

GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING

Background regulations: Articles L. 561-4-1, L. 561-32, L. 561-33 of the Monetary and Financial Code and Articles 320-20, 320-22 321-147, 321-149 and 560-9 of the AMF General Regulation

The purpose of the risk-based approach is to improve the efficiency of combating money laundering and terrorist financing by adapting the measures taken to the level of risk of money laundering and terrorist financing and by optimising the resources allocated.

This approach has been central to all AML/CFT regulations since the third AML directive 2005/60/EC is required of obliged entities and European and national authorities alike.

The purpose of these guidelines is to assist obliged entities under AMF supervision: portfolio asset management companies, financial investment advisors and crowdfunding investment advisors (hereinafter the “obliged entities”), to develop a common understanding of the risk-based approach and to help them to implement this approach.

The risk-based approach requires that risks be identified, assessed and classified by level before mitigation measures are set up: **this is known as risk classification (1)**. Based on this classification, the obliged entity determines the scope of the due diligence obligations required of it before entering into the business relationship. The obliged entities shall refer to AMF Position-Recommendation 2019-16 Guidelines regarding obligations of vigilance with respect to clients and their beneficial owners.

Furthermore, pursuant to Articles 320-22 and 321-149 of the General Regulation of the AMF, “*when it implements its investment policies for its own account or for third parties, the asset management company shall assess the risk of money laundering and terrorist financing and establish procedures to oversee the investment selections made by its employees.*”

Portfolio asset management companies are therefore obliged to perform AML/CFT due diligence, not only for their customers (share/unit holders) but also for investments or divestments made on the assets of the funds or of the individual portfolios: this is **asset due diligence (2)**.

1. CLASSIFICATION OF RISKS

To apply the appropriate due diligence measures, obliged entities shall define and implement mechanisms for identifying and assessing the risks of money laundering and terrorist financing. They will then classify these risks.

When the obliged entities belong to a group, and the parent company of the group has its registered office in France, they shall implement a mechanism for identifying and assessing the risks that exist at group level as well as an appropriate policy for dealing with those risks. Group level organisation and procedures shall be defined by the parent company.

1.1. Risk factors

In accordance with Article L.561-4-1 of the Monetary and Financial Code, to identify the risks to which it is exposed through its activity, the obliged entity must analyse:

- ❖ The nature of the products and services offered, the terms of the transactions proposed and the distribution channels used, hereinafter the **Product Risk (1.1.1)**;
- ❖ The country or geographical region of origin or destination of the funds, hereinafter the **Country risk (1.1.2)**;
- ❖ Characteristics of customers, hereinafter **Customer Risk (1.1.3)**.

The obliged entity shall also take into account the **Supranational Risk Assessment published by the European Commission**¹ and its recommendations, the joint opinion published by the European supervisory authorities,² and the **National Risk Assessment published by the Advisory Board for the Fight Against Money Laundering and Terrorist Financing (COLB)**.³

To measure these risks, the obliged entity must take into account those factors considered to be exacerbating and those considered to be mitigating.

The law has already set the risk levels of several situations, in particular:

LOW RISK	HIGH RISK
<p><u>Regulated financial institution</u>: the customer, or where applicable, the beneficial owner, is an obliged entity, referred to in paragraphs 1 to 6 b of Article L. 561-2 of the Monetary and Financial Code, established in France or in another Member State of the European Economic Area or in a third country that imposes equivalent obligations with regard to money laundering and terrorist financing (Article R. 561-15 of the Monetary and Financial Code)</p>	<p>The customer or its legal representative is not physically present at the time of establishment of the business relationship (Article L. 561-10 of the Monetary and Financial Code);</p> <p>Transaction with persons located in a State that appears on the lists published by the FATF of States with laws or practices that obstruct the fight against money laundering and terrorist financing or published by the European Commission (Article L. 561-10 of the Monetary and Financial Code)</p>
<p><u>Public entity</u>: The customer is a public authority or public body, under the Treaty on European Union, treaties establishing the European Communities, derivative Community law, the public law of a Member State of the European Union or any other commitment made by France, and meets the following criteria:</p> <ul style="list-style-type: none"> - Its identity is publicly available, transparent and certain; - Its activities, as well as its accounting practices, are transparent; - It is either accountable to an EU institution or to the authorities of a Member State, or subject to the appropriate control procedures of its activity. <p>(Article R. 561-15 of the Monetary and Financial Code)</p>	<p>Politically Exposed Persons (Article 561-10 and R. 561-18 of the Monetary and Financial Code);</p>

