The Criminal Justice (Money Laundering and Terrorist Financing) Bill 2009 Q&A for Irish Investment Funds

What is the Criminal Justice (Money Laundering and Terrorist Financing) Bill 2009 (the "Bill")?

The main purpose of the Bill is to transpose the 3rd Money Laundering Directive ("the Directive") into Irish Law and provide for one consolidated piece of legislation in Ireland covering the prevention of money laundering and terrorist financing. The Bill also intends to ensure compliance with recommendations from the 2006 Financial Action Task Force ("FATF")[1] report on Ireland, concerning how the anti money laundering ("AML") and combating the financing of terrorism ("CFT") measures currently in place, can be strengthened.

What relevance does it have for the Irish investment funds industry?

The Bill contains requirements for designated persons. Within the Irish investment funds industry fund administrators, custodians/ trustees, investment managers and investment funds / collective investment undertakings are considered designated persons. For the board of directors of an investment fund there is an obligation to identify the investors in the investment fund and report suspicious transactions to An Garda Síochána (Irish police) and the Revenue Commissioners in Ireland. The Bill has particular relevance for fund administrators who are heavily relied upon by the board of directors of an investment fund to carry out the Customer Due Diligence on investors.

What is Customer Due Diligence or ("CDD") in the Bill?

CDD relates to the identification and verification of investors in the investment fund, also known as Know Your Customer or ("KYC"). Identification is achieved by reliance on AML documentation provided by the investor. Verification is the independent background identity checks obtained from other independent sources and is typically carried out by the fund administrator. Where applicable, e.g. in the case of a trust, CDD involves identifying and verifying the beneficial owners to understand the control and ownership structure of the trust. Finally CDD requires that appropriate ongoing monitoring be carried out by way of scrutinising investor transactions by the fund administrator with oversight by the fund MLRO ("Money Laundering Reporting Officer").

What is the difference between CDD and Simplified Customer Due Diligence ("SCDD") and how should it be applied to an investment fund?

The Bill provides an exemption for the fund administrator from undertaking all the AML documentation requirements under CDD by availing of a Simplified Customer Due Diligence ("SCDD") approach, in certain cases. This applies to investors who, following a risk assessment by the fund administrator, may be deemed to have a lower risk of money laundering or terrorist financing, e.g. blue-chip or regulated businesses such as credit and financial institutions, listed companies trading on a regulated market in the EU and third countries with FATF equivalent AML measures. Therefore in the case of a UK regulated bank investing in an investment fund, it would be sufficient for the fund administrator to rely on documented proof of regulation from the UK's Financial Services Authority website as opposed to obtaining separate confirmations from the bank on its identity and ownership structure.

When is Enhanced Customer Due Diligence ("ECDD") required?

ECDD is applicable where investors in an investment fund present a higher risk of money laundering or terrorist financing by virtue of their domicile and/or lack of transparency in ownership structure. For example, where an investor is an unlisted corporate structure domiciled in a non-FATF country, this will warrant ECDD. Additionally the Bill specifically refers to ECDD when providing a financial service to a Politically Exposed Person ("PEP").

Who are PEPs and what action should be taken by the board of directors where a PEP is identified in an investment fund?

The Bill defines a PEP as "an individual who is, or has at any time in the preceding year been, entrusted with a prominent public function". ECDD must also be applied to "close associates" and "immediate family members" of PEPs. The Wolfsberg Group[2] gives a better description than the Bill or the Directive to aid interpretation. It defines PEPs to include:

- Heads of state, government and cabinet ministers;
- Influential functionaries in nationalised industries and government administration;
- Senior judges;
- Senior party functionaries;
- Senior and/or influential officials, functionaries and military leaders and people with similar functions in international or supranational organisations;
- Members of ruling royal families;
- Senior and/or influential representatives of religious organisations (if these functions are connected with political, judicial, military or administrative responsibilities).

The Bill considers that some of the above individuals could represent a potential risk for corruption and bribery given their position and contacts. Additionally if the PEP is domiciled in a non-FATF country which lacks the infrastructure or resources to address money laundering and terrorist financing, then ECDD must be applied.

Investment funds are not precluded from dealing/transacting with PEPs, however if a PEP is identified, the fund administrator and the board of directors of the investment fund should:

- ascertain what risk (if any) the individual poses given the information sourced on the PEP. It may involve the board of directors or the administrator of an investment fund contacting the individual for more information;
- have a system in place between the board of directors and the administrator of an investment fund to approve transactions with a PEP;
- subject the business relationship with a PEP to ongoing monitoring by the board of directors and the fund administrator.

To identify and monitor PEPs, board of directors of an investment fund will place heavy reliance on the risk intelligence databases used by a fund administrator, e.g. Worldcheck, to screen investors for any known sanction/regulatory, financial or reputational risks the individual or the organisation may hold.

Who/what are beneficial owners?

Under the current AML legislation in Ireland, the Criminal Justice Act 1994 (as amended) there is no explicit provision that requires the identity of a beneficial owner to be established and verified. This is now changed to become an essential part of CDD. The Bill provides for the definition of a beneficial owner in relation

to entities such as corporate bodies, trusts, partnerships and estates of deceased persons. In all cases the beneficial owner is defined as being the individual or natural person having ultimate entitlement to or exercising ultimate "control" over more than 25% of the entity. In the case of investment funds, it is common for investors to invest via a trust structure. A trust is a group of undetermined individuals using a legal entity to invest for tax efficiency purposes or to protect their identity. A look through approach must be taken by the fund administrator to identify and verify the beneficial owner. To use an example, where an individual ("the settlor") sets up a trust for the benefit of his wife and family and provides funds on their behalf, the settlor is considered the beneficial owner and AML documentation is obtained from him. Thereafter, once the ownership and control structure of the trust has been understood, it may/may not be necessary to perform CDD on his wife and family.

