



ML/TF SUB-SECTOR RISK ASSESSMENT

Specialised Professionals of the Financial Sector providing corporate services (Trust and Company Service Provider activities)

July 2020

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FOREWORD

Luxembourg is a dynamic and fast-growing economy and one of the leading financial centres in the world. At the heart of Europe with a highly-skilled and multinational workforce, our financial sector serves a diverse range of clientele both at home and abroad. Professionals performing Trust and Company Service Provider (TCSP) activities are important in supporting this.



The growth of the financial sector has naturally impacted Luxembourg's exposure to the evolving threat of money laundering and terrorism financing (ML/TF). Whilst the whole financial services sector is exposed, professionals performing TCSP activities are particularly at risk. This has been highlighted in the 2018 National Risk Assessment (NRA), confirming similar findings by the Financial Action Task Force and the European Commission's Supra-National Risk Assessment.

Luxembourg and CSSF are deeply committed to combatting ML/TF and ensuring that the risks arising from and within our jurisdiction are effectively managed and mitigated. We have implemented a series of reforms to further strengthen our regime for combatting ML and TF (AML/CFT), and our efforts continue apace. The 2018 NRA has been critical to this process, strengthening the AML/CFT regime across both CSSF and supervised professionals. More recently, we have published dedicated sub-sector risk assessments for Private Banking and Collective Investments, demonstrating our commitment to further strengthening the understanding of ML/TF risks in areas of high risk.

This first TCSP Sub-Sector Risk Assessment focuses on CSSF-supervised Specialised Professionals of the Financial Sector (Specialised PFS) providing corporate services. It is to be noted that TCSP activities are also carried out by other professionals and, whilst they are not the focus of this assessment, they may also find this assessment useful.

This document further strengthens our comprehensive and shared understanding of the inherent risks of TCSP activities, the strengths of the current AML/CFT regime, and areas where mitigating measures should be developed further. It has been a joint and coordinated effort as it includes input from the Cellule de Renseignement Financier (CRF) and the Luxembourg Alternative Administrators Association ("L3A asbl").

This risk assessment is a valuable tool for all stakeholders to better understand the ML/TF risks associated with TCSP activities and the measures necessary to combat them. Supervised professionals should use it to strengthen their understanding of ML/TF threats and vulnerabilities and the development of proportionate and effective controls. To this end, the assessment details observed best practices, common findings from supervision, and targeted recommendations the private sector should adopt. CSSF will monitor professionals' adherence to these recommendations as part of its supervisory activities.

I would like to thank all of those who have participated in this exercise for their valuable contributions. I expect everyone in the sector to continue strengthening their AML/CFT efforts so as to ensure that the AML/CFT framework remains effective and that Luxembourg remains a place where the TCSP activities can thrive.

Marco Zwick - Director, CSSF

1. PURPOSE AND SCOPE OF THE DOCUMENT

The *Commission de Surveillance du Secteur Financier* (CSSF) applies a risk-based approach (RBA) when supervising anti-money laundering and counter-terrorism financing (AML/CFT). A central component of this approach is the production of thematic risk assessments outlining money laundering and terrorism financing (ML/TF) vulnerabilities.

In 2018, Luxembourg published a National Risk Assessment (NRA) to identify, understand and assess the country's ML/TF risks and support the definition of the national AML/CFT strategy. The NRA includes an assessment of the inherent risks and mitigating factors associated with trust and company service providers (TCSPs) and describes how they could be misused or abused for ML/TF purposes. The NRA concluded that Specialised PFS providing corporate services were "high" inherent risk. The quality of the implemented mitigation measures allowed to reduce the residual risk to medium.

Table 1: Specialised PFS providing corporate services risk assessment outcome

Sub-sectors	Inherent risk	Residual risk
Specialised PFS providing corporate services	High	Medium

The CSSF conducts entity-level risk assessments on supervised professionals to increase its understanding of the inherent risk, mitigating measures and resulting residual risk of each supervised professional and to instruct entity-level supervisory plans.

This sub-sector risk assessment (SSRA) provides for the link between the NRA and entity-level risk assessments. It will fulfil multiple objectives, in particular:

- Reflect the CSSF's own understanding of specific ML/TF risks in the sub-sector;
- Further improve the CSSF supervisory activities and sub-sector specific supervisory strategy, where relevant;
- Act as an input into CSSF's entity-level risk assessments;
- Serve as a resource for the industry in informing their own ML/TF risk assessments;
- Promote the understanding of ML/TF risks and AML/CFT obligations in the industry; and
- Support public-private interaction.

The scope of this assessment focuses on TCSP activities (see further details on page 8) carried out by Specialised PFS. We also point out that 3 Support PFS hold TCSP licenses and are included in the present analysis as they are supervised for AML purposes by the Specialised PFS department. Non-TCSP activities such as registrar agent, professional depositaries of financial instruments, professional depositaries of assets other than financial instruments, operators of a regulated market authorised in Luxembourg, currency exchange dealers, debt recovery, professionals performing lending operations, professionals performing securities lending, family offices and mutual savings fund administrators do not fall under the scope of this assessment.

Important note: While this assessment does not cover other professionals carrying out TCSP activities such as banks, investment firms and asset management companies and other professionals whose supervision falls outside the remit of CSSF (that may perform TCSP activities as ancillary services), these professionals might however find the information contained in this assessment helpful to reflect upon and as the case may be strengthen their AML/CFT framework.

1. Introduction

This section introduces the TCSP activities performed by Specialised PFS. A detailed understanding of the industry is key to identify, understand and assess ML/TF risks to which it is exposed. An overview of the landscape and its main stakeholders must precede any ML/TF risk assessment.

1.1 Sub-sector overview

TCSPs play an important role in the global economy as financial intermediaries, providing a link between financial institutions and many of their clients. They are often involved in the establishment and administration of legal entities and arrangements, playing a key role as gatekeepers of the financial sector. They also assist clients in the management of their financial affairs and hence, can significantly impact transactional flows through the financial system.

Several factors have contributed to the development of the sector. The country enjoys a high degree of political stability, and an advanced legal and regulatory framework. As a leading international financial centre, it also benefits from high quality professionals, and good infrastructure and connections to other European and international markets, making it attractive to investors and corporations.¹ In addition, the country is a major centre of activity for private equity and real estate investment asset managers.

The TCSP industry is comprised of five main types of stakeholders:

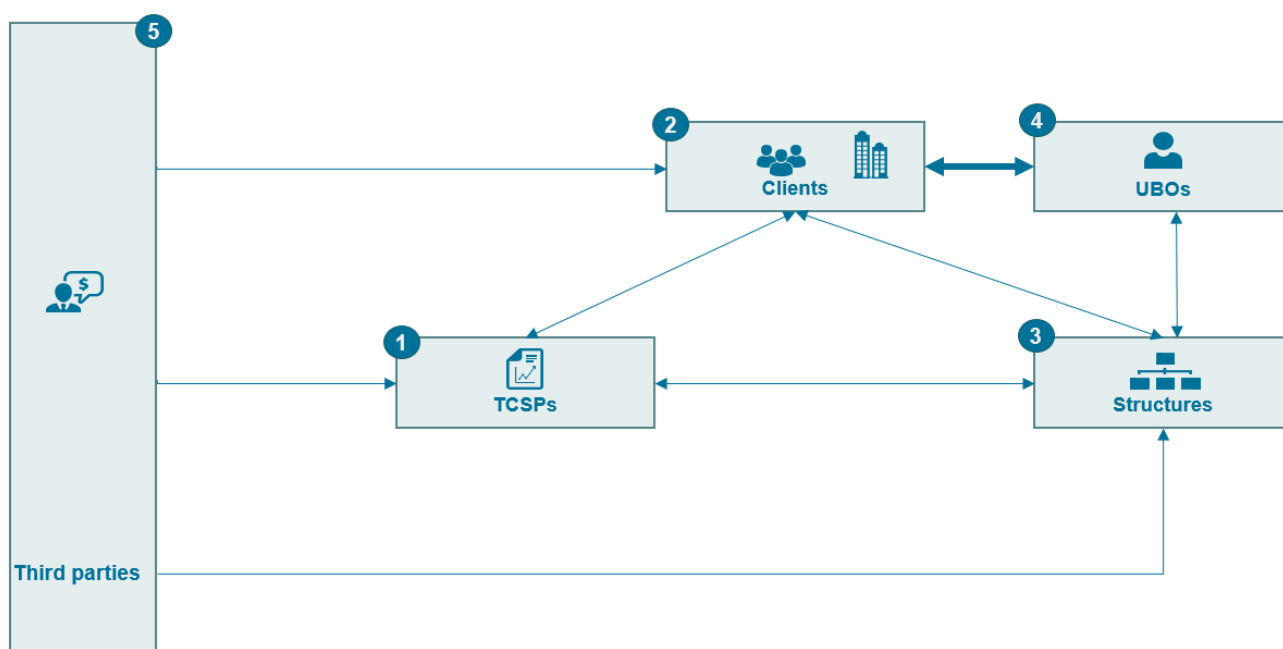
1. **TCSPs** create and service structures on behalf of their clients. The services they conduct are incorporation, provision of directorships and corporate secretarial services, domiciliation of companies, trustee of an express trust and nominee shareholder. For the avoidance of doubt other services can also be provided by TCSPs but these services are not covered by the definition of the FATF.
2. **Clients** employ TCSP services to structure and manage their businesses and assets. They can be natural, legal persons or legal arrangements. In general the structures serviced by Specialised PFS are legal persons/legal arrangements. Therefore **the document mostly refers to legal persons but when it is used in a general context, it is not limited to legal persons but also includes legal arrangements** as it might be relevant to other professionals providing TCSP services.

¹ Luxembourg for Finance, <https://www.luxembourgforfinance.com>

3. **Structures** are vehicles used either for the pooling or ownership transfer of assets, and they can take multiple legal forms. They can be set-up, managed and/or administrated by the TCSP on behalf of the client.
4. **The ultimate beneficial owners (UBOs)** of a structure are any natural person(s) who ultimately own or control the structure or on whose behalf a transaction or activity is being conducted.²
5. **Third parties** support TCSPs, clients and structures with specialised services. They can act either as introducing intermediaries, advisors or service providers (i.e. outsourcing of activities).

A simplified interaction between these stakeholders is shown in the next table (cf. Table 2). Each stakeholder is described in detail in the sub-sections that follow. Note that the definitions and descriptions included have been detailed for the purpose of this risk assessment only and are not based in law unless specified explicitly.

Table 2: TCSP industry landscape



² Law of 12 November 2004 ("AML/CFT Law"), Article 1 (7)

1.1.1.1. Specialised PFS acting as Trust and Company Service Providers (TCSPs)

FATF defines TCSPs as providers of the following services to third parties:

- Acting as a formation agent of legal persons;
- Acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
- Providing a registered office, business address or accommodation correspondence or administrative address for a company, a partnership or any other legal persons;
- Acting as (or arranging for another person to act as) a trustee of an express trust or performing the equivalent function for another form of legal arrangement; and
- Acting as (or arranging for a person to act as) a nominee shareholder for another person.

In Luxembourg, TCSPs are not recognised or regulated i.e. authorised under the laws as a separate business sector, however they have to be registered with the supervisory authority or self-regulatory body that is competent for each one of them as per Article 7-2 of the 2004 AML/CFT Law (as modified by the Law of 25 March 2020). Several categories of professionals carry out the services identified in the FATF definition of TCSPs including some of the Specialised PFS.

The 2004 AML/CFT Law recognises five types of TCSP activities:³

- 1. Incorporation:** Forming companies or other legal persons;
- 2. Directorship and secretarial services:** Acting as or arranging for another person to act as a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
- 3. Domiciliation:** Providing a registered office, business address, correspondence or administrative address or business premises and other related services for a company, a partnership or any other legal person or arrangement;
- 4. Fiducie/trust:** Acting as, or arranging for another person to act as, a *fiduciaire* in a *fiducie* (as defined the 2003 *Fiducies* and Trust Law), a trustee of an express trust or an equivalent function in a similar legal arrangement⁴; and
- 5. Nominee shareholder:** Acting as, or arranging for another person to act as, a nominee shareholder for another person other than a company listed on a regulated market that is subject to disclosure requirements in accordance with European Union law or subject to equivalent international standards.

³ Law of 12 November 2004 ("AML/CFT Law"), Article 1(8)

⁴ Specialised PFS are not allowed to provide fiduciary services under the 2003 *Fiducies* and Trust law

For the purpose of this risk assessment, we focus on the application of the TCSP definition to Specialised PFS. As a result, this sub-sector risk assessment does not cover *Fiducie*/trust services as these are very limited in Luxembourg for the Specialised PFS (in 2019 only one Specialised PFS reported providing trustee services representing 1% of its revenues).

The Specialised PFS performing TCSP activities hold the licenses defined in the following table:

Table 3: Mapping of CSSF-supervised TCSP professions to activities (based on applicable laws to profession)⁵

CSSF supervised professional	TCSP Activity (as defined in 2004 AML/CFT Law)				
	Incorporation	Directorship	Domiciliation	<i>Fiducie</i> /trust	Nominee shareholder
Family Offices	x ⁶	✓	x ⁷	8	✓
Corporate domiciliation agents	✓	✓	✓	9	✓
Professionals providing company incorporation and mgmt. services	✓	✓	x	10	✓

In 2019, 92 out of 107 of the Specialised PFS held at least one license allowing it to provide TCSP activities. Although one TCSP activity could be provided as a standalone service, in practice, TCSP provide a combination of at least two services, as TCSP activities are complementary. It is therefore a way for Specialised PFS to develop the business. In order to develop the business further, some of the Specialised PFS have also complemented their service offering with other activities (not falling in the TCSP category):

- 1) In Luxembourg, the prominence of funds has led many Specialised PFS to request other licenses such as Registrar agent and Professional depositary of assets other than financial instruments. However, these activities do not fall in the scope of this document.

