

## **MARKETING INTERMEDIARY DUE DILIGENCE – HOW DOES IT WORK?**

### **Document Purpose**

This document was prepared by the Findel Distribution Advisory Group (“DAG”), a working group of the Findel Group. The purpose of this document is to provide guidance on the requirements of Oversight and AML/CFT and similar obligations of IFMs & contractual requirements of their appointed Transfer Agents.

### **Background**

Luxembourg-domiciled Funds Management Companies “IFM’s” are subject to the regulatory oversight of the CSSF. In 2018 the CSSF issued Circular 18/698 that set all substance requirements related to the governance and organisational structures of Luxembourg IFMs. This includes requirements applicable to the oversight of marketing and distribution.

The implementation of Distribution Oversight programs by Luxembourg IFMs has led to an enhanced level of oversight on Financial Intermediaries<sup>1</sup> and for the Intermediaries to provide information and documentation requested by IFMs. There has also been a significant amount of confusion in the marketplace around the exact nature of the requirements, particularly where there is significant overlap with pre-existing AML/CFT requirements. This is further complicated by the often-overlapping obligations of IFMs themselves as well as any obligations they have delegated to Transfer Agents appointed by them, specifically in the area of AML/CFT.

### **Distribution Oversight**

Circular 18/698 places an obligation on the IFM to develop a continuous risk-based approach for the oversight of its distribution network. This approach must be based on; -

1. the types of intermediaries as well as information on the country of establishment of the intermediary and the AML / CFT legal and regulatory framework applicable therein, the authority and the supervisory regime which is applicable, the ownership and the control structure of the intermediary.
2. obtaining sufficient information to fully understand the nature of the intermediary's activities and to assess, on the basis of information available to the public, its reputation and the quality of the supervision to which it is subject;

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<sup>1</sup> Source: ALFI Consideration on marketing and distribution March 2022 Various types of intermediaries can be considered within the scope of the Marketing Intermediary Due Diligence requirement. We would include to the following intermediaries: Distributors, including distribution to retail investors; Independent financial advisors; Dealing/order routing platforms; certain Nominees (i) appearing in the register as acting on behalf of underlying investors (e.g. banks investing on behalf of their clients) and (ii) bound by a distribution agreement; Insurance – unit-linked, where the policy holders can select the underlying funds/ sign the application form/are in the register; Structured products/pension plan where the policy holder can select the fund; General partner/fund board of directors acting as global distributor; Independent Broker/Dealers

3. obtaining the documentation required on AML / CFT obligations when entering into an intermediary relationship ("Know Your Distributor");
4. the distribution channels; for example, the use of unclear or complex distribution channels and cases where the intermediary is located in a country or territory with a higher risk, may be high risk factors requiring implementation of enhanced monitoring of these intermediaries;
5. The associated country risk.

The IFM should put in place a procedure for continuous oversight of its distribution network.

A Distinction needs to be made between:

- a Marketing Intermediary, where according to CSSF 18/698, is understood as appointing a intermediary via contract to perform marketing.
- an intermediary, where according to the CSSF regulation 12-02, as amended, Art.3 defines an intermediary as a situation "where the units or shares of a UCITS are subscribed through an intermediary acting on behalf of his customers."

These concepts will drive the level of the distribution oversight, more specifically, the level of Distribution Due Diligence ("DDD") and the level of Know Your Distributor ("KYD") to be performed.

The purpose of DDD is ensuring compliance by the distributor with applicable marketing laws and regulations.

The KYD due diligence process aims at obtaining comfort that the Marketing Intermediary complies with the AML and CFT requirements as stipulated in the Luxembourg regulations.

The **Initial Due Diligence** must enable the IFM to ensure that the distribution intermediary is qualified and meeting the terms of the agreement in compliance with legal and regulatory and contractual requirements. During its initial due diligence, the IFM must assess its ability to ensure continuous monitoring of the intermediary, taking into consideration the risks identified and the specificities of the intermediary.

The **Ongoing Due Diligence** of the Marketing Intermediary must allow the IFM:

- to ensure that the services provided by the intermediary are contractually in compliance with legal and regulatory provisions and that they have a satisfactory level of quality;
- to assess in the long term the adequacy of the organizational structure and procedures of the intermediary
- Regularly reassess the risks arising from each Intermediary in order to manage them appropriately.

In an effort to ease the burden of this requirement on Marketing Intermediary & IFMs, the industry, developed an industry standard Distribution Due Diligence Questionnaire, which has been adopted by the majority of the IFMs in Luxembourg. The hope is that, by using a consistent template across all IFMs, Intermediaries will not have to complete a bespoke questionnaire for every IFM that they work with. Some IFMs deliver the questionnaires and collect the responses and related documentation

directly. Others have procured services or technology solutions of the Due Diligence program to third party providers.

In addition to the Ongoing Due Diligence, the IFM is also expected to perform Ongoing Monitoring. This monitoring should follow a risk-based approach, i.e. the level and frequency is determined by the risk assessed. IFM's are therefore required to collect information and monitor Key Performance Indicators (KPIs). These may vary from IFM and likely to contain at a minimum;

- The number of investor complaints
- The number of Target Market exceptions
- The number of Marketing Incidents

Please refer to the [KPI guidance](#) for further information.

### **Anti-Money Laundering & Countering Terrorism Financing**

It important to note that, the Distribution Oversight requirement includes an obligation to perform AML checks on the Marketing Intermediaries themselves – that is the Legal entity with whom the IFM has signed a Distribution Agreement. This is a separate obligation from the **Know Your Customer** requirements set out in Luxembourg Law that is an obligation for a Luxembourg-domiciled Fund to perform AML/CFT checks on the Investors in the Funds. At times, the Intermediary and the Investor may be the same legal entity.

AML/CFT checks must be carried out when an investor first subscribes to the Fund and then on an ongoing basis, with the frequency of checks determined by the risk attached to that Investor.

The IFM and the TA may come to an arrangement to share documentation gathered with each other where the same party is both the Marketing Intermediary and the investor in order to ease the burden on the intermediary. KYC and KYD performed will commensurate with the legal form of the entity and capacity through which the business relationship is established e.g. as the named investor on the register, a correspondent relationship may be established.

Again, in an effort to ease the burden on our business partners, IFMs, led by the Findel Group, have created an industry standard [Ultimate Beneficial Ownership Form](#), which can be used by IFMs and their Transfer Agents. Transfer Agents & Investors are encouraged to adopt this UBO Form template, to reduce the follow up questions or requirements from Transfer Agents when opening accounts or complying with ongoing requirements.

### **Conclusion**

There is significant overlap between various regulations relating to the distribution of investment funds – overlap between Distributor Due Diligence requirements and AML/CFT and overlap between the obligations of IFMs and of the Transfer Agents or other third parties they may delegate certain function to. As such, there can be duplication in some of the requests that intermediaries are asked to comply with. Through the Findel Group, Cross-Border IFMs have tried to standardize the questionnaires and



documentation being requested to ease the process for intermediaries. However, in a complex, multi-faceted market, unfortunately a certain amount of duplication of effort is unavoidable. The Findel Distribution Advisory Group is always willing to engage with other market participants to identify efficiencies where possible.