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**DEPARTMENT OF THE TREASURY**

**31 CFR Part 103**

**RIN 1506-AA28**

**Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers**

**AGENCY:** Financial Crimes Enforcement Network (FinCEN), Department of the Treasury.

**ACTION:** Proposed rule.

**SUMMARY:** FinCEN is proposing to amend its Bank Secrecy Act rules to require certain investment advisers that manage client assets to establish anti-money laundering programs, to establish minimum requirements for such programs, and to delegate its authority to examine certain investment advisers for compliance with such program requirements to the Securities and Exchange Commission.

**DATES:** Written comments may be submitted to FinCEN on or before [INSERT DATE THAT IS 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** Because paper mail in the Washington area may be subject to delay, commenters are encouraged to e-mail comments. Comments may be sent to Internet address [regcomments@fincen.treas.gov](mailto:regcomments@fincen.treas.gov) with the caption “Attention: Section 352 Investment Adviser Rule Comments” in the body of the text. Comments may be mailed to FinCEN, Section 352 Investment Adviser Rule Comments, P.O. Box 39, Vienna, VA 22183. Comments should be sent by one method only. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m. in the FinCEN Reading Room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by

telephoning (202) 354-6400 (not a toll-free number).

**FOR FURTHER INFORMATION CONTACT:** Office of Chief Counsel (FinCEN), (703) 905-3590; Office of the General Counsel (Treasury), (202) 622-1927; or Office of the Assistant General Counsel for Banking & Finance (Treasury), (202) 622-0480 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**I. Background**

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (Public Law 107-56) (the Act). Title III of the Act makes a number of amendments to the anti-money laundering provisions of the Bank Secrecy Act (BSA), which are codified in subchapter II of chapter 53 of title 31, United States Code. These amendments are intended to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism.

Section 352(a) of the Act, which became effective on April 24, 2002, amended section 5318(h) of the BSA. As amended, section 5318(h)(1) requires every financial institution to establish an anti-money laundering program that includes, at a minimum, (i) the development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test programs. Section 5318(h)(2) authorizes the Secretary of the Treasury (Secretary), after consulting with the appropriate Federal functional regulator, which in the case of investment advisers is the Securities and Exchange Commission (SEC), to prescribe minimum standards for anti-money laundering programs. The

Secretary has delegated the authority to administer the BSA to the Director of FinCEN. To date, FinCEN has issued interim final rules prescribing minimum anti-money laundering program requirements for numerous types of financial institutions,<sup>1</sup> has proposed rules for other financial institutions,<sup>2</sup> and is studying how to design such standards for numerous other types of financial institutions.

FinCEN is today proposing a similar rule for commodity trading advisors, which is published elsewhere in this issue of the Federal Register.<sup>3</sup>

## **II. Investment Advisers Determined to be Financial Institutions**

The BSA does not expressly enumerate investment advisers among the entities defined as financial institutions under sections 5312(a)(2) and (c)(1).<sup>4</sup> Nevertheless, the BSA definition is extremely broad, listing numerous types of businesses, and section 5312(a)(2)(Y) authorizes the Secretary to include additional types of businesses within the BSA definition if he determines that they engage in any activity similar to, related to, or a substitute for any of the listed businesses. Because of the types of activities certain

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<sup>1</sup> Anti-Money Laundering Programs for Financial Institutions, 67 FR 21110 (April 29, 2002); Anti-Money Laundering Programs for Mutual Funds, 67 FR 21117 (April 29, 2002); Anti-Money Laundering Programs for Money Services Businesses, 67 FR 21114 (April 29, 2002); Anti-Money Laundering Programs for Operators of a Credit Card System, 67 FR 21121 (April 29, 2002).