¹ Supranational risk assessment of the money laundering and terrorist financing risks affecting the Union, https://europa.eu/rapid/press-release_IP-19-4452_fr.htm;

² Pursuant to Article 6(5) of Directive 2015/849 (4th AML/CFT Directive)

³ <https://www.tresor.economie.gouv.fr/Articles/2019/09/20/le-conseil-d-orientation-de-la-lutte-contre-le-blanchiment-de-capitaux-et-le-financement-du-terrorisme-approuve-l-analyse-nationale-des-risques-anr-en-france>

The customer is a company whose securities are admitted for trading on a regulated market in France or in a State that is a party to the European Economic Area agreement or in a third country that imposes disclosure requirements recognised as equivalent by the European Commission (Article R. 561-15 of the Monetary and Financial Code)	Products or transactions that encourage anonymity (Article L. 561-10 of the Monetary and Financial Code)
	Transactions that are particularly complex or involve unusually high amounts or that seem to have no economic justification or legal purpose (Article L. 561-10-2 of the Monetary and Financial Code)

Aside from these assumptions, the measurement and classification of risks are the responsibility of the obliged entity and correspond to subjective criteria defined by the obliged entities themselves.

To do this, the obliged entity refers to the **Joint Guidelines of the European Supervisory Authorities on risk factors**⁴ published on 4 January 2018.

The risk factors below are not exhaustive and obliged entities are not obliged to take into account risk factors that do not apply to them.

1.1.1. Product Risk

The obliged entity carries out its risk analysis based on the services provided (for example, fund management, individual asset management, order reception/transmission, investment advice) as described in its programme of activity:

- Types of services provided (for example, individual asset management, order reception-transmission, investment advice) or transactions proposed;
- Activities carried out (alternative fund of funds programmes of activity, unlisted securities, management of real estate collective investment undertaking and other real estate management activities, etc.);
- Types of products or financial instruments proposed (UCITS, AIF, etc.).

The obliged entity assesses the risk related (i) to the level of transparency or opacity, (ii) to the complexity of the product, service or transaction, and (iii) to the value, size, amount of the product, service or transaction.

The obliged entity also takes into account the methods used in marketing its products or services and in particular the risk related to (i) distance selling (without the physical presence of the parties) and (ii) the intermediaries that the entity may use, as well as the nature of its relations with them.

The obliged entity takes into account the innovative or disruptive nature of a product, a service or commercial practice.

1.1.2. Country Risk

Obliged entities include in their risk classification the risks related to countries or geographical regions (i) in which customers and/or beneficial owners are established, have their business and/or registered office, or with which they have a close relationship, and (ii) in which the funds used for the transaction were generated, or to which or from which the funds are received or transferred.

To assess the level of Country Risk, obliged parties take the following into account:

- The quality of Member State or non-member of the EEA,
- The list of countries identified by the European Commission as countries with ALM/CFT systems that have strategic deficiencies in accordance with Article 9 of Directive (EU) 2015/849;
- FATF lists of countries or geographical regions of high risk and that are not cooperative;

- Mutual assessment and follow-up reports by the FATF that provide better knowledge of the level of compliance of national regimes with FATF recommendations and the level of effectiveness of such regimes;
- Assessment of the IMF as well as Financial Sector Assessment Programme (FSAP) reports.

Focus on country lists

To help professionals know the level of money laundering and terrorist financing risks, there are several lists that identify high-risk countries.

A distinction must be made between:

- The “grey list” list drawn up by the FATF of countries with strategic deficiencies in their AML/CFT regimes.⁵ This list may change at each FATF plenary meeting
- The “black list” drawn up by the FATF of high-risk countries that may be subject to a call to apply counter-measures.⁶

These two lists are different from:

- The list of high-risk third country jurisdictions that have strategic deficiencies that the European Commission has prepared in accordance with Article 9 of Directive (EU) 2015/849. This list was published for the first time as an appendix to Delegated Regulation (EU) 2016/1675 of the Commission, and has been amended three times since then.⁷ Although this list takes into account the lists drawn up by the FATF, the European Commission could extend or complete it provided that it follows a robust methodology.

The obliged parties also consult the lists of countries, organisations and persons that are the subject of sanctions, embargos or other similar measures imposed by the European Union or the United Nations.

At the national level, the obliged parties consult the list of non-cooperative countries in tax matters as defined in Article 238-0 A of the General Tax Code.

