The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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FinCEN Proposes AML and Reporting Regulations for Investment Advisers; Call Scheduled to Discuss Proposal

[29323]

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TO: AML COMPLIANCE WORKING GROUP No. 3-15
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 55-15
INVESTMENT ADVISERS COMMITTEE No. 11-15
OPERATIONS COMMITTEE No. 20-15
SEC RULES COMMITTEE No. 29-15
SMALL FUNDS COMMITTEE No. 28-15
TRANSFER AGENT ADVISORY COMMITTEE No. 46-15 RE: FINCEN PROPOSES AML AND REPORTING REGULATIONS FOR INVESTMENT ADVISERS; CALL SCHEDULED TO DISCUSS PROPOSAL

The Financial Crimes Enforcement Network ("FinCEN") has proposed rules requiring SEC-registered investment advisers to establish anti-money laundering ("AML") programs and report suspicious activity to FinCEN. [1]

ICI intends to submit a comment letter in response to the Proposal, and we will be discussing the Proposal and soliciting member feedback:

- at the AML Compliance Working Group in-person meeting on September 11; and
- during a member call scheduled for Tuesday, September 15 at 3 p.m. ET (if you are interested in participating, please contact Kim Hair at kim.hair@ici.org or 202-326-5818).

Comments are due to FinCEN on or before November 2.

Background

The Bank Secrecy Act ("BSA") does not include "investment adviser" within its definition of "financial institution." However, it authorizes the Secretary of the Treasury to include additional types of business within this definition if the Secretary determines that they engage in an activity which is similar to, related to, or a substitute for, any of the listed businesses. In 2003 FinCEN published a notice of proposed rulemaking to require certain investment advisers to establish and implement AML programs. [2] FinCEN never finalized

the proposal, and formally withdrew it in 2008. [3] Consequently, investment advisers are not currently subject to the same AML and reporting obligations as banks, broker-dealers, and mutual funds (to name a few), although many have implemented such programs.

Summary of the Proposal

Broadly speaking, FinCEN proposes three regulatory changes affecting investment advisers:

(1) including them within the general definition of "financial institution" in the regulations implementing the BSA and adding a definition of investment adviser;

(2) requiring them to establish AML programs; and

(3) requiring them to report suspicious activity.

FinCEN has not proposed a customer identification program requirement for investment advisers, and has not included within their AML program requirements those provisions proposed for other financial institutions in 2014, [4] although it expects to address these issues in subsequent rulemakings. Furthermore, FinCEN has not proposed separate rules applicable to unregistered investment companies, and apparently has no intention of doing so. [5]

1, Definition of "Investment Adviser" and Delegation of Examination Authority to SEC

FinCEN proposes to define "investment adviser" as "[a]ny person who is registered or required to register with the SEC under section 203 of the Investment Advisers Act of 1940… ." This would include foreign advisers that are registered or required to register with the SEC, but that have no place of business in the U.S. FinCEN's intent is to make it easy for advisers to determine whether they are subject to the Proposal. State-regulated advisers, venture capital fund advisers, and private fund advisers [6] (among others) would not be subject to the Proposal. FinCEN notes, however, that in future rulemaking it could include other investment advisers outside of the proposed definition.

FinCEN also proposes to include investment advisers within the list of financial institutions that the SEC has authority to examine for compliance with FinCEN's rules (the SEC already has this authority with respect to broker-dealers and mutual funds).

2. The Proposed AML Program Rules

The Proposal would require each investment adviser to develop and implement a written AML program, to be approved in writing by its board of directors and made available for inspection by FinCEN and the SEC upon request. Each adviser's program, at a minimum, would:

(1) Establish and implement policies, procedures, and internal controls reasonably designed to prevent the investment adviser from being used for money laundering or the financing of terrorist activities and to achieve and monitor compliance with the applicable provisions of the BSA and regulations thereunder;

(2) Provide for independent testing for compliance to be conducted by the adviser's personnel or by a qualified outside party;

(3) Designate a person or persons responsible for implementing and monitoring the operations and internal controls of the program; and

(4) Provide ongoing training for appropriate persons.

FinCEN emphasizes that the proposed AML program requirement is risk-based, providing advisers the flexibility to design their programs to meet the specific risks of their services and clients. An adviser's program generally must cover all of its advisory services, but the nature of this coverage will depend on the particular service (e.g., whether it involves management of client assets). FinCEN then sets forth specific expectations for a risk-based program with respect to:

(1) Non-pooled investment vehicle clients; [7]

(2) Registered open-end fund clients; [8]

(3) Registered closed-end fund clients; [9]

(4) Private fund clients/unregistered pooled investment vehicles; [10] and

(5) Wrap fee programs.

FinCEN also considers investment advisers dually-registered as broker-dealers, and explains that such advisers need not establish separate programs so long as their programs cover all of their advisory and broker-dealer activities and businesses.

Finally, FinCEN recognizes that an investment adviser may conduct some of its operations through agents and third party service providers. Consequently, FinCEN permits advisers to delegate contractually some elements of their AML programs to these service providers, but reminds advisers that they remain fully responsible for the effectiveness of their programs.