⁵ Ministry of Finance, *National Risk Assessment of Money Laundering and Terrorist Financing*, December 2018

⁶ A Family Office must also hold a "Professionals providing company incorporation and mgmt. services" license to provide incorporation services

⁷ A Family Office must also hold a "Corporate domiciliation agents" license to provide domiciliation services

⁸ Specialised PFS are authorised to provide trust services, but cannot act as *fiducie* under Law of 27 July 2003 on *Fiducies* and Trusts, Art. 4

⁹ Specialised PFS are authorised to provide trust services, but cannot act as *fiducie* under Law of 27 July 2003 on *Fiducies* and Trusts, Art. 4

¹⁰ Specialised PFS are authorised to provide trust services, but cannot act as *fiducie* under Law of 27 July 2003 on *Fiducies* and Trusts, Art. 4

- 2) Specialised PFS also provide ancillary services such as accounting services and filing of tax related documents, which do not require a specific license. However, these activities do not fall in the scope of this document.

Family Offices administer structures that are set up to address the needs of wealthy families. It should be noted that as a general principle Family Offices do not perform any TCSP activities as main activity. However, the Family Offices within the Specialised PFS have a specificity. As all the CSSF supervised Specialised PFS do not hold a Family Office licence on a standalone basis but hold other licenses such as for Corporate domiciliation agents or Professionals providing company incorporation and management services, Specialised PFS which perform Family Offices services fall in the category of TCSP. Indeed, out of 27 Family Offices recorded as having this license in Luxembourg (because they use this license in practice), none of them provide Family Offices services on a standalone basis or with other activities which would not include Corporate domiciliation agents and Professionals providing company incorporation and management services activities. Moreover, in theory and as a general principle, Family Offices may perform TCSP activities (directorship or nominee shareholder) on an accessory basis. In order to clearly reflect the Luxembourg market it has been decided to categorise Family Offices as TCSP. However, as the Family Office activity only is not categorised as a TCSP service, it is not covered by this report.

Approximately 64% of the Specialised PFS performing TCSP activities employ more than 10 staff members and a majority of these Specialised PFS generate a revenue between EUR 22,000 and EUR 1,700,000.

This risk assessment reviews the activities conducted by Specialised PFS under their complete TCSP services offering to clients. For the purposes of this risk assessment, the activities performed are grouped into four categories: (1) **incorporation**, (2) **provision of directorship and secretarial services**, (3) **domiciliation of companies** and (4) **nominee shareholder**.

Table 4: Percentage of Specialised PFS which reported income in TCSP activities in 2019.

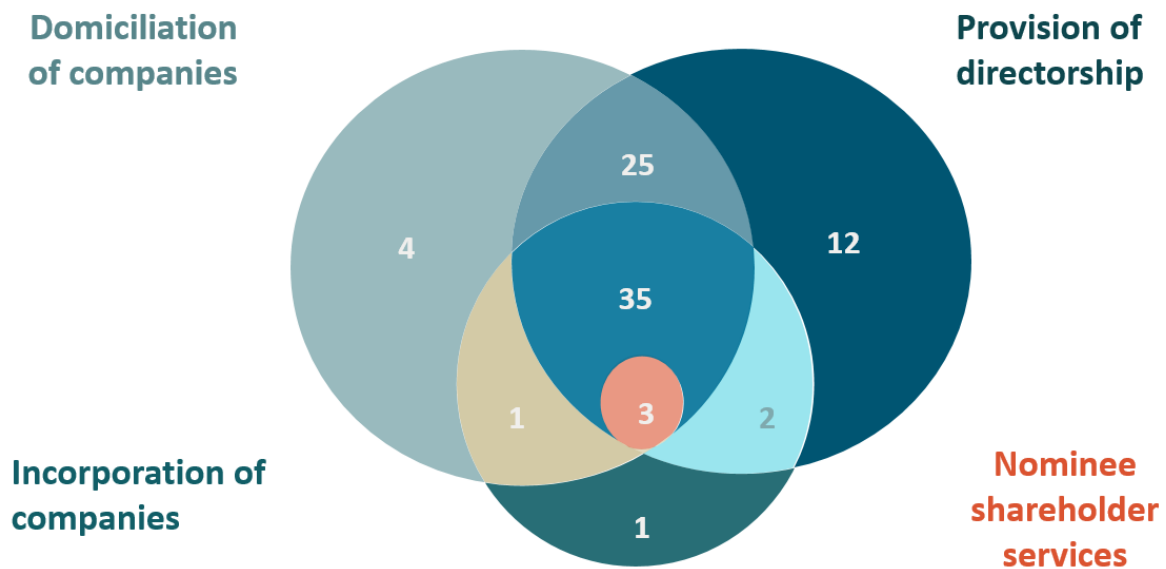


Table 5: Number of Specialised PFS which reported income in TCSP activities in 2019.

Service	Number¹¹
Incorporation of companies	42
Provision of directorship and secretarial services	77
Domiciliation of companies	68
Nominee shareholder services	3

In light of the above explanation, please note that the number of Specialised PFS which reported income in TCSP activities in 2019 cannot be added as it would lead to double counting.

1.1.2. Clients

Clients employ TCSP services in order to effectively administer and structure their assets and businesses. This report does not define clients as the UBOs of the structure or the transaction (except if the client is a natural person). Instead it defines them as the

¹¹ CSSF internal data as at 31.12.2018

immediate clients of the TCSP. For example, in the case of a public multi-national company (MNC) using a TCSP to set up a holding company, the client is the MNC as opposed to the individual shareholders of the holding company, or any other UBOs.

In general, it is not uncommon for one client to set up several structures (see hereafter).

As a result of the prominence of funds in Luxembourg and considering the fact that the transfer agency activity is carried out by 71% of the Specialised PFS performing TCSP activities, many clients are investment fund managers.

1.1.3. Structures

Structures are vehicles “*through which a wide variety of commercial activities are conducted and assets are held*”¹². TCSPs interact with these structures when setting-up, managing and/or administrating them. They can be categorised, based on the vehicle type or legal form.

Considering the fact that the Specialised PFS performing TCSP activities provide transfer agency services to over 2,400 Luxembourg and foreign funds (regulated and non regulated), and that it is often required for various reasons to set up one or more related vehicles (such as wholly owned subsidiaries, general partners, etc.), many structures are related to investment funds and Specialised PFS performing TCSP activities try as much as possible to provide services to all vehicles.

1.1.3.1. Vehicle type

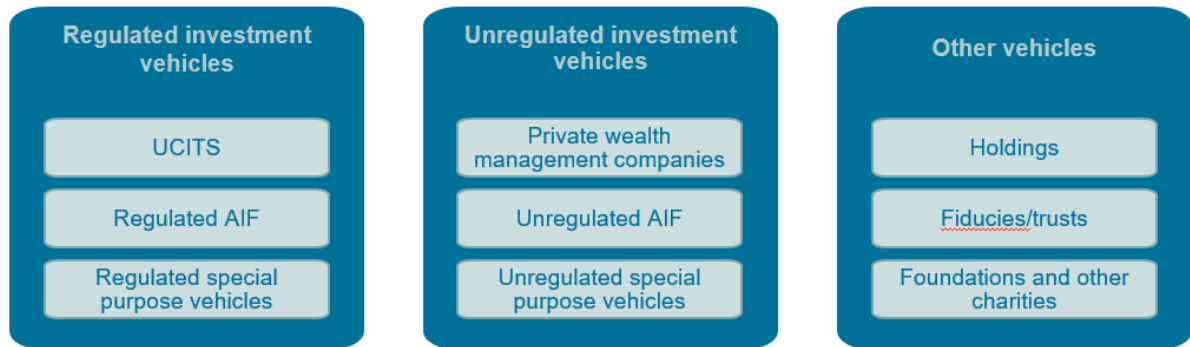
Vehicles are structures used for the pooling and transfer of ownership of assets for different purposes. There are three vehicle types:

- **Regulated investment vehicles** are undertakings pooling assets from investors with the intention of generating positive returns for investors. They are governed and supervised pursuant to sectoral laws of the financial sector.
- **Unregulated investment vehicles** serve the same purpose as regulated vehicles; however, they are not regulated or supervised by the CSSF.
- **Other vehicles** are those used to hold assets. They may be regulated or unregulated.

These vehicles can be further categorised based on their functions and characteristics.

¹² OECD, *Behind the Corporate Veil*, 2001

Table 6: Vehicle categorisation^{13,14}



These categories are comprised of additional sub-categories, which are governed by sectoral laws.¹⁵

¹³ Regulated AIF include regulated non-AIF SIF and SICAR.

¹⁴ Unregulated AIF include any entity not regulated by the Law of 17 December 2010 – Part I (“UCITS Law”); Law of 15 June 2004 (“SICAR Law”); or, Law of 13 February 2007 (“SIF Law”) but meeting the criteria of the AIFM Law.

¹⁵ Refer to OPC risk assessment for further details on sub-categories of regulated investment vehicles.

Table 7: Vehicle type categorisation

Vehicle type	Regulated investment vehicles						Unregulated investment vehicles			Other vehicles				
Category	UCITS	Regulated AIF (and regulated non-AIF SIF and SICAR)				Reg. special purpose vehicle	Unreg. special purpose vehicle	Private wealth mgmt. company	Unreg. AIF	Holdings	Foundations and other charities		Fiducies/trusts	
Sub-category	UCITS Part I	UCI Part II	SIF	SICAR	RAIF	SV ¹⁶		SPF	SCS/SCSp	SOPARFI and other holdings	Charitable assoc	Foundations	Fiducie	Intl. trust
Law	2010 UCITS Law	2010 UCI Law	2007 SIF Law	2004 SICAR Law	2016 RAIF Law	2004 Securitisation Law		2007 SPF Law	1915 Company Law	1915 Company Law	1928 Charities Law		2003 Fiducie and Trust Law	

As of 31/12/2019, 74% of the vehicles/structures domiciled by Specialised PFS were SOPARFI.

1.1.3.2. Legal forms

The vehicles identified above can be set up under different legal forms:

- **Corporate** legal forms are those where the legal entity has a standalone legal personality.¹⁷ These structures are considered independent from their partners or shareholders and will have rights and obligations such as capacity to enter into contracts, suing and being sued. Corporate legal forms fall in the legal persons category as per the FATF definition¹⁸.

¹⁶ Only undertakings issuing securities to the public on a continuous basis are required to be supervised as defined in Law of 22 March 2004 ("Securitisation Law"), Art. 19: "Securitisation undertakings which issue securities to the public on a continuous basis ("authorised securitisation undertakings") must be authorised by the Commission de Surveillance du Secteur Financier (hereinafter the "CSSF") to exercise their activities."

¹⁷ Exceptions to this are SCSp which does not have a legal personality, and ASBL as it acquires its legal status after performance of filing and registration with the Trade and Companies' Register requirements

¹⁸ Glossary, the FATF recommendations, updated June 2019

- **Contractual** legal forms are those based on a contractual agreement, and thus have no separate legal personality from the parties involved in the agreement. Contractual legal forms fall in the legal arrangement category as per the FATF definition.¹⁹

Table 8: Legal form categorisation

Legal form	Corporate								Contractual			
Category	Sociétés commerciales			Sociétés civiles				Foundations	Non-profit organisations	Fonds commun de placement		Fiducies
Sub - category	Limited liability companies	Société en commandite	Société coopérative						Intl. NPOs	Other ASBL	Intl. trust	
Legal entity	SA ²⁰ , SAS ²¹ , Sàrl ²²	SCA ²³ , SCS ²⁴ , SCSp ²⁵	SC ²⁶ , SCoSA ²⁷	Société universelle tous biens presents ²⁸	Société universelle de gains ²⁹	Société particulière ³⁰	Société civile immobilière	Fondation d'utilité publique ³¹	ASBL ³²	FCP ³³	Intl. trust ³⁴	Fiducie ³⁵

Each of these legal forms will have a series of characteristics and requirements based on which they can be segmented. These characteristics and requirements will influence

¹⁹ Glossary, the FATF recommendations, updated June 2019

²⁰ *Société anonyme* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 410-1

²¹ *Société par actions simplifiée* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 500-1

²² *Société à responsabilité limitée* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 710-1

²³ *Société en commandite par actions* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 600-1

²⁴ *Société en commandite Simple* as defined by Law of 15 August 1915 ("Companies Law"), Art. 301-1(1)

²⁵ *Société en commandite spéciale* as defined by Law of 15 August 1915 ("Companies Law"), Art. 320-1

²⁶ *Société coopérative* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 811-1

²⁷ *Société coopérative organisée comme une société anonyme* as defined by the Law of 15 August 1915 ("Companies Law"), Art. 820-1

²⁸ As defined by Luxembourg Civil Code, Art. 1837

²⁹ As defined by Luxembourg Civil Code, Art. 1838

³⁰ As defined by Luxembourg Civil Code, Art. 1841

³¹ *Fondation d'utilité publique* as defined by Law of 21 April 1928 ("NPOs Law"), Art. 27

³² *Association sans but lucratif* as defined by Law of 21 April 1928 ("NPOs Law"), Art. 1

³³ *Fonds commun de placement* defined as "any undivided collection after performance of filing and registration with the Trade and Companies' Register requirements of assets made up and managed according to the principle of risk spreading on behalf of joint owners who are liable only up the amount contributed by them [...]" in 2016 RAIF Law, the 2007 SIF Law and the 2010 UCI Law

³⁴ As defined by the Den Hague Convention of 1st July 1985 and ratified by the Law of 27 July 2003 ("Fiducies and Trust Law")

³⁵ For definition see Law of 27 July 2003 ("Fiducies and Trust Law"), Art. 4 and 5

clients' decision on which legal form is the most appropriate for their business and asset planning purposes.