<sup>2</sup> Anti-Money Laundering Programs for Unregistered Investment Companies, 67 FR 60617 (Sept. 26, 2002); Anti-Money Laundering Programs for Insurance Companies, 67 FR 60625 (Sept. 26, 2002); Anti-Money Laundering Programs for Dealers in Precious Metals, Stones, or Jewels, 68 FR 8480 (Feb. 21, 2003).

<sup>3</sup> Commodity trading advisors, which are subject to regulation by the Commodity Futures Trading Commission (CFTC), were added to the statutory BSA list of “financial institutions” in section 321 of the Act.

<sup>4</sup> The BSA definition includes institutions that are already subject to federal regulation such as banks, savings associations, credit unions, securities broker-dealers, and futures commission merchants. Money services businesses (such as money transmitters and currency exchanges) are also defined as financial institutions under the BSA, and, like the former categories, under FinCEN’s implementing regulations. The BSA definition also includes dealers in precious metals, stones, or jewels; pawnbrokers; loan or finance companies; private bankers; insurance companies; travel agencies; telegraph companies; sellers of vehicles, including automobiles, airplanes, and boats; persons engaged in real estate closings and settlements; investment bankers; investment companies; and commodity pool operators and commodity trading advisors that are registered or required to register under the Commodity Exchange Act (7 U.S.C. 1 et seq).

investment advisers engage in and the services they provide, FinCEN is proposing to exercise its authority to define these investment advisers as financial institutions solely for purposes of section 5318(h) and to require them to establish anti-money laundering programs.

An investment adviser is defined in the Investment Advisers Act of 1940 (Advisers Act) (15 U.S.C. 80b et seq.) as “any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or . . . issues . . . analyses or reports concerning securities,” subject to certain exceptions.<sup>5</sup> Many investment advisers provide investment advice to clients who have granted the adviser the power to manage the assets in their accounts, frequently on a discretionary basis. As a result, these investment advisers engage in activities that are “similar to, related to, or a substitute for” financial services that are provided by other BSA financial institutions.

Advisers managing clients’ assets work so closely with other BSA financial institutions – such as by directing broker-dealers to purchase or sell client securities or by directing banks to transfer client funds – that the advisers’ activities are related to those of the other financial institutions. Advisers’ services can be a substitute for products offered by investment companies or insurance companies, for example, when clients seek to have advisers manage their assets through other forms of pooled investment vehicles or through separate accounts. Some investment advisers offer asset management services that are similar to, and that may even compete directly with, asset management services provided by certain banks through their trust departments. FinCEN also notes that the close interrelationship between investment advisers and other financial institutions (such

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<sup>5</sup> Advisers Act, Section 202(a)(11) (15 U.S.C. 80b-2(a)(11)).

as securities broker-dealers, mutual funds, commodity trading advisors, and commodity pool operators) is further demonstrated by the fact that they are often jointly registered with, affiliated with, or sponsored by each other.

### **III. Money Laundering and Investment Advisers**

Money laundering occurs when money from illegal activity is moved through the financial system to make it appear that the funds came from legitimate sources. Money laundering usually involves three stages, known as placement, layering, and integration. In the placement stage, cash or cash equivalents are placed into the financial system. Investment advisers rarely have occasion to receive currency from or disburse it to clients. Nevertheless, in some instances, FinCEN has received reports of suspicious activities indicating that clients may attempt to use investment advisers in the placement stage. These reports include attempts by clients to structure transactions with an investment adviser to avoid reports of currency transactions,<sup>6</sup> as well as attempts to fund accounts with fraudulent checks.

“Layering” describes the distancing of illegal proceeds from their criminal source through the creation of complex layers of financial transactions. A money launderer could use its client account with an investment adviser as one of many accounts in a layering scheme, frequently transferring funds to the adviser for management and then withdrawing the funds or transferring them to accounts at other institutions. Layering could also involve establishing an advisory account in the name of a fictitious corporation or an entity designed to conceal the true owner. For example, FinCEN in one instance received reports of suspicious activity involving an investment advisory client who established an account under an alias for the family of a Colombian narcotics trafficker.