Have the provisions for reliance on Third Parties changed?

Section 40 of the Bill provides that a designated person may rely on a relevant third party to carry out CDD. This is of particular relevance for an investment fund given that:

- the board of directors of an investment fund relies on the fund administrator to carry out CDD on the investors as part of the duties outsourced to the fund administrator and
- to avoid repeated CDD, leading to potential delays and inefficiency in business, the fund administrator may rely on a letter of introduction or letter of comfort from other regulated financial institutions, to identify and verify investors coming into the investment fund.

It is important to be aware that when the investment fund relies on the fund administrator, ultimate responsibility for carrying out CDD still resides with the board of directors of the investment fund. This responsibility also includes other requirements of the Bill, such as the requirement to report suspicious transactions by investors and ensure investor records are maintained for a period of not less than 6 years.

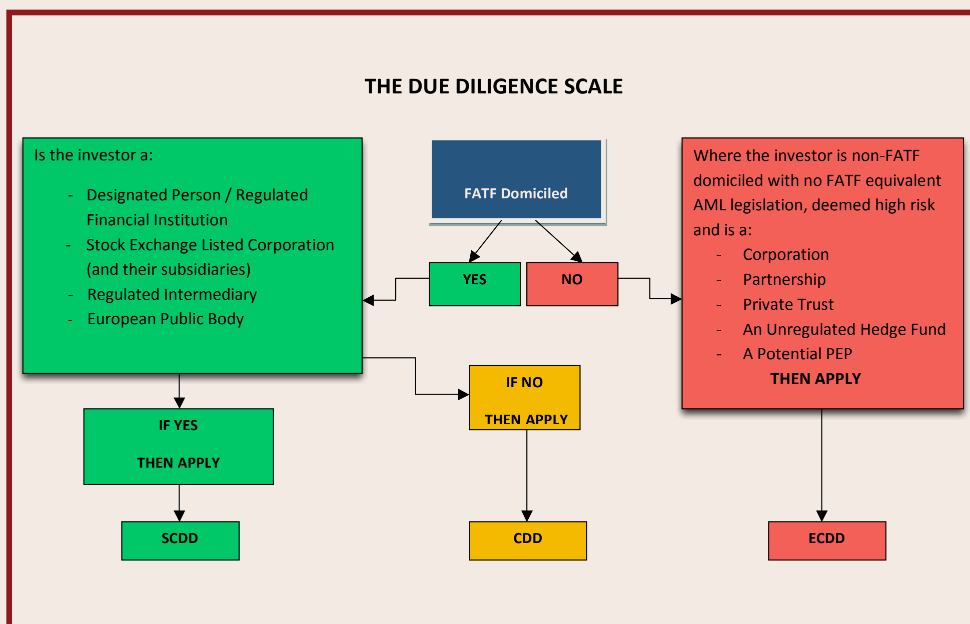
What is the risk based approach?

While not explicitly defined, the Bill essentially provides for a risk based approach by allowing the designated person to apply a level of CDD, SCDD or ECDD commensurate with the potential risk of money laundering associated with a particular investor.

To date many fund administrators in Ireland already apply some level of risk assessment when dealing with investors from FATF and non-FATF jurisdictions. Fund administrators determine the level of risk before carrying out a financial transaction with an unregulated investor in a high risk jurisdiction. The risk based approach also encompasses PEP monitoring as described above but additionally requires a designated person to monitor dealings with investors "to the extent reasonably warranted by the risk of money laundering or terrorist financing" [3)] by scrutinising investor transactions.

Has the role of the Money Laundering Reporting Officer ("MLRO") changed under the Bill?

While there is no explicit requirement under the Bill to appoint a MLRO to a designated person, it is a requirement of the Irish Financial Services Regulatory Authority ("the Financial Regulator"), therefore all investment funds authorised by the Financial Regulator will have a MLRO. While the individual's main responsibility to report suspicious transactions in the fund to An Garda Síochána and the Revenue Commissioners remains unchanged, the role has a strong element of independent monitoring to ensure that the investment fund is compliant with the requirements of the Bill. The person appointed must be sufficiently senior, have a significant degree of responsibility and be familiar with all aspects of the legislation.



What are the implications for non-compliance with the Bill?

Chapter 8 of the Bill deals with the role of the "competent authority" responsible for ensuring that designated persons are compliant with AML/CFT legislation. For the investment fund industry, the Financial Regulator will remain the competent authority. It will have new powers to impose a broad range of administrative sanctions and/or general supervisory actions ranging from the revocation of fund authorisations to onsite inspections of fund administrators. The board of directors of an investment fund must ensure, therefore, that active AML & CFT monitoring is being carried out on the investment fund and should rely on the MLRO and/or the administrator of the investment fund to ensure compliance.

When will the Bill be transposed into Irish law?

The existing legislation in Ireland, the Criminal Justice Act 1994 (as amended), will be repealed and it is anticipated that the Bill will be transposed into Irish Law before the end of 2009. Thereafter it will be referred to as the Criminal Justice (Money Laundering and Terrorist Financing) Act 2009.

1) The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

2) The Wolfsberg Group is an association of eleven global banks, which aims to develop financial services industry standards, and related products, for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies.

3) Section 35 (3) of The Criminal Justice (Money Laundering and Terrorist Financing) Bill 2009.

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