

**MEMO# 15974**

April 29, 2003

## **TREASURY PROPOSES INVESTMENT ADVISER AML PROGRAM RULE**

[15974] April 29, 2003 TO: INVESTMENT ADVISERS COMMITTEE No. 9-03 MONEY LAUNDERING RULES WORKING GROUP No. 26-03 SEC RULES COMMITTEE No. 42-03 RE: TREASURY PROPOSES INVESTMENT ADVISER AML PROGRAM RULE The Bank Secrecy Act, as amended by the USA PATRIOT Act, requires certain financial institutions to establish anti-money laundering (AML) compliance programs. As explained more fully below, investment advisers currently are not financial institutions subject to the BSA. The Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has proposed a rule that would extend the BSA requirement to establish AML programs to certain investment advisers that manage client assets. A copy of the proposed rule is attached and briefly summarized below.<sup>1</sup> FinCEN will accept comments for sixty days after publication of the proposed rule in the Federal Register. The Institute will hold a conference call of the Working Group and other interested members to discuss possible Institute comments on the proposed rule. Information on that call will be sent in a subsequent memorandum. In the meantime, if there are issues you would like us to consider addressing in our comment letter, please contact me at (202) 371-5430 or by email to [rcg@ici.org](mailto:rcg@ici.org) or Frances Stadler at (202) 326-5822 or by email to [frances@ici.org](mailto:frances@ici.org). BACKGROUND The NPRM expresses FinCEN's view that although advisers rarely hold financial assets themselves and even more rarely accept cash, they are often in a critical position of knowledge as to the movement of large amounts of financial assets through financial markets. As a result, 1 See Financial Crimes Enforcement Network, "Anti-Money Laundering Programs for Investment Advisers" (the NPRM). The NPRM should be published in the Federal Register shortly and posted to the FinCEN web site at [www.fincen.gov](http://www.fincen.gov). FinCEN also concurrently proposed a similar rule for commodity trading advisors. 2 FinCEN believes that investment advisers have an important role to play in preventing the use of their services for money laundering and the financing of terrorism. However, the BSA does not expressly list investment advisers among the entities defined as financial institutions under BSA sections 5312(a)(2) and (c)(1). Section 5312(a)(2)(Y) of the BSA authorizes the Secretary of the Treasury to include additional types of businesses within the BSA definition of financial institution if the Secretary determines that those businesses engage in any activity similar to, related to, or a substitute for any of the businesses listed in the definition. Because of the types of activities certain investment advisers engage in and the services they provide, FinCEN proposes to exercise that authority and define these investment advisers as financial institutions solely for purposes of section 5318(h) of the BSA and to require them to establish anti-money laundering programs.<sup>2</sup> THE PROPOSED RULE The proposed rule would require each investment adviser subject to the rule to establish a written anti-money laundering program. As with the requirement for other financial institutions, the AML program, at a minimum, must: (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; (2) Provide for independent testing for compliance to be conducted by the investment 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. The program must be approved in writing by the investment adviser's board of directors or trustees, or if it does not have one, by its sole proprietor, general partner, or other persons who have similar functions. The NPRM notes that the board's approval could be given at its first regularly scheduled meeting after the program is adopted.

**INVESTMENT ADVISERS SUBJECT TO THE RULE** The proposed rule would apply to two groups of advisers: (1) Advisers that (i) have a principal office and place of business in the U.S. (U.S. advisers), (ii) are registered with the SEC, and (iii) report to the SEC that they have assets under management in Part 1A of Form ADV. This group includes advisers registered with the SEC that have either discretionary or non-discretionary authority. 2 The NPRM indicates that FinCEN is currently considering whether investment advisers should be subject to additional BSA requirements, including filing suspicious activity reports pursuant to section 5318(g) of the BSA and complying with accountholder identification and verification procedures pursuant to section 326 of the Patriot Act. 3 to manage client assets. It excludes, however, advisers that are not registered with the SEC because they are smaller, state-registered firms as well as advisers that are registered with the SEC but do not manage client assets. (2) U.S. advisers that are not registered with the SEC, but have \$30 million or more of assets under management and are relying on the registration exemption provided by section 203(b)(3) of the Investment Advisers Act of 1940 (unregistered advisers). Under section 203(b)(3), advisers that have fewer than 15 clients and do not hold themselves out generally to the public as investment advisers are exempted from SEC registration. With respect to this second group of investment advisers, the proposed rule would exclude those entities that would qualify as unregistered advisers but that are otherwise required to have an anti-money laundering program under the BSA because they are dually registered as a financial institution in another capacity and are examined by a Federal functional regulator for compliance with the requirement in that other capacity. The NPRM notes that some investment advisers, such as advisers that are dually- registered as broker-dealers, may already have anti-money laundering programs in place. The proposed rule would not require that such investment advisers establish duplicative anti- money laundering programs.