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<sup>6</sup> “Structuring” is described infra at note 25 and accompanying text.

Investment advisory firms could also be used for integrating illicit income into legitimate assets. “Integration” occurs when illegal funds previously placed into the financial system are made to appear to have been derived from a legitimate source. For example, proceeds from investments made on a client’s behalf by an investment adviser would appear legitimate to any financial institution receiving such proceeds.

The crime of money laundering also encompasses the movement of funds to support terrorism or terrorist organizations.<sup>7</sup> These funds may be from illegitimate or legitimate sources. Even where the funds derive from legitimate sources, money launderers might attempt to use investment advisers to aid movement of the funds through the money laundering patterns described above, in order to disguise the identity of the originator of the funds.

Investment advisers in the United States today control over \$21 trillion in assets.<sup>8</sup> 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.<sup>9</sup> If some of these assets include the proceeds of illegal activities, or are intended to further such activities, an anti-money laundering program should help discover them. In some cases, an investment adviser may be the only person with a complete understanding of the source of invested assets, the nature of the clients, or the objectives for which the assets are invested. Other market participants may, for example, hold and trade assets in an account controlled by the

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<sup>7</sup> 18 U.S.C. 1956, 2339A, and 2339B.

<sup>8</sup> Information filed by investment advisers registered with the SEC shows that these advisers had assets under management of over \$21 trillion as of February 2003.

<sup>9</sup> Rule amendments proposed by the SEC would generally prohibit an adviser from holding clients’ funds or securities directly; instead, the adviser would have to maintain these assets in accounts with a broker-dealer, bank, or other qualified custodian. Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Release No. 2044 (July 17, 2002) (67 FR 48579 (July 25, 2002)).

adviser, but these parties often rely solely on an investment adviser's instructions and lack knowledge of the adviser's clients. In other cases, an adviser may be the only participant aware of the overall investment program of a client who may use multiple broker-dealers to trade securities in transactions that individually may not raise money laundering concerns.<sup>10</sup> As a result, 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.<sup>11</sup>

#### **IV. Section-by-Section Analysis**

##### **A. Definition of Investment Adviser for Purposes of the Proposed Rule**

The SEC regulates investment advisers under the Advisers Act. The proposed rule relies on terms and definitions used by the Advisers Act and in the SEC's regulations to define the scope of the rule.<sup>12</sup> Section 103.150(a) of the proposed rule defines two groups of advisers located within the United States required to have anti-money laundering programs.

The first group consists of 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

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<sup>10</sup> 18 U.S.C. 1956 and 1957 make it a crime for any person, including an individual or company, to engage knowingly in a financial transaction with the proceeds from any of a long list of crimes or "specified unlawful activity." Although the standard of knowledge required is "actual knowledge," actual knowledge includes "willful blindness." Thus, a person could be deemed to have knowledge that proceeds were derived from illegal activity if he or she ignored "red flags" that indicated illegality.

<sup>11</sup> Moreover, FinCEN is concerned that the failure of advisers to implement effective anti-money laundering programs may result in money launderers seeking their services to access financial markets while avoiding detection by banks, broker-dealers, mutual funds, and other financial institutions that have adopted programs.

<sup>12</sup> This approach would permit advisers to determine easily whether they are subject to the proposed rule, and would permit both Treasury and the SEC to identify which advisers have obligations under the proposed rule.

SEC that they have assets under management.<sup>13</sup> This group includes advisers registered with the SEC that have either discretionary or non-discretionary authority to manage client assets.<sup>14</sup> It excludes, however, advisers that are not registered with the SEC because they are smaller, state-registered firms that have less than \$30 million of assets under management, as well as advisers that are registered with the SEC but do not manage client assets.<sup>15</sup> Because these excluded firms, unlike many “financial institutions” such as banks or broker-dealers, do not accept funds or hold financial assets directly, and have relatively few (or no) assets under management, these firms are unlikely to play a significant role in money laundering.