As of 31/12/2019, 95% of the legal forms serviced by Specialised PFS were legal persons.

1.1.4. Ultimate beneficial owners (UBOs)

The UBO(s) of the structures set up, managed and administrated by TCSPs is (are) the natural person(s) who ultimately own(s) the structure, on whose behalf the structure's transaction is being carried out, or who control(s) the structure. Establishing who the UBO of a structure is, depends on its legal form since it depends also on the control structure, etc. and ownership structure.³⁶

1.1.5. Third parties

Third parties play a key role in the TCSP industry as either advisors, service providers or introducing intermediaries.

Advisors typically advise clients. They inform the actions of other industry stakeholders, decisions relating to the incorporation of structures and planning of assets may be based on these advisor's recommendations. Advisory services may be provided by a range of professions which include accountants, tax advisors, lawyers and wealth advisors.

Introducing intermediaries are professionals that facilitate the first contact between the TCSP and the client. Once this first introduction has taken place, they may not be involved in any ongoing transaction between the TCSP and the client. These introductions are common in the industry. Only the more sophisticated clients like HNWI's or IFM, will choose a TCSP directly. Additionally, it is not uncommon that foreign TCSPs refer or hire the services of other local, TCSP professional to conduct the requested services. For example, as Specialised PFS are in many cases part of international groups, the TCSP in a foreign jurisdiction will often be a sister company of the Specialised PFS which will refer a client in need of Luxembourg in the structuring of its assets. Therefore, referrals are one of the main sources of new clients to TCSPs. The network of clients, third parties and TCSPs can span across multiple jurisdictions, and be comprised on multiple layers.^{37,38}

1.2. TCSP ML/TF context

The CSSF applies a risk-based approach to AML/CFT supervision, in line with FATF guidelines and recommendations. This implies identifying, assessing and understanding ML/TF risks faced by the TCSP sector, its specific products and services, the customers

³⁶ See CSSF Circular 19/732 for further details on clarifications on the identification and verification of the identity of UBOs

³⁷ van der Does de Willebois et al., *The Puppet Masters*, 2011

³⁸ Lord et al. *Other People's Dirty Money*, 2019

and jurisdictions, the channels of delivery involved, and taking AML/CFT measures commensurate to those risks in order to mitigate them effectively.

FATF has identified the TCSP sector as particularly exposed to ML/TF and has published several reports to assist firms and supervisors in understanding and mitigating the risks associated with their activities. The most relevant include:

- **Guidance for a risk-based approach, TCSP sector** (2019):³⁹ this report describes the foundations of a risk-based approach for both professionals and supervisors; it details specific guidance of TCSPs (covering actions for risk identification, assessment and mitigation), and elements of a robust supervisory approach. Several of the recommendations for TCSPs and 'red flags' for ML/TF are detailed in Section 6 of this report;
- **Report on the concealment of beneficial ownership** (2018):⁴⁰ this report focuses on how criminals abuse/misuse legal persons, legal arrangements and professional intermediaries to conceal beneficial ownership. It highlights how criminals abuse/misuse numerous professional intermediaries, including CSPs due to their central role in forming and managing legal persons and arrangements. This could include to distance themselves from illicit funds and transactions, thus permitting the laundering of criminal proceeds;
- **Money Laundering using TCSPs** (2010): this report reviews the AML/CFT landscape for TCSPs. It outlines the vulnerabilities of TCSPs as lying in the abuse or misuse of pre-constituted structures, the abuse or misuse of TCSPs to create increasingly complex structures in exchange for higher fees, and the challenge TCSPs may encounter to obtain adequate CDD (particularly, if outsourced to third parties) and subsequently understand the client's economic background and activity.⁴¹

The European Union Supra-National Risk Assessment (EU SNRA) has also highlighted in section 2.1.3 the non-financial sector's exposure to ML/TF risk as significant or highly significant. As per the FATF reports, it notes how TCSPs can be abused/misused to set up complex structures that conceal the identity of beneficial owners. The report highlights the challenges associated with identifying beneficial ownership, particularly when TCSP services are delivered through non-face-to-face channels. The identification and transparency of beneficial ownership is, thus, central to the TCSP industry in its AML/CFT efforts.⁴²

Luxembourg's NRA also considers TCSP activities to be high risk (see previous section). This is driven by several factors, including that: (1) globally the sector is characterised by a range of different professions that can act as TCSPs; (2) there are a large number of international and potentially higher-risk beneficial owners of structures incorporated by TCSPs; (3) non face-to-face transactions are available; and (4) complex structures can be used.⁴³

³⁹ FATF, *Guidance for a risk-based approach, TCSP sector*, 2019

⁴⁰ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, 2018

⁴¹ FATF, *Money Laundering using TCSPs*, 2010

⁴² European Commission, *Supranational Risk Assessment*, 2019

⁴³ Ministry of Finance, *National Risk Assessment of Money Laundering and Terrorist Financing*, 2018.

2. Approach

This section describes the approach used to assess ML/TF risks for Specialised PFS.

2.1 Stakeholders

The CSSF led this sub-sector risk assessment, which integrates input from other stakeholders. In particular, this report was drafted using information provided by the following parties:

- **CSSF:** internal AML/CFT teams and sub-sector experts;
- **Cellule de Renseignement Financier (CRF):** the CRF provided SAR/STR data pertaining to Specialised PFS; and
- **Industry associations and private sector:** the CSSF interacted with the Luxembourg Alternative Administrators Association⁴⁴ ("L3A asbl").

2.2 Process

This assessment follows the general CSSF risk assessment approach defined in the AML/CFT risk assessment policy:

- The Specialised PFS AML Division in charge of the risk assessment defined the scope and methodology of the report.
- The Specialised PFS AML Division performed desk-based research, reviewing national and international sources, and gathering input from relevant CSSF experts across departments.

⁴⁴ The Luxembourg Alternative Administrators Association (L3A) was set up in 2004 to support and promote the interests of the Luxembourg Fund and Corporate Services sector.

3. METHODOLOGY

3.1 Methodology of the assessment and scope

The assessment looks at ML/TF threats and vulnerabilities (inherent risk), and then at the measures put in place by both CSSF and the private sector to mitigate them. The methodology is based on CSSF's AML/CFT risk assessment policy and closely aligned to that used in Luxembourg's NRA.⁴⁵ It is also aligned to the FATF's Guidance for a Risk-Based Approach⁴⁶.

A clustering aims to group together activities with similar characteristics and risk profiles into a manageable number of classes, in order to assess their relative ML/TF risk. The classes are defined according to common characteristics used to compare ML/TF risk.

This report groups TCSPs in four taxonomies (activity classes) which are subject to a detailed risk assessment:

- Incorporation
- Directorship and secretarial services
- Domiciliation
- Nominee shareholder

3.2 Inherent risk – threat assessment

In this section we target predicate offences generating illicit proceeds which could give rise to ML/TF present threats to the financial sector. The objective of the threat assessment is to understand the environment in which predicate offences are committed, to identify their nature and to assess the exposure of Specialised PFS providing TCSP services to them.

This report examines the most relevant threats for these Specialised PFS, considering "very high" and "high" threats highlighted in the NRA (i.e. fraud and forgery, tax crimes, robbery or theft, etc.), as well as the additional "medium" and "low" risk threats (i.e. trafficking in human beings and migrant smuggling, illicit arms trafficking, extortion, etc.). The NRA threats are themselves based on the FATF list of designated categories of predicate offence.⁴⁷

This report outlines in chapter 4 why Specialised PFS may be at risk of being abused or misused for ML; TF threats are presented separately. The report highlights the low prevalence of TF via Specialised PFS and provides the reasons behind this observation.

⁴⁵ Note, the NRA ranks risks on a five-point scale (Very High, High, Medium, Low, Very Low) – this risk assessment uses a four-point scale (High, Medium-High, Medium-Low, Low)

⁴⁶ FATF, *Guidance for a risk based approach for trust and company service providers*, June 2019

⁴⁷ FATF, [Glossary](#)

Table 9: Illustration of ML scheme using TCSPs⁴⁸

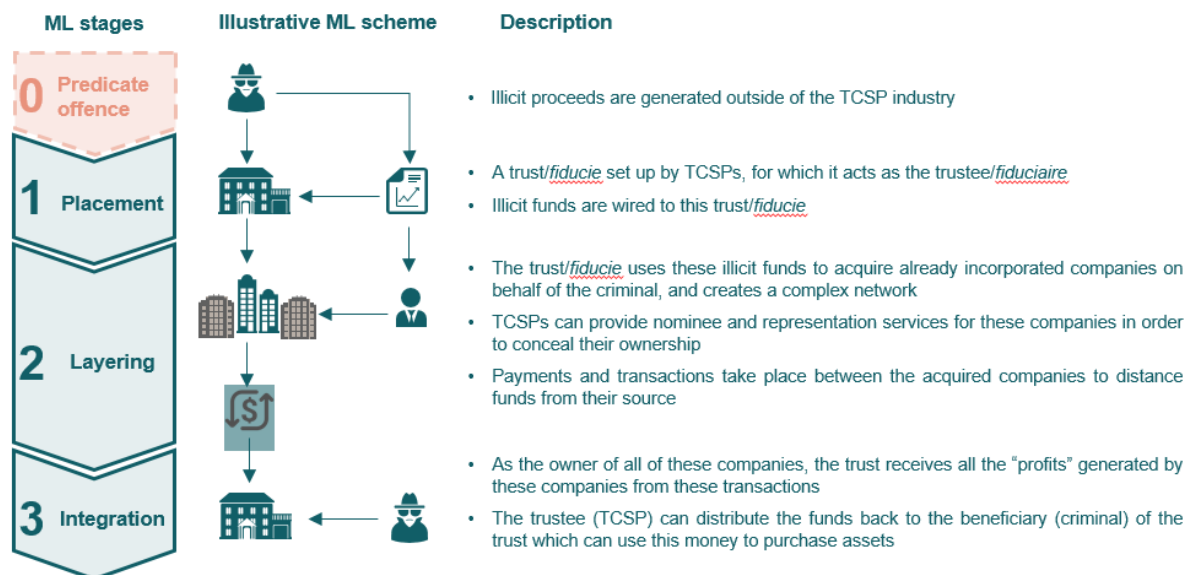
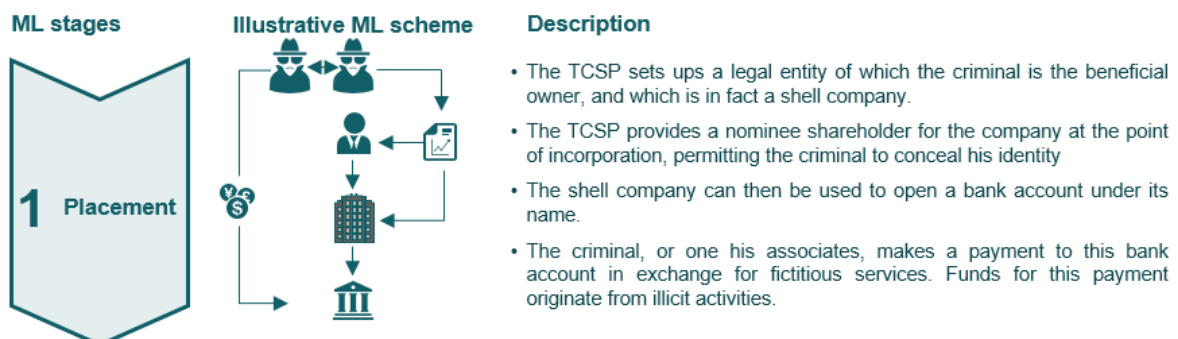


Table 10: Illustration of placement of illicit funds using a shell company⁴⁹



⁴⁸ Based on case studies presented in FATF, *Money Laundering using TCSPs*, 2010

⁴⁹ Based on case studies presented in FATF, *Money Laundering using TCSPs*, 2010 and FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, 2018

Table 11: Illustration of layering of illicit funds using directorship services⁵⁰




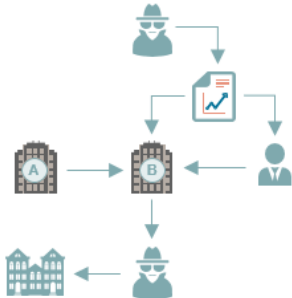
ML stages	Illustrative ML scheme	Description
 <p>2 Layering</p>		<ul style="list-style-type: none"> • One, or several, TCSPs are appointed as nominee directors of multiple legal entities across multiple jurisdictions • Third party advisors, representing the criminals, instruct the TCSPs to carry out wire transfers between the legal entities • These transactions create layers, which permit the criminal to distance the illicit funds from their source

Table 12: Illustration of integration of illicit funds using third-party loans⁵¹

ML stages	Illustrative ML scheme	Description
 <p>3 Integration</p>		<ul style="list-style-type: none"> • Company A holds illegal proceeds obtained through a number of previous layer transactions • The criminal requests a TCSP to incorporate a new company B with domiciliation in their own country with the TCSP acting as a director • The criminal's identity is concealed as a TCSP provides a nominee shareholder at incorporation • Cash deposits are made into Company B from Company A • As a director of Company B, the TCSP approves a direct loan for the criminal, which is worth the amount of cash deposited by A • The criminal can now use these funds to purchase real assets

3.3 Inherent risk – vulnerability assessment

Vulnerability is the relative exposure of a sector or sub-sector for ML/TF purposes. FATF defines vulnerabilities as “things that may be exploited by the threat or that may support or facilitate its activities”.⁵² This may also include the features of a particular sector, a financial product or type of service that make them exposed to ML/TF.

