe zum Wissens- und Wertemanagement

Bereits erschienen

2016	Daniel Nepgen	Machbarkeitsstudie eines Audiportals für Qualitätsjournalismus. Eine empirische Untersuchung in Luxemburg	Band 16
2016	Niklas Jung	Abolition of the Safe Harbor Agreement – Legal situation and alternatives	Band 17
2017	Marco Pate	Kriterien zur Kreditbesicherung mit Immaterialgüter-rechten anhand der Finanzierungsbesicherung mit Immobilien	Band 18
2017	Patrick Matthias Sprenker	RAIF – Reserved Alternative Investment Fund – The impact on the Luxembourg Fund Market and the Alternative Investment Fund landscape	Band 19
2017	Sebastian Fontaine	Quo vadis Digitalisierung? Von Industrie 4.0 zur Circular-Economy	Band 20
2017	Andrea Dietz	Anti-Money Laundering and Counter-Terrorist Financing in the Luxembourg Investment Fund Market	Band 21