The second group consists of 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 Advisers Act (15 U.S.C. 80b-3(b)(3)) (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.<sup>16</sup> Many of the advisers that use this registration

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<sup>13</sup> SEC-registered advisers report their assets under management in Part 1A of Form ADV (17 CFR 279.1), which is the investment adviser registration form. The item currently requiring this information is Item 5.F of Part 1A.

<sup>14</sup> When a client places its assets with an advisory firm for management, the client authorizes the advisory firm to buy or sell securities for the client’s account, and the account itself is maintained with a broker-dealer, bank, or other custodian. However, many advisory firms, such as financial planners or pension consultants, do not manage clients’ assets. While these investment advisers may recommend securities or asset allocations, their clients make their own arrangements to purchase and sell securities; in some cases, the adviser may not be told whether the client has acted on the firm’s advice.

<sup>15</sup> Section 203A of the Advisers Act generally prohibits advisers with assets under management of less than \$25 million from registering with the SEC. Primary responsibility for regulating these firms rests with state securities authorities. Under SEC rules, however, firms with between \$25 and \$30 million in assets under management may choose whether to register with the SEC or with the states, and certain other investment advisers – such as certain pension consultants – register with the SEC even though they may not manage \$25 million in assets. 17 CFR 275.203A-1; 17 CFR 275.203A-2.

<sup>16</sup> Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding 12 months has had fewer than 15 clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any registered investment company or business development company that has elected to be regulated as such.



exemption may control substantial client assets, either because they have a few individual clients with very large accounts or because they advise certain types of pooled investment vehicles, such as limited partnerships.<sup>17</sup>

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.<sup>18</sup> This explicit exclusion will avoid potential duplicative anti-money laundering regulation of these financial institutions by the SEC and other Federal functional regulators and promote the efficient allocation of scarce government resources.

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, or that are sponsored or administered by financial institutions subject to such requirements.<sup>19</sup> To prevent overlap

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<sup>17</sup> An SEC rule permits the adviser to count the partnership or other pooled investment vehicle as a single client, rather than count each limited partner or other investor as a client. 17 CFR 275.203(b)(3)-1. As a result, the adviser may have only one or two pooled investment vehicle clients, yet manage tens or hundreds of millions of dollars. While some of these pooled investment vehicles may be subject to FinCEN's proposed rule requiring unregistered investment companies to implement anti-money laundering programs, these advisers may have other clients not subject to that rule. See Anti-Money Laundering Programs for Unregistered Investment Companies, 67 FR 60617 (Sept. 26, 2002) (UIC NPRM).

<sup>18</sup> For example, as noted above, FinCEN is proposing today a similar rule for commodity trading advisers. FinCEN is also considering requiring that commodity pool operators (which are also BSA financial institutions subject to regulation by the CFTC) establish and implement the anti-money laundering programs required pursuant to the UIC NPRM, supra note 17, for commodity pools that they operate.

<sup>19</sup> For example, an investment adviser may be adviser to a mutual fund, or adviser to a bank's common or collective trust fund. BSA rules obligate mutual funds and banks to maintain anti-money laundering programs to protect against attempted money laundering by their customers. Anti-Money Laundering Programs for Mutual Funds, 67 FR 21117 (April 29, 2002); Anti-Money Laundering Programs for Financial Institutions, 67 FR 21110 (April 29, 2002). An adviser may also act as adviser to other investment pools, such as an insurance company's separate accounts or certain unregistered investment companies, that will be similarly subject to anti-money laundering program rules under pending FinCEN

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.