In the context of this sub-sector risk assessment, the vulnerability assessment was conducted at the level of each element of the taxonomy. Vulnerability arises from TCSP activities offered to clients which are particularly exposed to abuse or misuse for ML/TF

⁵⁰ Based on case studied presented in van der Does de Willebois et al., *The Puppet Master*, 2011 and FATF, *Money Laundering using TCSPs*, 2010

⁵¹ European Commission, *Annex to the Assessment of the risk on ML/TF affecting the internal market and relating to cross-border activities*, 2017

⁵² FATF, *FATF Guidance on National Money Laundering and Terrorist Financing Risk Assessment*, February 2013

purposes. The objective is to determine the level of ML/TF risk posed by each element of the TCSP client and activity taxonomies presented previously

Vulnerability is driven by multiple risk factors all relevant in the TCSP industry, comprised of market structure, geography, clients (including UBOs and representatives), channels of distribution, products and services, and the nature of transactions.⁵³

Mitigating factors are all the elements in place that contribute to combat ML/TF. This includes both supervisory measures and controls at entity level (e.g. legal, judicial, supervisory and internal AML/CFT frameworks) in place to reduce ML/TF risks.

In the context of this sub-sector risk assessment, the assessment of mitigating factors was conducted at the level of each element of the clustering. Mitigating factors may be distinguished with the following dimensions: Risk Based Approach, AML/CFT supervision, Ongoing Monitoring and Procedures & Trainings.

The mitigating factor assessment was used to determine specific actions and recommendations where gaps were identified.

3.4 ML/TF risk scoring

ML/TF risk is assessed using a scorecard approach, both before and after considering mitigating measures in place. This is centred on three components:

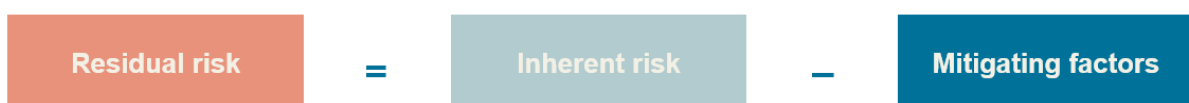
- **Inherent risk** is the risk of ML/TF occurring through a particular class of the taxonomy before accounting for mitigating measures (including both ML/TF threats and vulnerabilities);
- **Mitigating factors** are the supervisory measures and controls at entity level in place to reduce ML/TF risks for a particular class of the taxonomy; and
- **Residual risk** is the risk of ML/TF occurring through a particular class of the taxonomy after considering mitigating measures in place.

Table 13: Overview of inherent and residual risk calculation

Inherent risk (i.e. in the absence of mitigating factors)



Residual risk (i.e. with mitigating factors considered)



⁵³ The risk factor guidelines as adopted by CSSF Circular 17/661

3.5 Areas for further enhancement

The last section of this document focuses on a series of recommendations to reinforce controls and mitigating measures across the regulatory and supervisory framework. All recommendations are designed as part of the CSSF AML/CFT strategy and aligned to a specific action plan.

3.6 Data sources

This assessment uses both quantitative and qualitative data. This includes international sources (e.g. from international organisations, foreign competent authorities, industry bodies, academia), other domestic competent authorities (e.g. CRF), CSSF internal data collected as part of supervisory measures, CSSF expert input, information provided by the private sector (e.g. via questionnaires, interviews or workshops) and other domestic sources.

4. INHERENT RISK – THREAT ASSESSMENT

The objective of this section is to understand the environment in which predicate offences are committed (i.e. predicate offences not necessarily related to TCSPs but for which illicit proceeds could be channelled through the TCSP sector and therefore possibly the Specialised PFS sub-sector), to identify their nature and to assess the exposure of Specialised PFS to them.

It should be noted that threats are analysed within the inherent risk assessment, that is, in the absence of mitigating factors and controls.

4.1 ML/TF threat overview

The NRA identified predicate offences which may occur in Luxembourg. Starting from the FATF list of designated categories of predicate offences, and using a weighted average of external and domestic exposure, it concluded that drug trafficking, fraud and forgery, tax crimes and corruption, as well as bribery were very high threats.

This report considers both domestic and international threats. The NRA noted that the threat of ML proceeds from domestic crimes is significantly smaller, due to Luxembourg's relatively low crime rate and limited presence of organised crime. The threat of ML proceeds from international crime is however higher, given the international exposure of Luxembourg's TCSP industry.

4.2 ML threats for Specialised PFS

4.2.1. General ML threats

Specialised PFS can be abused or misused to launder the proceeds from all threats identified in the NRA. This can occur across all three stages of the ML process – placement, layering, and integration.⁵⁴ Typically, such misuse or abuse evolve around concealing the identity of the UBO of structures and the origin of funds, as well as channelling illicit funds through the financial system.^{54,55,56}

In Luxembourg, TCSPs may be exposed for multiple reasons:

The sector is large and diverse, with a variety of licensed professionals and activities that can be conducted. Detection of ML threats may prove challenging in a fragmented market when a number of diverse TCSPs and products exist.

The international nature of the business, large foreign client base and foreign ownership of assets, in particular from high-risk jurisdictions or offshore financial centres, increase the likelihood of dealing with illicit proceeds.⁵⁷ TCSPs can also provide services using laws from other jurisdictions (for example acting as trustee of a foreign trust), which can make them more vulnerable to international criminals.⁵⁸ With regards to the Specialised PFS, the vast majority of UBOs/clients are indeed coming from foreign countries and some are located in medium-high and high risk jurisdictions. However, with regards to using laws from other jurisdictions, the number of offshore structures serviced by Specialised PFS has significantly been reduced over the past few years.

Challenges in UBO identification and origin of the wealth as a result of the diverse nature of clients which include legal entities and arrangements in the structure which can enable the beneficial owner to hide his identity, particularly in instances where the primary relationship is with a third party advising the client.⁵⁹ Indeed, the Specialised PFS deal with legal entities (very few legal arrangements) and intermediaries, such as group introducers, sometimes lawyers and tax advisors being often involved in the relationship. Origin of wealth for these is also particularly challenging because it could be from multinational corporate groups, family fortune or unexplained gains of the past, etc.

Intermediation of the relationships between TCSP and client as a result of the presence of intermediaries in the transactions, or of non-face-to-face transactions. This can reduce transparency around client identity.

The use of complex products offered by TCSPs may be abused or misused to conceal the true identity of the beneficial owner or their source of funds and facilitate the

⁵⁴ FATF, *Money Laundering using TCSPs*, 2010

⁵⁵ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, 2018

⁵⁶ FATF, *The Misuses of Corporate Vehicles, including TCSPs*, 2006

⁵⁷ FATF, *Guidance for a Risk-Based Approach*, TCSP sector, 2019

⁵⁸ FATF, *Money Laundering using TCSPs*, 2010

⁵⁹ FATF, *Guidance for a Risk-Based Approach*, TCSP sector, 2019

laundering of illegal proceeds.⁶⁰ With regard to the structures, according the AML/CFT questionnaire as at 31/12/2019, 94% of the structures serviced are legal entities. The number of legal arrangements serviced is significantly lower due to the fact that Specialised PFS are not allowed to provide fiduciary services under the 2003 Fiducie and Trust Law and therefore there are no such arrangements. The fiduciary services are therefore limited to fiduciary contracts (nominee agreements) and foreign Trusts. Specialised PFS providing nominee services reported in 2019 that the income related to this service represented in average less than 1% of their revenues.

4.2.2. Specific ML threats significant for Specialised PFS

There are three specific predicate offences that are most relevant for Specialised PFS performing TCSP activities, which are: fraud and forgery, tax crimes, corruption and bribery (see Table 14 below).

The number of SARs/STRs received from the CRF is used to illustrate each type of predicate offense encountered by the Specialised PFS. However, it should be noted that it is possible that predicate offenses are being perpetrated without suspicions leading to SARs/STRs filing, therefore the significance of this indicator is good but limited.

The following sub-sections explain each threat, present global typologies and then focus on particular risks for Luxembourg⁶¹.

Table 14: Overview of predicate offences perpetrated within PFS providing TCSP services

Predicate offence	Number of SARs/STRs filed in 2018	Number of SARs/STRs filed in 2019
Fraud and forgery	98	65
Tax crimes	49	42
Corruption and bribery	18	17

Fraud and forgery and related money laundering

As per the NRA, “fraud and forgery” refers to a broad set of deceptive practices as defined in Luxembourg’s *Code Pénal*⁶² and *Loi modifiée du 10 août 1915 concernant les sociétés commerciales*.⁶³ TCSPs could be abused or misused to launder the proceeds of these offences, or to facilitate the predicate offence itself.

⁶⁰ FATF, *Money Laundering using TCSPs*, 2010

⁶¹ Red flags indicators are available in appendix A & B

⁶² *Code Pénal* Art. 175, 179 to 182, 184, 186, 187, 187-1, 194 to 197, 208, 211, 212, 215, 216, 221, 223 and 489 to 496-4

⁶³ *Loi modifiée du 10 août 1915 concernant les sociétés commerciales* Art. 1500-8 and 1500-11

Globally, the UNODC⁶⁴ estimates that fraud generates ~12% of criminal proceeds.⁶⁵ The international nature of the TCSP sector, combined with the lack of transparency in specific jurisdictions regarding the UBO of structures can facilitate the integration of these illicit funds into the economy. Additionally, the TCSP industry is exposed to fraudulent abuse or misuse given their central role as gatekeepers of the financial sector.⁶⁶

Luxembourg's position as an international payments and investment hub, together with its stable regulatory framework, and its central European location contribute to the number of TCSPs operating from Luxembourg. The concentration of TCSPs in the country increases the likelihood that national and international criminals may attempt to commit fraud by abusing or misusing the services provided by a TCSP (including Specialised PFS). Exposure is increased by the fact that TCSPs play a significant role in managing the financial flows through the economy and in setting up and managing the structures used in international transactions.

Tax crimes

Tax crimes involve the intentional breach of law to evade tax payments. Tax evasion ("*escroquerie fiscale*") and aggravated tax fraud ("*fraude fiscale aggravée*") are predicate offences in Luxembourg.^{67,68}

Globally, TCSPs are vulnerable to tax crimes due the international nature of their activities and their local expertise of regulatory and fiscal requirements. As a result, criminals can abuse or misuse TCSPs' technical expertise to devise tax evasion schemes. These schemes leverage structures in offshore jurisdictions to conceal their assets. TCSPs such as Specialised PFS can set up and manage these offshore structures. However, it is to be noted that this service is decreasing. In 2012, Specialised PFS were servicing over 2,000 offshore companies. In 2016 the number of offshore companies serviced had fallen to 1,000 and in 2018 less than 900⁶⁹ offshore entities were reported

Tax fraud can also be committed via TCSP using third-party loan-backed schemes. These schemes involve money being sent to companies owned or controlled by, or on behalf of, the same individual and returned in the guise of a private third-party loan. They tend to operate following two steps:⁷⁰

1. **Payment of business invoices:** An individual directly or through a company A pays an invoice or a series of invoices to Company B, which will often be located offshore, and the individual is the beneficial owner of Company B. The purpose of this initial

⁶⁴ United Nations Office on Drugs and Crime

⁶⁵ UNODC, *Report Estimating Illicit Flows Resulting from Drug Trafficking and Other Transnational Organised Crimes*, 2011

⁶⁶ FATF, *Money laundering using TCSPs*, 2010

⁶⁷ Law of 23 December 2016 and Circular CSSF 17/650, 2017

⁶⁸ Aggravated tax fraud is defined according to the tax thresholds evaded or the level of reimbursement obtained. For tax evasion, increased gravity is related both to the amounts involved and the fact that means have been employed with a view to deceiving the tax authorities. Both offences related both to direct (e.g. income/inheritance tax) and indirect taxes (VAT).

⁶⁹ CSSF internal data

⁷⁰ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, July 2018

stage is to reduce the taxable income of the originating individual or company by apparently increasing their business expenses.

2. **Third-party loan:** Once the funds have been pooled into the accounts of Company B, they are returned to the original individual or company A. Fake loan agreements can be produced by the client. In this way, the assets are returned to the beneficial owner in a manner that assisted him in evading income taxation.

Luxembourg's TCSP sector is vulnerable to tax crimes due the presence of global wealth in the country⁷¹ and the international nature of its operations. In particular, the diverse geographic origin of TCSP clients (including those of Specialised PFS) expose Luxembourg to the risk that *foreign* individuals may misuse/abuse TCSPs for tax crimes. In contrast, misuse/abuse related to *domestic* tax crimes is much lower. This is due to Luxembourg's tax system and small shadow economy (domestic tax evasion is estimated to be lower in Luxembourg than most other OECD countries, ~0.9% of GDP).⁷²

In total the CRF identified 1,440 suspicious transactions related to tax crimes in 2017 across all sectors. The majority of these (~50%) related to bank transfers, and a significant minority (~18%) to cash collection and payments.⁷³

Luxembourg has put in place a legal and regulatory framework to combat international tax evasion. For example, Luxembourg has introduced legislation to implement the Organisation for Economic Co-operation and Development (OECD) Common Reporting Standard (CRS) for the automatic exchange of financial information. Luxembourg is also actively involved in the OECD Base Erosion and Profit Shifting (BEPS) initiative and has enacted legislation to address BEPS Action 13, on country-by-country reporting. As noted above, the legislator has added in December 2016 aggravated tax fraud ("*fraude fiscale aggravée*") and tax evasion ("*escroquerie fiscale*") to the list of predicate offences for ML, helping to reduce the likelihood of such crimes by extending AML/CFT measures to these offences (e.g. KYC and Suspicious Activity Reporting (SAR) obligations).