Lastly, obliged parties are also invited to regularly consult the websites and press releases of the Minister for the Economy and Finance and TRACFIN.

1.1.3. Client Risk

As part of its assessment of risks related to customers, the obliged party shall take into account the characteristics of customers and the business relationship, in particular:

- The nature of the customers (natural persons or entities in the form of more or less complex structures, that may or may not promote anonymity - foundations, trusts, etc.- persons acting on their own behalf or on behalf of third parties, politically exposed persons, customers that are not physically present);
- The quality of long-term or occasional customers;
- The professional or economic activities of customers, their assets and financial situation, their financial history, etc.;
- The amount, nature and volume of the transactions envisaged or completed, the origin and destination of the funds;
- The investment habits of customers;

⁵ <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/fatf-compliance-october-2019.html> (12 countries)

⁶ <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/public-statement-october-2019.html> (North Korea and Iran)

⁷ https://ec.europa.eu/info/policies/justice-and-fundamental-rights/criminal-justice/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en. Note that the European Commission proposed a fourth version of the list in February 2019 (23 countries), which was unanimously rejected by the Council.

- The economic justification of the contemplated business relationship;
- The duration of the ongoing business relationship;
- The intervention of intermediaries between the customer and the obliged party;
- The origin of the assets;
- The customer's conduct, such as the refusal to provide information or a change in attitude towards the obliged party.

Obligations of identification of the customer and collection of information about the business relationship that will enable the obliged parties to draw up and regularly update their risk classification.

The obliged entity will refer to AMF Position-Recommendation 2019-16 relating to obligations of vigilance with respect to customers and their beneficial owners.

1.2. Weighting

The obliged entities should take a holistic view of the AM/CFT risk factors they have identified. The assessment of the overall risk associated with a specific relationship or an occasional transaction may be based on the weighting of risk factors depending on their importance.

In this respect, the Guidelines on risk factors⁸ state:

36. When weighting risk factors, firms should make an informed judgement about the relevance of different risk factors in the context of a business relationship or occasional transaction. This often results in firms allocating different "scores" to different factors; for example, firms may decide that a customer's personal links to a jurisdiction associated with higher AML/CFT risk is less relevant in light of the features of the product they seek.

37. Ultimately, the weight given to each of these factors is likely to vary from product to product and customer to customer (or category of customer) and from one firm to another. When weighting risk factors, firms should ensure that:

- weighting is not unduly influenced by just one factor;
- economic or profit considerations do not influence the risk rating;
- weighting does not lead to a situation where it is impossible for any business relationship to be classified as high risk;
- the provisions of Directive (EU) 2015/849 or national legislation regarding situations that always present a high money laundering risk cannot be over-ruled by the firm's weighting; and
- they are able to override any automatically generated risk scores where necessary. The rationale for the decision to override such scores should be documented appropriately.

38. Where a firm uses automated IT systems to allocate overall risk scores to categorise business relationships or occasional transactions and does not develop these in house but purchases them from an external provider, it should understand how the system works and how it combines risk factors to achieve an overall risk score. A firm must always be able to satisfy itself that the scores allocated reflect the firm's understanding of AML/CFT risk and it should be able to demonstrate this to the competent authority

1.3. Obligations related to the risk identification and classification regime

1.3.1. Risk classification documentation

Pursuant to Articles 320-20, 321-147 and 560-9 of AMF General Regulation, the obliged party must clearly record its risk classification in a durable medium (for example, procedure, Excel table, software).

Position

Risk assessment must be sufficiently documented to enable a demonstration of the principles to the supervisory authority during an audit.

1.3.2. Regular update

This classification must be **regularly updated** (Articles 320-19 and 321-146 of the AMF's General Regulation). To ensure that it remains relevant in the long term, it must be monitored and updated or revised if necessary. It shall into account regulatory developments and emerging risks (see annual reports, Tracfin or FATF reports).

1.3.3. Staff training

Staff members concerned by AML/CFT must understand the principles of the risk-based approach and their practical application in their company, in order to be able to carry out, with all the necessary expertise and knowledge, the tasks for which they are responsible and that require them to exercise their judgment. The training and information programme provided for in Article L. 561-34 of the Monetary and Financial Code shall therefore include this aspect, which is essential to ensure the effectiveness of the systems.