**SCOPE OF THE ADVISER'S AML PROGRAM** The NPRM notes that in some instances, investment advisers that would be subject to the proposed rule advise pooled investment vehicles that are themselves required to maintain anti-money laundering programs under BSA rules, such as mutual funds. To prevent overlap and redundancy, the proposed rule would permit investment advisers covered by the rule to exclude from their anti-money laundering programs any investment vehicle they advise that is subject to an anti-money laundering program requirement under BSA rules. On the other hand, the NPRM states that advisers providing investment advice to pooled investment vehicles that are not subject to BSA anti-money laundering requirements, and that are created and administered by a third party, would need to establish procedures to assess whether the entity that created and administers the vehicle, or the nature of the vehicle itself, reduces the risk of money laundering. In explaining this risk-based approach, the NPRM states that: For example, an employee retirement savings plan sponsored by a public corporation that accepts assets only in the form of payroll deductions or rollovers from other similar plans presents no realistic opportunity for money laundering activity, whereas an offshore vehicle not itself subject to any anti-money laundering program requirement would present a more significant risk. The adviser's program would need to

analyze the money laundering risks posed by a particular investment vehicle by using a risk-based evaluation of relevant factors including: the type of entity; its location; the statutory and regulatory regime of that location (e.g., if the entity is organized or registered in a foreign jurisdiction, does the jurisdiction comply with the European Union anti-money laundering directives, and has the jurisdiction been identified by the Financial Action Task 4 Force as non-cooperative); and the adviser's historical experience with the entity or the references of other financial institutions. As the entity's potential vulnerability to money laundering increases, the adviser's procedures would need to reasonably address these increased risks, such as by obtaining and reviewing information about the identity and transactions of the investors in the vehicle.

**DELEGATION OF AML FUNCTIONS** The NPRM indicates that if the adviser needs to look to affiliated or unaffiliated service providers to evaluate some transactions or perform parts of its anti-money laundering program, it would be permissible to delegate the implementation and operation of appropriate elements of its program by contract. The investment adviser, however, would remain fully responsible for the effectiveness of its anti-money laundering program, as well as for ensuring that federal examiners are able to obtain information and records relating to the program and to inspect the third party for purposes of the program. The NPRM further indicates that the adviser also would need to undertake reasonable steps to assess whether the service provider would carry out such procedures effectively, and that it would not be sufficient to simply obtain a certification from a service provider that the service provider "has a satisfactory anti-money laundering program."

**COMPLIANCE EXAMINATIONS** The proposed rule would delegate FinCEN's authority to examine investment advisers for compliance with the rule to the Securities and Exchange Commission.

**EFFECTIVE DATE & COMPLIANCE PERIOD** The proposed rule would require AML programs to be adopted within 90 days of the effective date of the final rule.

**REQUEST FOR COMMENTS** As noted above, the deadline for submitting comments on this proposal will be sixty days from its publication in the Federal Register. In the NPRM, FinCEN specifically requests comment on the proposed definition of "investment adviser," whether it is appropriate to determine that investment advisers are financial institutions under the BSA and to require these investment advisers to implement anti- money laundering programs, and whether other categories of investment advisers should be covered by or excluded from the rule. FinCEN also requests comment regarding the proposed provisions designed to avoid imposing overlapping or duplicative regulation of investment advisers and other financial institutions that are (or are proposed to be) subject to anti-money laundering program requirements.

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Attachment (in .pdf format)