3. The Proposed Reporting Rules

The Proposal would require investment advisers to report suspicious activity to FinCEN. This requirement is designed to provide useful information for investigations and proceedings involving domestic and international money laundering, terrorist financing, fraud, and other financial crimes. [11] The Proposal addresses filing and notification procedures; confidentiality of SARs; limitation of liability; and compliance.

Additionally, by including investment advisers within the definition of "financial institution," the Proposal would subject them to Currency Transaction Report ("CTR") filing requirements; [12] the recordkeeping, transmittal of records, and retention requirements for the transmittal of funds under the Recordkeeping and Travel Rules; [13] and other related recordkeeping requirements.

4. Information Sharing

The Proposal would subject investment advisers to FinCEN's rules implementing the information sharing procedures to detect money laundering or terrorist activity requirements of Sections 314(a) and 314(b) of the USA PATRIOT Act. [14]

5. Compliance and Timing

FinCEN proposes that an investment adviser develop and implement a compliant AML program on or before six months from the effective date of the regulation. Additionally, FinCEN proposes that advisers start filing SARs for transactions initiated after they implement their AML programs.

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endnotes

[1] Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers (Aug. 24, 2015)(the "Proposal"), available at www.fincen.gov/statutes_regs/frn/pdf/1506-AB10_FinCEN_IA_NPRM.pdf.

[2] Anti-Money Laundering Programs for Investment Advisers, 68 FR 23646 (May 5, 2003), available at www.fincen.gov/statutes_regs/frn/pdf/352investmentadvisers_fedreg050503.pdf. See Institute Memorandum No. 15974, dated April 29, 2003, for a summary of the 2003 proposal.

[3] Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering Programs for Investment Advisers, 73 FR 65568 (Nov. 4, 2008), available at www.sec.gov/about/offices/ocie/aml/73fr65568-69.pdf.

[4] Customer Due Diligence Requirements for Financial Institutions, 79 FR 45151 (Aug. 4, 2014), available at http://www.fincen.gov/statutes_regs/files/CDD-NPRM-Final.pdf. See Institute Memorandum No. 28307, dated August 11, 2014, for a summary of FinCEN's customer due diligence proposal.

[5] In 2002, FinCEN published a notice of proposed rulemaking that would have required unregistered investment companies to establish AML programs. FinCEN withdrew this proposal in 2008. In this Proposal, FinCEN states that a new, separate rule proposal for unregistered investment companies is unnecessary because the Dodd-Frank Act subjected formerly unregistered hedge fund, private equity, and other private fund advisers to SEC registration, and that this Proposal affecting registered investment advisers will result in coverage substantially similar to what would have existed if the two previously proposed rules had been adopted.

[6] The Investment Advisers Act of 1940 provides a registration exemption to an adviser to private funds only that has less than $150 million in assets under management in the U.S.

[7] This risk assessment "should take into account the types of accounts offered (e.g., managed accounts), the types of clients opening such accounts, and how the accounts are funded." Proposal at 28.

[8] FinCEN acknowledges the lower risk profile of these clients because they "are subject to the full panoply of FinCEN's rules implementing the BSA." Therefore, these requirements applicable to mutual funds "may mitigate the money laundering risks that a mutual fund client and the mutual fund's underlying client base or investors present to an investment adviser." Id. at 28-29.

[9] FinCEN recognizes the lower risk profile of these clients, because "[p]urchases and sales of closed-end fund shares are executed through broker-dealers or banks, and these entities are already required to establish and implement AML programs under the BSA." Id. at 29.

[10] FinCEN suggests that advisers of private funds make a risk-based assessment of the

risks presented by the investors in these funds, and points out that advisers generally should have access to information about the identities and transactions of the fund investors.

[11] The Proposal requires an investment adviser to report a transaction if it knows, suspects, or has reason to suspect that the transaction: (i) involves funds derived from illegal activity or is intended or conducted to hide or disguise funds or assets derived from illegal activity; (ii) is designed to evade the requirements of the BSA; (iii) has no business or apparent lawful purpose, and the investment adviser knows of no reasonable explanation for the transaction after examining the available facts; or (iv) involves the use of the investment adviser to facilitate criminal activity. The Proposal also includes a number of "red flags," to provide advisers with some indication of when filing a suspicious activity report ("SAR") might be appropriate.

[12] Investment advisers are currently required to file reports on Form 8300 for the receipt of more than $10,000 in cash and negotiable instruments. The volume of Form 8300s currently filed by investment advisers is relatively low. FinCEN would replace this with the obligation to file CTRs for a transaction involving a transfer of more than $10,000 in currency by, through, or to the investment adviser.

[13] Under the Recordkeeping and Travel Rules, financial institutions must create and retain records for transmittals of funds, and ensure that certain information pertaining to the transmittal of funds "travel" with the transmittal to the next financial institution in the payment chain.

[14] Section 314(a) provides for the sharing of information between the government and financial institutions and allows FinCEN to require financial institutions to search their records to determine whether they have maintained an account or conducted a transaction with a person that law enforcement has certified is suspected of engaging in terrorist activity or money laundering. Section 314(b) provides financial institutions with the ability to share information with one another, under a safe harbor that offers protections from liability, in order to identify better and report potential money laundering or terrorist activities.