1.3.4. Appointment of the person in charge of the system

The provisions of the General Regulation (Articles 320-17, 321-144 and 560-10) that require the appointment of a person responsible for implementing the anti-money laundering and terrorist financing system stipulated in Article L. 561-32 of the Monetary and Financial Code specify that this person must be a member of management.

For management companies, member of management means an "executive" who is a natural person, as defined in Articles 321-13 and 317-5 of the AMF General Regulation.

The provisions of the General Regulation provide for the option, for the member of management appointed to be in charge of implementing the AMF/CFT system, to delegate some or all of this implementation,

- to a third-party, i.e. another employee of the organisation, either from the group or outside the group, in the case of portfolio asset management companies, financial investment advisors and crowdfunding investment advisors (Articles 320-17, 321-144, 325-22 and 325-62 of the AMF General Regulation);
- To one of the employees of the organisation, in this case, central securities depositaries (560-10 of the AMF General Regulation).

The manager may delegate this function, all the while remaining responsible for the delegated activities. The delegation meets the conditions set out in Articles 320-17, 321-144, 325-22 325-62 and 560-10 of the AMF General Regulation:

- "1°) *The delegated person must have the necessary authority, resources and skills, and access to all relevant information*" and
- "2°) *The delegated person must not be involved in the execution of the services and activities under supervision.*"

Position

The delegated person may be responsible for compliance and internal audit, provided that this delegation is appropriate and compliant with Articles 313-62 et seq., 321-83 et seq. of the AMF General Regulation and Article 62 of the Commission delegated Regulation (EU) 321/2013 for Alternative Investment Funds Managers.

The delegated person may be chosen among other employees of an entity of the group to which the management company, financial investment advisor or crowdfunding investment advisor belongs. He or she may also be another person who meets the conditions defined by the AMF General Regulation.

The delegation should, under no circumstances, adversely affect the effectiveness of the system.

2. ASSET DUE DILIGENCE

As indicated above, in keeping with the risk-based approach and to determine the extent of their obligations to combat money laundering and terrorist financing, the obliged entities shall assess the risks of money laundering and terrorist financing presented by their activities in this field.

This obligation is set out in Articles 320-22 and 321-149 of the AMF's General Regulation, which states that:

“when it implements its investment policy as part of investment management of a collective investment or discretionary management mandate, the asset management company shall assess the risk of money laundering and terrorist financing and establish procedures to oversee the investment decisions made by its employees.

In accordance with Article R. 561-38-2 of the Monetary and Financial Code, management companies may entrust an external service provider with the performance, in their name and on their behalf, of all or part of the due diligence related to this obligation.

- Portfolio asset management companies shall identify the risks to which their investments are exposed in the same way as the risks to which they are exposed in the management of their liabilities, following the risk factors mentioned above, with the following features:
- Under “Product” Risk: portfolio asset management companies shall take into account, in addition to the elements mentioned in Section 1.1.1 above, the proposed transaction terms (term, co-investment, size of the investment envisaged, use of intermediate structures) and the forms and methods of sourcing (use of business finders);
 - Under Country Risk (1.1.2 above): portfolio asset management companies focus on the location of targets (if the companies or real estate assets are located in high-risk countries), the source or destination of the financial flows involved in the investment transactions;
 - Under “Customer” Risk or, in this case Counterparty Risk: portfolio asset management companies shall take into account the capacity of their co-contracting parties (natural persons or legal entities), their reputation, the presence of politically exposed persons.

Position

Prior to the investments made by the portfolio asset management company, the obliged party shall collect that it will need to assess the money laundering and terrorist financing risk.

- When the risks have been identified they are assessed and classified

Position

When the investment target, the co-investor or the counterparty is a person specified in paragraphs 1°, 2° and 3° of Article R. 561-15 of the Monetary and Financial Code, i.e.:

1) An entity (or its subsidiary) subject to the anti-money laundering rules in France or in another Member State of the European Union or European Economic Area;

- 2) A company whose securities are admitted to trading on a regulated market in France, in another Member State of the European Union, the European Economic Area or a third country that imposes obligations equivalent to those of the “transparency” Directive or the subsidiary more than 75% owned by such a company;⁹**
3) A public authority or public body.

This organisation presents, in the absence of any suspicion, a low risk of money laundering and terrorist financing.

- After the risks have been identified, assessed and classified, the portfolio asset management companies determine the scope of the due diligence to be performed before concluding an investment transaction, based on a proportionate approach.

Like the due diligence performed on their customers, portfolio asset management companies perform asset due diligence in a proportionate manner according to their assessment of the risk of money laundering or terrorist financing.