Moreover, CSSF has adopted Circular CSSF 17/650, drafted jointly with the Parquet/CRF, which aims at (i) providing further details by both authorities concerning the practical application of these new provisions by the professionals of the financial sector supervised by the CSSF and (ii) providing a list of indicators to assist the professionals.⁷⁴

After the law of 21 December 2018 implementing Directive (EU) 2016/1164 ("ATAD 1"), on 19 December 2019, the Luxembourg Parliament adopted the law transposing the Council Directive (EU) 2017/952 of 29 May 2017 ("ATAD 2") into Luxembourg law.

⁷¹ BCG, [Global Wealth Report](#), 2018

⁷² CESifo Group, *Size and Development of Tax Evasion in 38 OECD Countries*, 2012. The shadow economy includes "all market-based legal productions of goods and services that are deliberately concealed from public authorities for the following reasons: avoid payment of taxes, avoid payment of social security contributions, avoid certain legal labour market standards and avoid complying with certain administrative procedures" (CESifo, F. Schneider, *Estimating the size of the shadow economies*, December 2016)

⁷³ CRF, *Annual activity report 2017*, 2018

⁷⁴ Circular CSSF 17/650, February 2017. While aggravated tax evasion was added as a new predicate offence, tax evasion was already criminalised prior to 2017. With the 2017 tax reform the legislation has been strengthened and both offences are now also a predicate offence to ML.

Finally, in March 2020, the Chamber of Deputies adopted the law on reportable cross-border arrangements transposing the Directive (EU) 2018/822, commonly known as "DAC6".

Corruption and bribery

Corruption and bribery includes the relevant offences defined across several parts of Luxembourg's *Code Pénal*, specifically: domestic bribery (private to public) as defined in Articles 240 et seq.; domestic bribery (private to private) as defined in Articles 310 et seq.; and corruption of foreign public officials as defined in Article 252.⁷⁵ These crimes have a significant impact on the development and health of economies worldwide,⁷⁶ undermining the rule of law and the principle of fair competition and often contributing to political instability and abuse of human rights.⁷⁷

Globally, TCSPs may be exposed to High Net Worth Individuals and Politically Exposed Persons (PEPs). This makes them vulnerable to misuse/abuse for corruption and/or bribery. TCSPs and the structures they set up and manage can be abused or misused by criminals in order to channel funds for bribery and corruption purposes, and to distance themselves from the origin of these funds. Globally, corruption and bribery are estimated to account for 2% of total proceeds of crime.⁷⁸

Luxembourg's TCSP industry is vulnerable due to the presence of MNC and international fund managers, as well as PEPs in the client base of the TCSP including Specialised PFS.

4.3 TF threats

Terrorism financing (TF) refers to the financing of terrorist acts, and of terrorists and terrorist organisations.⁷⁹ It encompasses the raising, movement and use of funds by terrorist actors and is an important threat to global security.⁸⁰

There are no known cases where Specialised PFS have been abused or misused for the purpose of TF. Indeed, historical FATF research has focused primarily on the abuse or misuse of TCSPs for ML due to the "little information" available in relation to TF.⁸¹ In 2018 there was one SAR made by a Specialised PFS relating to TF and in 2019 no SAR was made by Specialised PFS relating to TF.

⁷⁵ Luxembourg, *Code pénal*, 2018 (Note, the Luxembourg Criminal Code does not establish quantitative or qualitative limitations on facilitation payments. The analysis regarding a qualification as bribery is made on a case-by-case basis)

⁷⁶ UNODC, *Annual report*, 2017

⁷⁷ Transparency International, [Why corruption matters, 2019](#)

⁷⁸ UNODC, *Annual report*, 2017

⁷⁹ Luxembourg Criminal Code, *Chapitre III-1. - Du terrorisme, Section I. - Des infractions à but terroriste, Art. 135-5.*

⁸⁰ FATF, *International standards on combating money laundering and the financing of terrorism and proliferation – the FATF recommendations*, 2012

⁸¹ FATF, *Money laundering using TCSPs*, 2010

The assessment that the threat of TF via TCSPs in Luxembourg is relatively lower than the threat of ML stems from several factors, which include:

- **Short-term requirements** to move cash from one party to another (especially uncommon and unrelated parties). This is less compatible with the TCSP industry where the process of set-up, management and administration of companies typically involves longer time periods;
- **Low value transactions** involved in TF are unsuited to an industry which generally deals with higher value transactions;
- **Preference by terrorists and terrorist organisations for alternative remittance channels** (e.g. Hawala, Hundi, cash couriers), and lack of reliance on formal banking and payment channels that are used by the TCSPs; and
- **Knowledge requirements** as the product and services offered by TCSPs are often complex and require financial knowledge

Despite the threat being relatively lower than for ML, TF via the TCSP sector cannot be ruled out, particularly those cases involving the abuse or misuse of structures such as corporate and state-sponsored terrorism.⁸²

⁸² For definitions see RUSI, *From Lone Actors to Daesh: Rethinking the response to the diverse threats of terrorist financing*, 2018

5. INHERENT RISK – VULNERABILITY ASSESSMENT

Vulnerabilities are the intrinsic properties in a system or structure (including weaknesses in systems, controls, or measures) which make it open to abuse or exploitation by criminals for ML, TF, or both. The existence of vulnerabilities in a system makes the use of that system attractive for money launderers and terrorist financiers⁸³.

This section assesses the common vulnerabilities of the Specialised PFS before focusing on the relative exposure of each service relating to a TCSP activity.

5.1 Inherent risk – vulnerability overview

The vulnerability assessment considers five main **risk factors**: (1) **Market structure**, (2) **Clients**, (3) **Products and services**, (4) **Channels of distribution** and (5) **Geography**.

The summary of vulnerability assessment outlined in table 15 outlines the four TCSP activity classes and their respective inherent risk. It is important to note that Specialised PFS are authorised to perform one or more of these activities, as per their license. In general Specialised PFS providing TCSP services provide incorporation services, domiciliation services, directorship services and corporate secretarial services and nominee shareholder services.

The assessment is summarized in the table below. Further detail is provided in the following sections. It analyses how these five risk factors influence the ML/TF risk in each class.

Table 15: Summary of vulnerability assessment

Class	Inherent Risk (IR)
Incorporation of companies	High
Provision of directorships and corporate secretarial services	High
Domiciliation of companies	High
Nominee shareholder services	Medium-high

The computation of the overall inherent risk for a Specialised PFS depends on the underlying inherent risks of TCSP activities performed under their license.

⁸³ Definition of the FATF, Global Money Laundering & Terrorist Financing threat Assessment, July 2010

5.2 Common inherent risk factors across Specialised PFS activities providing TCSP services

The distribution risk factor describes the methods of delivery for different services. In other words, the various ways in which a TCSP finds new clients including communication channels. This factor affects ML/TF inherent risks in a consistent way across all Specialised PFS activities because the Specialised PFS usually offer several services to the same client therefore there is no specific distribution channel which could be associated to each TCSP service. On the contrary all of the below distribution channels apply.

Based on the consolidated data from the 2019 CSSF AML/CFT questionnaire ("the 2019 AML/CFT questionnaire"), we note that services can be offered face-to-face in a meeting with the UBO or with the representative of the structure or non-face-to-face. Based on the consolidated data from the 2019 AML/CFT questionnaire, a vast majority of Specialised PFS in all activity classes have declared that their procedures are covering customer due diligence for entering into business relationship not face to face showing that there is indeed non face to face business taking place.

Specialised PFS often use third parties to conduct a range of activities, from initial introduction to clients, to advisory on specific topics, as detailed in Section 1. These third parties may increase exposure to ML/TF in distribution channels, as they are often introducing intermediaries, who may conduct introduction to clients through remote channels. Non face-to-face business can increase the difficulty for Specialised PFS to accurately verify the identity of clients and their UBOs.

TCSPs may rely on or use the assistance from these third parties when performing their CDD requirements: while the ultimate responsibility of the CDD lies with the TCSP, this level of intermediation may result in exposure to AML/CFT risks. It should however be noted that reliance on 3rd party for CDD purposes is limited in Luxembourg to 3rd parties fulfilling specific conditions.⁸⁴

In practice the third party introducers can be other companies belonging to the same group as the Specialised PFS and the Specialised PFS has access to the information held by the group on the client.

5.3 Incorporation of companies

Market structure: Incorporation activities are conducted by 42 out of 92 Specialised PFS. To be noted that this is a little less than the proportion of Specialised PFS carrying out directorship and corporate secretarial services and domiciliation services. Even if the revenues coming from this activity are rather important (around EUR 6 millions), they are nevertheless much lower than the revenues generated by directorship and corporate secretarial services.

Client and geography: Based on the consolidated data from the 2019 AML/CFT questionnaire, the number of clients serviced by Specialised PFS providing incorporation

⁸⁴ Article 3-3 of the law of 12 November 2004 on the fight against money laundering and terrorist financing

services is close to the numbers of clients in other activity classes. Approximately one quarter of the clients/structures are considered high risk by Specialised PFS (including PEPs). We note that generally these clients do not use complex structuring, involving bearer shares, or providing services to legal arrangements in high risk countries.

Products, services and transactions: The incorporation of structures and/or the signing of a contract for legal arrangements require the registration of the legal entity in the "Registre de Commerce et des Sociétés" (RCS). As stated before, Specialised PFS mainly service legal entities. It should be noted that it is not a requirement that a Specialised PFS is directly involved in a company's incorporation. The nature of ML/T risks relating to the provision of these services is high because a criminal may abuse or misuse this service to set up a complex network of structures that permits the concealment of their identity and the source of the funds.^{85,86}

5.4 Domiciliation of companies

Market structure: This class contains the 2nd highest number of Specialised PFS (77 out of 92). Domiciliation, together with directorship and corporate secretarial services, represent the main activities. Domiciliation services are generating a revenue around EUR 22 millions⁸⁷. Like directorship and corporate secretarial services, the majority of the revenues is concentrated in 5 established large Specialised PFS. In this context, it has to be noted that the market includes multiple small Specialised PFS. This may drive some ML/TF risk from fragmentation from a supervisory point of view but in fact it is limited due to the concentration of revenues.

Client and geography: Based on the consolidated data from the 2019 AML/CFT questionnaire, the number of clients serviced by the Specialised PFS providing domiciliation services is close to the numbers of clients in other activity classes (except nominee services). Approximately one quarter of the clients/structures are considered high risk by Specialised PFS (including PEPs). Again, to be noted that the vast majority of Specialised PFS reported that their clients do not use complex structuring involving bearer shares and do not provide services to legal arrangements in high risk countries.

Products, services and transactions: Specialised PFS domicile mainly companies which are not authorised (cf. Table 16). In general, the domiciliation of structures in the form of authorised legal entities has a lower associated ML/TF risk which can be explained by the market entry controls performed by the regulators. For regulated entities under the prudential supervision of the CSSF such as funds please refer to the sub sector risk assessment of the collective investment sector.

In addition, we note that the structures domiciled are mainly commercial companies, i.e. legal persons which have a lower associated ML/TF risk due to the fact that these companies fall under the law of 10 August 1915 whereas legal arrangements such as trusts

⁸⁵ FATF, *Money Laundering using TCSPs*, 2010

⁸⁶ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, 2018

⁸⁷ May include revenues from services of any kind (Article 28-9 of the law of 5 April 1993 on the financial sector: "(1) Corporate domiciliation agents referred as other professionals of the financial sector in the list of paragraph 1 of Article 1 of the Law of 31 May 1999 governing the domiciliation of companies and referred to in this article, are natural or legal persons who agree to the establishment at their address by one or more companies of a seat and who provide services of any kind connected with that activity.")

are governed by a contract. As the law of 10 August 1915 on commercial companies provides a detailed legal framework for commercial companies, the risks in relation to commercial companies are mitigated.

In 2019, around 95% of the companies domiciled by Specialised PFS were not authorised.⁸⁸ Out of these 95%, we note that 8% are owned directly by authorised funds.

Table 16: Categorisation of companies domiciled by Specialised PFS⁸⁹

		Number in 2018	Number in 2019
Regulated	Regulated companies		
	<i>(UCITS, SICAR, SIF, securitisation vehicles, ...)</i>	689	609
Unregulated	SOPARFI	11 547	10858
	Unregulated AIF	778	331
	Securitisation	430	439
	Société de gestion de Patrimoine Familial	264	223
	Others	583	813

ML/TF risks relating to the provision of domiciliation services are considered to be higher, because a criminal may abuse or misuse these services to set up a complex network of structures that permits the concealment of their identity and the source of the funds. Moreover, Specialised PFS which do offer domiciliation services without providing directorship services for the same company might not be informed of transactions or changes relating to the company, making it therefore easier to launder money. However, many Specialised PFS providing domiciliation services, also insist on providing directorship services which enables them to have a better control and be in a position to detect suspicious activities in a timely manner.

5.5 Provision of directorship and secretarial services

Market structure: Directorship and/or secretarial services are conducted by 77 out of 92 Specialised PFS providing TCSP services and represent the main activity in terms of revenues. This activity class generates the biggest revenues, around EUR 45 millions. Like

⁸⁸ CSSF internal data

⁸⁹ As at 31.12.2018

domiciliation services, the majority of the revenues are concentrated in 5 established large Specialised PFS (to be noted that the market also includes multiple small Specialised PFS). This may drive some ML/TF risk from fragmentation from a supervisory point of view, but in fact it is limited due to the concentration of revenues.

Client and geography: Based on the consolidated data from the 2019 AML/CFT questionnaire, the number of clients serviced by the Specialised PFS providing directorship and/or corporate secretarial services is close to the numbers of clients in other activity class (except nominee services). Approximately one quarter of the clients/structures are considered high risk by Specialised PFS (including PEPs). Again, these clients do not use complex structuring involving bearer shares (except for clients in a few Specialised PFS) and a very small portion of the Specialised PFS provide services to legal arrangements in high risk jurisdictions.

Products, services and transactions: Specialised PFS offer directorship services to Luxembourg-based as well as to offshore companies. This class is by nature more likely to deal with offshore products which present a higher risk of ML due to the difficulty to identify and verify the UBO, to remain informed at all times and to understand the features of a product under foreign law.

Regarding the service offered, Specialised PFS can be abused because they assist clients in managing structures, helping clients to navigate through complex fiscal and reporting local requirements in place. The director will be considered as the originator or approver of decisions and actions conducted which potentially conceals the identity of the client or its representative giving the instruction. On the other hand, when managing these structures the directors provided by the Specialised PFS become personally liable for the decisions and actions, which are sometimes the execution of the advice previously provided by legal/tax advisors and thus must ensure that they apply an appropriate level of controls over actions and transactions they are approving. This reduces the level of exposure to ML/TF risk.

Moreover, the directorship services enable the Specialised PFS to be aware of all the transactions of the company (by participating to board meetings and signing documents). It should, however, be noted that the level of exposure to ML/TF risk may only be reduced where the number of mandates per director remains limited.

Corporate secretarial services are typically less vulnerable to ML/TF because they generally involve the execution of activities that have no or very limited overlap with actions which are typically carried out with the purpose of laundering illicit funds (e.g. international transactions). Clients remain responsible over decisions and actions executed by the structure. As such, clients or their UBOs will be recorded as the originator or approver of decisions, hence limiting the opportunities to conceal their identity. Therefore, the potential for administration services to be abused or misused for ML/TF purposes is limited compared to domiciliation and directorship services. Nevertheless, there may be instances which present higher risk, such as the use of administrative services to give substance to the company in order to be eligible for Luxembourg tax regime.

In the recent year, it has been noted that more and more clients are asking for administrative services in order to provide additional substance to the structures. Clients often need guidance and assistance from the Specialised PFS for the fulfilment of these administrative tasks such as corporate secretarial matters.

5.6 Nominee shareholder services

Market structure: Specialised PFS offering nominee shareholder services is the smallest activity class with only 3 Specialised PFS remaining to provide this type of services. It is also the smallest activity in terms of revenues (just below EUR 9,000). The small size of this activity is explained by the disclosure requirements in Luxembourg (i.e. Register of Beneficial Owners) which make this service less attractive.

Client and geography: Based on the consolidated data from the 2019 AML/CFT questionnaire, the number of clients to which the Specialised PFS are providing nominee services is the smallest in terms of number of clients/structures.

Products, services and transactions: As illustrated in several case studies of the FATF, the ML risk associated with this service is high because this service allows the name of Specialised PFS to appear on the share register of a company instead of the name of the UBO and a criminal may abuse or misuse this service to conceal his identity.^{90,91}

6. MITIGATING FACTORS AND RESIDUAL RISK ASSESSMENT

This section identifies and assesses the mitigating measures in place, both at supervisory and control levels, to reduce ML/TF inherent risk. These are grouped into four main areas: (1) **ML/TF risk assessment**; (2) **AML/CFT Supervision**; (3) **ongoing monitoring** and (4) **procedures and trainings**.

In addition it is to be noted that Specialised PFS look to provide the full scope of services and if this is not possible they often provide more than one service.

The table below summarises the residual risk of **each class**.⁹²

Table 17: Summary of mitigating measures – residual risk assessment

Element	Inherent Risk (IR)		Residual Risk (RR)
Incorporation of companies	High	<i>Impact of mitigating factors</i>	Medium-High
Provision of directorships	High	<i>Impact of</i>	Medium-High

⁹⁰ FATF, *Money Laundering using TCSPs*, 2010

⁹¹ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, 2018

⁹² The level of residual risk is determined by reducing the level of inherent risk by an amount commensurate with the strength of mitigating factors. If residual risk and inherent risk are the same, this does not mean that there are no mitigating measures in place (only that mitigating measures do not reduce inherent risk substantially).

		<i>mitigating factors</i>	
Domiciliation of companies	High	<i>Impact of mitigating factors</i>	Medium-High
Nominee services shareholder	Medium-High	<i>Impact of mitigating factors</i>	Medium-Low

Residual risk remains *Medium-High* within Specialised PFS providing **incorporation of companies, directorship** and **domiciliation services**. 79% of Specialised PFS providing these services have a ML/FT risk appetite and ML/FT Key Risk Indicators that have been defined by the appropriate internal governance body and properly communicated to their employees. Most of the Specialised PFS included in these classes have also set up a compliance function and had no significant findings from their internal auditors in 2018.

The residual risk for **Nominee shareholder services** is *Medium-Low*. It should be noted that there is a continuous decrease in the provision of nominee shareholder services by Specialised PFS and that there are only 3 Specialised PFS remaining to provide such services. All entities have a name screening system to detect PEP and person on targeted financial sanction lists. They all identify and verify the identification of the Beneficial Owners for clients (legal persons, legal arrangements) whose ownership and control structure is complex or opaque.

It is to be noted that if residual risk and inherent risk are the same, this does not mean that there are no mitigating measures in place, only that the mitigating measures do not reduce inherent risk substantially.

6.1 Risk mitigation by Specialised PFS

Risk mitigation factors are similar from one activity from another due to the fact that the same processes and systems for all activity classes therefore the mitigation factors are presented in a general way. Where an activity class differs from the other activity classes this is clearly highlighted.

6.1.1. ML/TF risk assessment and risk based approach

Specialised PFS are required to take all necessary steps to **identify, assess and understand their ML/TF risks**. For example, this includes risk assessments for customers, countries, products, services, distribution channels and the degree of complexity and transparency of the structure to be implemented. The risk assessment should then drive the application of the professional's risk-based approach to AML/CFT, for example with the definition of ML/TF risk appetite and key risk indicators.

A review of the 2018 AML/CFT risk assessment for the Specialised PFS showed that AML/CFT risk assessment were often incomplete and/or vague.

Responses to the AML/CFT questionnaire show that a large majority of Specialised PFS have defined a ML/TF risk appetite.

Specialised PFS are also required to apply control measures in relation to customer due diligence (CDD) at on-boarding and throughout the life of the business relationship.

When customers are on-boarded, Specialised PFS are required to complete a **due diligence process**, including the assessment of ML/TF risk. This involves identifying the customer and verifying the identity by using reliable, independent source documents and data. It also involves identifying the beneficial owner and obtaining information on the purpose and intended nature of the business relationship. This process involves screening against PEP, sanctions lists and other high-risk lists (e.g. using open-source database from a professional data provider). Where ML/TF risks are higher, an **enhanced due diligence** (EDD) will need to be performed. Situations bearing a higher risk include, but is not limited to business relationships and transactions with natural and legal persons from higher risk countries (e.g. as identified by FATF) and with PEPs. In certain circumstances, senior management approval may be required before establishing such business relationships whereas in the above-mentioned cases (PEP and high risk countries) it is compulsory. According to the 2019 AML/CFT questionnaire, a vast majority of Specialised PFS have a client acceptance policy based on a risk-based approach and different levels of internal authorisation in place.

6.1.2. Customer due diligence and ongoing monitoring

In addition to CDD/EDD at on-boarding, Specialised PFS are required to conduct **ongoing due diligence** on the business relationship **and transaction monitoring**. This includes ensuring that documentation and data collected during CDD/EDD is kept up to date, as well as conducting periodic due diligence on existing client relationships on the basis of materiality and risk (e.g. re-screening new/changed client data against sanctions, PEP and other high-risk lists during periodic and event driven reviews).

Responses to the AML/CFT questionnaire show that for the directorship and corporate secretarial services activity class, a few Specialised PFS are screening their data base against sanction lists partially therefore the mitigation is not as good as the mitigation for all the other activity classes.

In addition, on an ongoing basis, Specialised PFS are required to **scrutinize the transactions undertaken by clients** to ensure those conducted are consistent with their knowledge of the customer, their business and risk profile, and source of funds. These activities include checks against sanctions, PEPs, and other high-risk lists as well as transaction monitoring (identifying potentially suspicious activities, behaviours and transactions).

Responses to the 2019 AML/CFT questionnaire show that, a large majority of the Specialised PFS have a transaction monitoring in place.

While only a minority has automated systems in place regarding unusual transactions or patterns of activities/client transactional profile, a vast majority has automated system regarding PEP identification and Targeted Financial Sanctions.

Finally, Specialised PFS are also required to maintain all necessary records on transactions (both domestic and international), as well as records obtained through CDD measures, account files and business correspondence, and the results of any analysis undertaken.

In relation to tax crimes risks, a majority of the Specialised PFS have implemented the necessary measures in order to comply with the automatic exchange of tax information and anti-money laundering in tax matters (according to Circular CSSF 15/609 and Circular CSSF 17/650).

In 2019, almost all of the Specialised PFS have declared that they always identify and verify the identification of the Beneficial Owners for structures (legal persons, legal arrangements) whose ownership and control structure is complex or opaque (several layers) or involves bearer shares.

6.1.3. Procedures and trainings

Specialised PFS have in place ongoing employee training and awareness-raising programmes to ensure staff understand ML/TF risks and AML/CFT obligations. Participation in basic (internal and/or external) training is provided upon hiring and continuing education takes place throughout an individual's career. Responses to the 2019 AML/CFT questionnaire show that almost all Specialised PFS in all activity classes have trained their first line of defence on AML/CFT matters in 2019 however the results were not as good in relation to the training of senior management and the board for directorship and corporate services and domiciliation classes.

6.1.4. AML/ CFT supervision

Specialised PFS are not required to set up a compliance function and therefore have a three line of defence model. That said more than 85% of the Specialised PFS declared having a compliance function, the first activity class being the nominee shareholder activity class where all Specialised PFS active in this activity have a compliance function in place.

All specialised PFS have an internal and external audit function. Review of the 2018 closing documents of the Specialised PFS showed that over 80% of the Specialised PFS in all activity classes had no major findings from their internal audit function.

6.2. Risk mitigation by CSSF applicable to the Specialised PFS department

The mitigating factors employed by CSSF are grouped into four main factors, each of which is described below: (1) **Understanding of ML/TF risks**; (2) **Market entry**; (3) **Oversight and supervision**; and (4) **Rules enforcement**.

6.2.1. Understanding of ML/TF risk

CSSF promotes an understanding of ML/TF risks and AML/CFT obligations through multiple channels. These channels include: publication of guidance, CSSF circulars, other communications, public conferences and feedback to supervised professionals. For instance, in December 2019, a conference dedicated to Specialised PFS to discuss AML/CFT topics took place.

CSSF also performs a risk assessment on all Specialised PFS. This includes a risk assessment on the basis of findings by internal and external control functions, existence of policies, controls and procedures, provision of ongoing employee training and awareness-raising programmes to ensure staff understand ML/TF risks, AML/CFT obligations and the obligation to cooperate with authorities.

6.2.2. Market entry

CSSF operates AML/CFT market entry controls at the instruction of a Specialised PFS, (including a licensing process) and at any subsequent change within the ownership structure. These controls are designed to ensure that criminals and their associates are prevented from holding or being the beneficial owner of a significant or controlling interest in a supervised firm, and from holding a management function. Fit and proper checks are carried out on the management and ownership structure of the Specialised PFS in instruction and during the lifetime of the Specialised PFS.

6.2.3. Oversight and supervision

CSSF adopts a risk-based approach to supervision of compliance with AML/CFT obligations. This is achieved through both offsite and onsite activities.

Offsite supervisory activities include:

- ongoing desk-based review of AML/CFT relevant information and documentation (such as review of the closing documents of the Specialised PFS...);
- regular interactions with the professional, including face-to-face meetings and/or calls performed on a risk basis; and
- an annual AML/CFT questionnaire with specific questions depending on the activities of the Specialised PFS to collect additional information.

An on-site inspection division is dedicated to performing full scope, targeted or thematic AML/CFT on-site inspections, the frequency and intrusiveness of which have increased in recent years. In 2019, 7 AML/CFT inspections were carried out for Specialised PFS performing TCSP services.

The CSSF has significantly increased its staff number both in the Specialised PFS off-site department and in the on-site department.

Additionally, Luxembourg has recently established a Register of Beneficial Owners, improving the transparency over those with significant and/or control interest in structures.^{93,94} This register provides professionals with a direct view of the beneficial owner(s) of Luxembourg-registered entities.

6.2.4. Rules enforcement

Both the offsite and onsite inspection divisions can trigger remediation and enforcement and have at their disposal a wide range of supervisory tools. Enforcement follows the “*Procédure Administrative Non-Contentieuse* (PANC)” process.⁹⁵

CSSF’s sanctioning powers were further strengthened and broadened in February 2018 and March 2020, enhancing CSSF’s ability to ensure compliance with AML/CFT obligations.

Specialised PFS are since March 2020 categorised as a financial institution and is therefore exposed to the same method of sanctioning as other CSSF supervised entities (for instance banks).