Position

When the risk identified is considered to be high, the portfolio asset management company shall take all additional and/or enhanced due diligence measures before establishing the business relationship.

For example, in the event of a high risk, the portfolio asset management company shall take one or more of the following enhanced due diligence measures:

- The decision to carry out an investment is taken at the higher managerial level and, where appropriate, by a member of the executive body or any person authorised for this purpose by the executive body;
- Additional information and/or supporting documents are collected, relating to the purpose of the business relationship, the source of the assets and the funds involved in the business relationship;
- Constant due diligence measures shall be intensified: information that increases knowledge about the business relationship is regularly updated.

Conversely, where the portfolio asset management company chooses to invest the assets under management in low-risk assets, such as shares or bonds traded on a regulated market in the EEA or equivalent third country, and if there are no suspicions, the portfolio asset management company shall only perform minimal due diligence: identification of the issuer and collection of information that justifies the low risk.

Recommendation

With respect to the additional information to be collected, the AMF recommends that management companies follow the best practices below:

Before closing an investment in a company whose securities are not admitted for trading on a regulated market, the asset management company shall collect reliable information:

- the identity of the management and beneficial owners, for the purpose of identifying any politically exposed persons or persons on a list frozen assets;
- financial data, to assess the consistency with the company’s business.

Before subscribing for shares or units in a private equity fund, a specialised professional fund or a professional private equity investment fund or any other private equity vehicle registered in France or abroad, the asset

⁹ See the AMF Position in AMF-DOC 2019-16 – Guidelines regarding obligations of vigilance with respect to clients and their beneficial owners

management company shall collect and verify the information about said vehicle, as well as information about its asset management company: names of executives, shareholders and beneficial owners. The portfolio asset management company shall make inquiries about its co-investors.

Additional information about real estate asset due diligence

When they assess the risk of money laundering and terrorist financing in their investment choice, portfolio asset management companies specialising in the real estate sector (such as real estate investment companies, real estate collective investment undertakings, professional real estate collective investment undertakings) shall perform due diligences adapted to the nature of their target assets.

Portfolio asset management companies specialising in real estate are therefore required to perform due diligence on the counterparties to their property acquisition and disposal transaction. The extent of due diligence is adapted to the counterparty's risk profile, the characteristics of the business relationship and/or the transaction based on the usual risk factors (product, country and client risks)

➤ Does the due diligence have to concern any tenants of the acquired building?

Pursuant to Article L. 561-2 of the Monetary and Financial Code, portfolio asset management companies specialising in real estate are subject to the anti-money laundering and terrorist financing rules:

- **Under the supervision of the AMF**, in their capacity as a portfolio asset management company managing real estate AIFs, referred to in 6°), and;
- **Under the supervisions of the French fraud prevention authority (DGCCRF)**, in their capacity as real estate professionals referred to in 8°): carrying out the activities mentioned in 1°, 2°, 4°, 5, 8° and 9° of Article 1 of the Law No. 70-9 of 2 January 1970 that regulates the conditions of exercise of activities relating to certain transactions involving buildings and goodwill ("Hoguet Law")¹⁰.

The issue of due diligence relating to tenants under Article 320-22 of the AMF General Regulation therefore arises in the light of the requirements imposed under the Hoguet Law may apply concurrently.

Position

If the portfolio asset management company acquires a property on behalf of a real estate fund it manages, but uses the services of a third party for the research activity, linking and negotiation of the leases attached to the property, it does not carry out the rental activity referred to in 1° of Article 1 of the Hoguet Law, and is not bound by due diligence with regard to existing or new tenants in this respect. It is therefore not bound by Article 320-22 of the AMF General Regulation either.

Otherwise, when the portfolio asset management company acquires a property, on behalf of a real estate fund under its management, and carries out itself the research activity, linking and negotiating of the leases attached to the property, it is required to perform due diligence with respect to existing or new tenants, both on the basis of Article 1° of Article 1 of the Hoguet Law and on the basis of Article 320-22 of the AMF General Regulation.

¹⁰ The real estate management activity (mentioned in paragraph 6° of Article 1 of the Hoguet Law) which comprises the performance, in the name and on behalf of the owner of the property, of all usual acts of custody, maintenance and administration of the property, is excluded from the scope of application of AML/CFT due diligence measures. The same applies to the leasing or sub-leasing activity when it constitutes an ancillary to a property management mandate.