In addition, CSSF is required to systematically publish sanctions, unless the disclosure would seriously jeopardise the financial markets, an ongoing investigation or cause disproportionate damage to the parties involved.⁹⁶

6.3 Most frequent off- and on-site findings

CSSF hereby shares the **most frequent on-site and off-site inspection findings** for the Specialised PFS providing corporate services (TCSP activities):

⁹³ The Register of Beneficial Owners was set up by the law dated 13 January 2019 with effect from 1 March 2019 implementing provisions of the fourth Anti-Money Laundering Directive into Luxembourg law (“Loi instituant un Registre des bénéficiaires effectifs”)

⁹⁴ The Law transposes Article 30 of the 4th Anti-Money Laundering Directive, by creating a Register of Beneficial Owners of corporate entities. The registered entities may include, for example, public/private limited companies, partnership, non-profit organisations, together with Luxembourg-based branches of foreign companies and mutual funds (“Fonds communs de placement”)

⁹⁵ Law of 1 December 1978, Grand Ducal Regulation of 8 June 1979 and CSSF Note de Service 10/210

⁹⁶ 2004 AML/CFT Law, Article 8-6

Item	Description
Best practices	<ul style="list-style-type: none"> Establishing a clear AML/CFT risk appetite statement and communicating it throughout the organisation; Promoting a strict compliance culture throughout the organisation, especially in the first line of defence; Performing at least yearly AML/CFT trainings for all staff members, including typologies relevant to the TCSP industry and an update of the Specialised PFS internal procedure; Performing daily Targeted Financial Sanctions, PEP and adverse media screening to ensure screening is done immediately after an update in the sanction lists; Performing transaction monitoring by using automated systems (except when the professional can prove that the volume and nature of the customers and the transactions to be supervised do not require such automation) including rules of volume, pattern and frequency; Ensuring close oversight over branches, subsidiaries and all delegates and service providers performing AML/CFT controls on behalf of the Specialised PFS; Providing control functions (especially Compliance) with the necessary authority, independence, means and management support; Ensuring clear allocation of responsibilities between 1st and 2nd lines of defence; Ensuring an appropriate "tone from the top" such that there is direct participation of the management body in the AML/CFT strategy and framework definition, including regular reporting.
Most common shortcomings	<ul style="list-style-type: none"> Risk assessments too general, lacking entity-specific details and under-estimating the level of inherent and residual risk; Incomplete documentation/information on the origin of funds, source of wealth, the identity of legal persons and beneficial owners, as well as powers of attorney holders; Insufficient scrutiny of transactions undertaken throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the professionals' knowledge of the customer, the business and risk profile, including, where necessary, the source of funds and ensuring that the documents, data or information held are kept up-to-date; Lack of robust oversight when CDD is outsourced to 3rd parties; ML/TF suspicion not reported (or reported late) to CRF and/or other relevant public authorities; Incomplete and/or outdated documentation on internal policies and procedures; Insufficient frequency of Targeted Financial Sanctions screening.

7. AREAS FOR FURTHER IMPROVEMENT

This section outlines high-level recommendations to enhance the regulatory and supervisory framework. Each of these recommendations will be integrated as part of the CSSF's current AML/CFT strategy and action plan.

7.1 CSSF recommendations to the private sector

Specialised PFS should take a proactive approach to mitigating ML/TF risks. They should use this risk assessment to increase their understanding of ML/TF threats and vulnerabilities and develop proportionate and effective controls.

In line with the 2004 AML/CFT Law, regulations and recently published circulars, CSSF has issued important recommendations which apply to TCSP professionals. CSSF will monitor adherence to these as part of its supervisory activities and has indicated some examples of how professionals may show compliance with them.

Recommendations		How professionals may show compliance (examples)
1	Take appropriate steps to identify and assess firm-wide ML/TF risks	Documented and comprehensive ML/TF risk assessment in place, that considers all relevant risk factors (e.g. country/geographic risk, client risk, transaction/service and delivery channel risk) and clearly reflects findings of this sub-sector risk assessment, the NRA and the SNRA
2	Integrate the information provided in this Sub-Sector Risk Assessment, NRA and SNRA in the internal risk assessments	Internal risk assessments should make a clear reference to this Sub-Sector Risk Assessment, the NRA and the SNRA
3	Implement a clear AML/CFT risk appetite and strategy	Documented ML/TF risk appetite discussed and approved by Board, covering types of clients, geographies, products/services the professional wishes to cover (or avoid) and resources and tools required to properly mitigate ML/TF risks
4	Employ robust CDD process to reliably identify beneficial ownership and critically appraises origin of funds/source of wealth	Documented CDD/EDD procedure in place that states clearly how to identify beneficial ownership and which enhanced

5	Adopt enhanced measures for clients identified as high risk, including entities whose legal structure has been altered frequently and/or without adequate explanation	measures should be taken in high-risk cases (e.g. PEPs, higher risk countries)
6	Review client relationships on a periodic basis to determine whether ML/TF risk has changed	Evidence of periodic and event-driven risk assessments on existing clients
7	Ensure appropriate additional controls are in place where 3rd parties are used for CDD	Documented procedure governing 3 rd party CDD, with evidence of the TCSP verifying the robustness of any checks conducted by the 3 rd party (e.g. sample testing)
8	Ensure that name screening against Targeted Financial Sanctions screening is performed immediately as required notably by EU regulations	Implement daily TFS screening or be in a position to demonstrate that a mitigation measure has been put in place to ensure TFS screening immediately after release of a new TFS list
9	Ensure that the transaction monitoring process is effective and adapted to the activity performed and the type of client.	Implement automated transaction monitoring rules if the number of clients prevent manual ongoing monitoring, except when the professional can prove that the volume and nature of the customers and the transactions to be supervised do not require such automation.
10	When being part of a foreign-based group, ensure that the Luxembourg branch or subsidiary implement the Luxembourg requirements in addition to the policies and procedures of the group⁹⁷	AML/CFT measures clearly documented at both Group and branch/subsidiary level, with evidence that the central AML/CFT functions effectively control the implementation of group-wide policies and procedures
11	Report without delay suspicious activities and transactions to the CRF and targeted financial sanction breaches to the Ministry of Finance. Include CSSF if the	STR/SAR/TFAR/TFTR reporting in line with risk exposure

⁹⁷ FATF, Recommendation 18

suspicious activity relates to a supervised entity.		
12	Continue to collaborate closely with the Luxembourg competent authorities	Participate in events organised by authorities (e.g. CSSF, CRF) and provide prompt and accurate responses to information requests
13	Take appropriate steps to ensure compliance with latest revisions to Luxembourg Law, and consult CSSF for clarifications where necessary	Example: Ensure BO details are registered with "Registre des Bénéficiaires Effectifs (RBE)" and update these within one month of any changes
14	Promote understanding of ML/TF risks and a good compliance risk culture throughout the organisation	General training on ML/TF methods and risks which is relevant, along with targeted training for those employees and, where applicable, third parties providing higher risk services and/or servicing higher risk clients
15	Ensure that resources dedicated to AML/CFT are commensurate with the professional's level of risk	Level of human and technical resources and budgets allocated to AML/CFT activities justified based on level of risk/risk appetite

7.2 CSSF initiatives

CSSF has also identified opportunities and defined initiatives to further enhance its approach to supervise AML/CFT for TCSP activities. These are structured around three main themes:

- **CSSF will further promote understanding of ML/TF risks and AML/CFT obligations** among Specialised PFS. This will include continuing to organise relevant conferences on AML/CFT and publishing additional guidance where necessary.
- **CSSF will continue the improvement of data to support supervisory activities** for example by refining and enhancing the AML/CFT supervisory questionnaire completed annually by supervised professionals.
- **CSSF will take part in the national effort** to streamline actions on companies providing TCSP services.

APPENDIX A - FATF RISK FACTORS⁹⁸

A 1.1 FATF Guidance for a risk-based approach for Trust and Company Service Providers, June 2019

A 1.1.1 Country/Geographic risk

The provision of services by a TCSP may be higher risk when features of such services are connected to a higher risk country, for example:

- a) the origin, or current location of the source of funds in the trust, company or other legal entity;
- b) the country of incorporation or establishment of the company or the trusts;
- c) the location of the major operations or assets of the trust, company or other legal entity; and
- d) the country in which any of the following is a citizen or tax resident: a settlor, beneficiary, protector or other natural person exercising effective control over the trust or any beneficial owner or natural person exercising effective control over the company or other legal entity.

There are no universally agreed definition of a higher risk country or geographic area but TCSPs should pay attention to:

- a) Countries/areas identified by credible sources as providing funding or support for terrorist activities or that have designated terrorist organisations operating within them.
- b) Countries identified by credible sources as having significant levels of organised crime, corruption, or other criminal activity, including being a major source or a major transit country for illegal drugs, human trafficking and smuggling and illegal gambling.
- c) Countries subject to sanctions, embargoes or similar measures issued by international organisations such as the United Nations.
- d) Countries identified by credible sources as having weak governance, law enforcement, and regulatory regimes, including countries identified by FATF statements as having weak AML/CFT regimes, in relation to which financial institutions (as well as DNFBPs) should give special attention to business relationships and transactions.
- e) Countries identified by credible sources to be uncooperative in providing beneficial ownership information to competent authorities, a determination of which may be established from reviewing FATF mutual evaluation reports or reports by organisations that also consider various co-operation levels such as the OECD Global Forum reports on compliance with international tax transparency standards.

A 1.1.2 Client risk

The key risk factors that TCSPs should consider are:

⁹⁸ Please note that the indicators provided in this appendix are not exhaustive and for illustrative purposes only.

- a) The TCSP's client base includes industries or sectors where opportunities for ML/TF are particularly prevalent.
- b) The client include PEPs or persons closely associated with or related to PEPs, who are considered as higher risk clients⁹⁹.
- c) Clients conducting their business relationship or requesting services in unusual or unconventional circumstances (as evaluated taking into account all the circumstances of the client's representation).
- d) Clients where the structure or nature of the entity or relationship makes it difficult to identify in a timely manner the true beneficial owner or controlling interests or clients attempting to obscure understanding of their business, ownership or the nature of their transactions, such as:
 - i. Unexplained use of shell and/or shelf companies, front company, legal entities with ownership through nominee shares or bearer shares, control through nominee or corporate directors, legal persons or legal arrangements splitting company incorporation and asset administration over different countries, all without any apparent legal or legitimate tax, business, economic or other reason.
 - ii. Unexplained use of informal arrangements such as family or close associates acting as nominee shareholders or directors without any apparent legal or legitimate tax, business, economic or other reason.
 - iii. Use of trust structures for tax evasion or to obscure ownership in order to place assets out of reach to avoid future liabilities.
- e) Unusual complexity in control or ownership structures without a clear explanation, where there are certain transactions, structures, geographical location, international activities or other factors are not consistent with the TCSP's understanding of the client's business or economic purpose behind the establishment or administration of the trust, company or other legal entity with respect to which the TCSPs are providing services.
- f) Unusually high levels of assets or unusually large transactions compared to what might reasonably be expected of clients with a similar profile may indicate that a client not otherwise seen as higher risk should be treated as such.
- g) The offer by the person giving instructions to the TCSP to pay extraordinary fees for services, which would not ordinarily warrant such a premium.
- h) The relationship between employee numbers/structure is divergent from the industry norm (e.g. the turnover of a company is unreasonably high considering the number of employees and assets compared to similar businesses)
- i) Sudden activity from a previously dormant client without a clear explanation.
- j) Clients that start or develop an enterprise with unexpected profile or abnormal business cycles or clients that enter into new/emerging markets. Organised criminality generally does not have to raise capital/debt, often

⁹⁹ Please refer to FAFT Guidance (2013) on politically-exposed persons for further guidance on how to identify PEPs

making them first into a new market, especially where this market may be retail/cash intensive.

k) Indicators that client does not wish to obtain necessary governmental approvals/filings, etc.

l) Payments received from un-associated or unknown third parties and payments for fees in cash where this would not be a typical method of payment.

m) Clients who have funds that are obviously and inexplicably disproportionate to their circumstances (e.g. their age, income, occupation or wealth).

n) Clients who appear to actively and inexplicably avoid face-to-face meetings or who provide instructions intermittently without legitimate reasons and are otherwise evasive or very difficult to reach, when this would not normally be expected. Subsequent lack of contact, when this would normally be expected.

o) Inexplicable changes in ownership.

p) Activities of the trust, company or other legal entity are unclear or different from the stated purposes under trust deeds or internal regulations of the company or foundation.

q) The legal structure has been altered frequently and/or without adequate explanation (e.g. name changes, transfer of ownership, change of beneficiaries, change of trustee or protector, change of partners, change of directors or officers).

r) Management of any trustee, company or legal entity appears to be acting according to instructions of unknown or inappropriate person(s).

s) Unreasonable choice of TCSP without a clear explanation, given the size, location or specialisation of the TCSP.

t) Frequent or unexplained change of professional adviser(s) or members of management of the trustee, company or other legal entity.

u) The person giving instructions to the TCSP is reluctant to provide all the relevant information or the TCSP has reasonable grounds to suspect that the provided information is incorrect or insufficient.

v) Clients who request that transactions be completed in unusually tight or accelerated timeframes without a reasonable explanation for accelerating the transaction, which would make it difficult or impossible for TCSPs to perform a proper risk assessment.

w) Clients who insist, without adequate justification or explanation, that transactions be effected exclusively or mainly through the use of virtual assets for the purpose of preserving their anonymity.

x) Clients with previous convictions for crimes that generated proceeds, who instruct TCSPs (who in turn have knowledge of such convictions) to undertake specified activities on their behalf.

y) Clients who change their means of payment for a transaction at the last minute and without justification (or with suspect justification), or where there is a lack of information or transparency in the transaction. This risk

extends to situations where last minute changes are made to enable funds to be paid in from/out to a third party.

z) The transfer of the seat of a company to another jurisdiction without any genuine economic activity in the country of destination poses a risk of creation of shell companies which might be used to obscure beneficial ownership.

aa) Clients seeking to obtain residents rights or citizenship in the country of establishment of the TCSP in exchange for capital transfers, purchase of property or government bonds, or investment in corporate entities.

A 1.1.3 Transaction/service and associated delivery channel risk

Services which may be provided by TCSPs and which (in some circumstances) risk being used to assist money launderers may include:

a) Use of pooled client accounts or safe custody of client money or assets or bearer shares, without justification.

b) Situations where advice on the setting up of legal persons or legal arrangements may be misused to obscure ownership or real economic purpose (including setting up of trusts, companies or other legal entities, or change of name/corporate seat or establishing complex group structures). This might include advising in relation to a discretionary trust that gives the trustee discretionary power to name a class of beneficiaries that does not include the real beneficiary (e.g. naming a charity as the sole discretionary beneficiary initially with a view to adding the real beneficiaries at a later stage). It might also include situations where a trust is set up for the purpose of managing shares in a company with the intention of making it more difficult to determine the beneficiaries of assets managed by the trust.

c) In case of an express trust, an unexplained (where explanation is warranted) nature of classes of beneficiaries and acting trustees of such a trust.

d) Services where TCSPs may in practice represent or assure the client's standing, reputation and credibility to third parties, without a commensurate knowledge of the client's affairs.

e) Services that are capable of concealing beneficial ownership from competent authorities.

f) Services that have deliberately provided, or depend upon, more anonymity in relation to the client's identity or regarding other participants than is normal under the circumstances and in the experience of the TCSP.

g) Use of virtual assets and other anonymous means of payment and wealth transfer within the transaction without apparent legal, tax, business, economic or other legitimate reason.

h) Transactions using unusual means of payment (e.g. precious metals or stones).

i) The postponement of a payment for an asset or service delivered immediately to a date far from the moment at which payment would

normally be expected to occur, without appropriate assurances that payment will be made.

j) Successive capital or other contributions in a short period of time to the same company with no apparent legal, tax, business, economic or other legitimate reason.

k) Acquisitions of businesses in liquidation with no apparent legal, tax, business, economic or other legitimate reason.

l) Power of Representation given in unusual conditions (e.g. when it is granted irrevocably or in relation to specific assets) and the stated reasons for these conditions are unclear or illogical.

m) Transactions involving closely connected persons and for which the client and/or its financial advisors provide inconsistent or irrational explanations and are subsequently unwilling or unable to explain by reference to legal, tax, business, economic or other legitimate reason.

n) Situations where a nominee is being used (e.g. friend or family member is named as owner of property/assets where it is clear that the friend or family member is receiving instructions from the beneficial owner), with no apparent legal, tax, business, economic or other legitimate reason.

o) Commercial, private, or real property transactions or services to be carried out by the trust, company or other legal entity with no apparent legitimate business, economic, tax, family governance, or legal reasons.

p) Products/services that have inherently provided more anonymity or confidentiality without a legitimate purpose.

q) Existence of suspicion of fraudulent transactions, or transactions that are improperly accounted for. These might include:

i. Over or under invoicing of goods/services.

ii. Multiple invoicing of the same goods/services.

iii. Falsely described goods/services – over or under shipments (e.g. false entries on bills of lading).

iv. Multiple trading of goods/services.

r) Any attempt by the settlor, trustee, company or other legal entity to enter into any fraudulent transaction.

s) Any attempt by the settlor, trustee, company or other legal entity to enter into any arrangement to fraudulently evade tax in any relevant jurisdiction.

A 1.1.4 Examples of factors that may increase risk

a) Unexplained urgency of assistance required.

b) Unusual sophistication of structure, including complexity of control and governance arrangements and use of multiple TCSPs.

c) The irregularity or limited duration of the client relationship. One-off engagements for the establishment of complex trust, company or other

arrangements involving legal entities without ongoing involvement may present higher risk.

A 1.1.5 Examples of factors that may decrease risk are:

- a) Involvement of financial institutions or other DNFBPs or TCSPs which are regulated in their home jurisdiction and subject to appropriate AML/CFT regulation.
- b) Role or oversight of a regulator or multiple regulators (e.g. regulating TCSPs, trustees or any other person exercising effective control).
- c) The regularity or duration of the client relationship. Long-standing relationships involving frequent client contact throughout the relationship may present less risk. In addition, a relationship may present less risk where, for example, the TCSP provides an integrated service, including acting as or providing trustees or directors of the trust, company or other legal entity and responsibility for preparation of accounts or maintaining the books and financial records of such trust, company or other legal entity.
- d) Trusts, companies or other legal entities that are transparent and well-known in the public domain.
- e) Listed entities and other business arrangements, such as pension trusts and employee benefit trusts and other trusts used for commercial purposes.
- f) TCSP's familiarity with a particular country, including knowledge of local laws and regulations as well as the structure and extent of regulatory oversight.

APPENDIX B - RED FLAGS INDICATORS

The tables below detail red flag indicators for three categories of predicate offence that are particularly relevant to TCSPs in Luxembourg: fraud, tax crimes (fiscal offences) and corruption and bribery. Note that the presence of an indicator does not itself justify any conclusion that a predicate offence has been committed.

Further details on ML/TF red flag indicators can be found in publications including:

- CSSF, Circular 19/732 on clarifications on the identification and verification of the identity of ultimate beneficial owners (2019)
- CSSF, ML/TF risk analysis of private banking (2019)
- CSSF, ML/TF risk assessment of the collective investment sector (2020)
- CRF, Annual Activity Report 2018 (2019)
- FATF, Guidance for a risk-based approach, TCSP sector (2019)
- FATF and Egmont Group, Report on concealment of beneficial ownership (2018)
- FATF, ML through the physical transportation of cash (2015)
- FATF, ML and TF vulnerabilities of legal professionals (2013)
- FATF, Specific factors in laundering the proceeds of corruption (2012)
- FATF, Money Laundering using TCSPs (2010)

Table 18: Red flag indicators for fraud offences relevant to TCSPs^{100,101}

Category	Common red flag indicators (non-exhaustive)
Client characteristics	<ul style="list-style-type: none"> • Legal person or arrangement is incorporated in a jurisdiction with higher risk of tax crimes or international trade and/or financial centre; • Legal entity has banking activity outside of its domiciliation jurisdiction without any apparent justification; • Legal entity has a relationship with foreign professional intermediaries in the absence of genuine business transaction in the professional's country of operation • Director(s), controlling shareholder(s) and/or UBO(s) is listed against the accounts of other legal persons or arrangements
Client structure	<ul style="list-style-type: none"> • Complex structures are used which do not appear to legitimately require that level of complexity or which do not make commercial sense; • Informal nominee shareholders and directors are used (e.g. close associates or family members) • Legal structure has been altered frequently and/or without adequate explanation (e.g. name changes, transfer of

¹⁰⁰ FATF, *Guidance for a Risk-Based Approach*, TCSP sector, 2019

¹⁰¹ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, July 2018

	<ul style="list-style-type: none"> ownership, change of beneficiaries, change of trustee or protector, change of partners, change of directors or officers) Conflict of interest is evident between entity, relationship manager, external advisor and/or intermediary
Involvement of intermediaries	<ul style="list-style-type: none"> Employee of professional intermediary/third-party firm is acting as nominee directors or shareholders. Power of Representation (or Attorney) is given in unusual conditions and the stated reason for it is unclear or illogical Professional is introduced by an unknown / unfamiliar intermediary
Suspicious activities and transactions	<ul style="list-style-type: none"> Bearer shares are used without appropriate registration with a custodian Professional requests unusual contract terms

Table 19: Red flag indicators for tax crimes (fiscal offences) relevant to TCSPs^{102,103}

Category	Common red flag indicators (non-exhaustive)
Client location and structure	<ul style="list-style-type: none"> Legal person or arrangement is incorporated in a jurisdiction with higher risk of tax crimes or international trade and/or financial centre; Legal person uses a complex set-up without clear economic or patrimonial justification, or which appears designed to conceal information (e.g. trusts from jurisdiction with no requirement to disclose beneficiaries)
Client characteristics	<ul style="list-style-type: none"> Legal person has no real business activities Legal person is not paying taxes, superannuation, retirement funds contributions or social benefits; Legal person has been identified as non-tax compliant in Luxembourg or another jurisdiction
Involvement of intermediaries	<ul style="list-style-type: none"> Legal person is receiving loans from private third parties without any supporting loan agreements, collateral or regulate interest repayments; Legal person and TCSPs are receiving directions and decisions via foreign professional intermediaries;
Documentation	<ul style="list-style-type: none"> Complicated transaction routings are used without sufficient explanations or trade records Findings of anomalies in documentation justifying transactions, and notably atypical or unusual transactions (e.g. no VAT number, no invoice number, circular transactions)
Hold mail	<ul style="list-style-type: none"> Request to have hardcopy documents retained for a short time only or personal collection with long time spans in between Hold mail not collected and the client or their beneficial owners have not visited Luxembourg for an extended period

¹⁰² FATF, *Guidance for a Risk-Based Approach*, TCSP sector, 2019

¹⁰³ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, July 2018

Suspicious activities and transactions	<ul style="list-style-type: none"> • Legal person or arrangement is used exclusively to facilitate transit transactions and does not appear to generate wealth or income; • Funds are sent to, or received from, a foreign country when there is no apparent connection between the country and the client; and • Funds are sent to, or received from, a jurisdiction with higher risk of tax crimes or international trade or financial centre. • Payment or reception of fees to or from foreign companies without business activities or without substance or link between the counterparties and whose purpose seems to be economically unjustified re-invoicing • Transactions are executed in an apparently cyclical way;
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Table 20: Red flag indicators for bribery and corruption relevant to TCSPs^{104,105}

Category	Common red flag indicators (non-exhaustive)
Client characteristics	<ul style="list-style-type: none"> • The client is a PEP or a person closely associated or related to PEPs; • Legal entity has no real business or commercial activity • Client base includes industries or sectors where opportunities for ML/TF via bribery and corruption are particularly prevalent • Client has flawed background or reputation (e.g. convicted of a criminal offence; subject or linked to a judicial investigation; subject to negative press articles; corruption identified in previous audit reports)
Involvement of intermediaries	<ul style="list-style-type: none"> • Legal entity or TCSPs has a relationship with foreign professional intermediaries in the absence of genuine business transaction in the professional's country of operation • Nominee shareholder(s) and director(s) are used when clients involved are PEPs or persons closely associated or related to PEPs
Documentation	<ul style="list-style-type: none"> • Client refuses to provide required documentation
Suspicious activities and transactions	<ul style="list-style-type: none"> • Legal entity or arrangement is exclusively facilitating transit transaction and does not appear to generate wealth or income • Funds are sent to, or received from a jurisdiction with higher risk of tax crime, an international trade or financial centre, or country with known levels of corruption • Bearer shares are used without appropriate registration with a custodian • Connections between parties are questionable, or generate doubts, and cannot be sufficiently explained by the client • Transactions are executed from a business account but appears to fund personal purchases, including assets and recreational activities

¹⁰⁴ FATF, *Guidance for a Risk-Based Approach*, TCSP sector, 2019

¹⁰⁵ FATF and Egmont Group, *Report on Concealment of Beneficial Ownership*, July 2018

**Links to
bribery and
corruption**

- Link between the client company and a negatively known company
 - Link between the client and a convicted person
 - Link between the client and a person who has been involved in a corruption case
 - Link between the client and a person who has been the subject of a judicial inquiry
 - Link between the client and a corruption case
 - Link between the prospect and a customer who has been involved in a corruption case
 - Link between a company related to the client and the aware of public contracts
 - Link between funds from targeted entities and a corruption case
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APPENDIX C - ACRONYMS

Acronym	Definition
AIF	Alternative Investment Fund
AML	Anti-Money Laundering
BEPS	Base Erosion and Profit Sharing
CDD	Customer Due Diligence
CRF	Cellule de Renseignement Financier / Financial Intelligence Unit
CFT	Countering the Financing of Terrorism
CSSF	Commission de Surveillance du Secteur Financier
EBA	European Banking Authority
EDD	Enhanced Due Diligence
EU	European Union
FATF	Financial Action Task Force
KYC	Know Your Customer
ML/TF	Money Laundering and Terrorist Financing
MNC	Multi-national company
NRA	National Risk Assessment
OECD	Organisation for Economic Cooperation and Development
OPC	Organismes de Placement Collectif
PANC	Procédure Administrative Non-Contentieuse
PEP	Politically Exposed Person
Specialised PFS	Specialised Professional of the Financial Sector (<i>Professionnels du Secteur Financier spécialisés</i>)
RCS	Registre de Commerce et des Sociétés
RBA	Risk Based Approach
RBE	Registre des Bénéficiaires Effectifs
SAR	Suspicious Activity Report
SSRA	Sub-sector Risk Assessment

SIF	Specialised Investment Fund
SICAR	Société d'Investissement en Capital à Risque
SNRA	(EU's) Supra-National Risk Assessment
STR	Suspicious Transaction Report
TCSP	Trust & Company Service Provider
TF	Terrorist Financing
UBO	Ultimate Beneficial Owner
UCITS	Undertakings for Collective Investments in Transferable Securities
UNODC	United Nations Office on Drugs and Crime