## **B. The Anti-Money Laundering Programs**

### **1. Individualized Program**

Section 103.150(b) of the proposed rule would require each investment adviser subject to the proposed rule to develop and implement its own anti-money laundering program reasonably designed to prevent the firm from being used to launder money or finance terrorist activities and to achieve and monitor compliance with the other applicable requirements of the BSA and FinCEN's implementing regulations. Every program must incorporate four minimum requirements, discussed below, but each adviser will tailor its program to address the risks presented by the nature of its services and clients. In addition, each adviser may implement its program in a manner reasonably practicable in light of the firm's size and resources. For example, according to recent information filed by the approximately 7,750 investment advisers registered with the SEC, only ten percent of them reported that their firms had more than 50 employees, whereas nearly half reported having one to five employees. While FinCEN expects that large firms will adopt detailed procedures addressing the responsibilities of the individuals and departments involved in carrying out each aspect of the program, smaller firms may adopt procedures consistent with their simpler, centralized organizational structure.<sup>20</sup>

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proposals. See, e.g., Anti-Money Laundering Programs for Insurance Companies, 67 FR 60625 (Sept. 26, 2002); UIC NPRM, supra note 17.

<sup>20</sup> The legislative history of the Act reflects that Congress intended that each financial institution should have the flexibility to tailor its program to fit its business, taking into account factors such as size, location,

To assure that the requirement to have an anti-money laundering program receives the highest level of attention, the proposed rule would require that each investment adviser's program be approved in writing by the board of directors or trustees or, if it doesn't have one, by its sole proprietor, general partner, or other persons who have similar functions.<sup>21</sup> The four required elements of the anti-money laundering program are discussed below.

## **2. The Four Required Elements of Each Anti-Money Laundering Program**

### **(1) Establish and Implement Policies, Procedures, and Internal Controls**

**Reasonably Designed to Prevent the Investment Adviser From Being Used to Launder Money or Finance Terrorist Activities, Including but not Limited to Achieving Compliance with Applicable Provisions of the BSA and FinCEN's Implementing Regulations.**

Each investment adviser subject to the proposed rule would be required to develop a written program reasonably designed to prevent the firm from being used to launder money or finance terrorist activities and to achieve compliance with applicable requirements of the BSA and FinCEN's implementing regulations. As described below, this would require each investment adviser to review the types of services it provides and the nature of its clients to identify its vulnerabilities to money laundering and terrorist financing activity. The adviser would then develop and implement procedures and

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activities, and risks or vulnerabilities to money laundering, so long as the program meets the four minimum statutory requirements. This flexibility is designed to ensure that all firms subject to the Act, from the largest to the smallest, have in place policies and procedures appropriate to monitor for money laundering. See USA PATRIOT Act of 2001: Consideration of H.R. 3162 Before the Senate, 147 Cong. Rec. S10990-02 (October 25, 2001) (statement of Sen. Sarbanes); Financial Anti-Terrorism Act of 2001: Consideration Under Suspension of Rules of H.R. 3004 Before the House of Representatives, 147 Cong. Rec. H6938-39 (October 17, 2001) (statement of Rep. Kelly) (provisions of the Financial Anti-Terrorism Act of 2001 were incorporated as Title III in the Act).

<sup>21</sup> The board's approval could be given at its first regularly scheduled meeting after the program is adopted.

controls that would reasonably address each vulnerability and assure compliance with these requirements, and periodically assess the effectiveness of its procedures and controls.

An adviser's vulnerabilities to money laundering and terrorist financing activity are minimal with respect to clients for whom the adviser does not manage assets. Many advisers that manage portfolios for some clients have other clients to whom the firm provides very different services, such as pension consulting, securities newsletters or research reports, or financial planning. Accordingly, in designing its anti-money laundering procedures, an adviser could exclude clients for whom the firm does not manage assets.

Advisers face higher vulnerability to money laundering when clients place their assets under management with the firm. An adviser's procedures for these clients would seek to identify unusual transactions whereby clients place funds under the firm's management through checks drawn on (or wire transfers made from) accounts of third parties with no family or business relationship to the client, or through numerous checks or transfers from one or more issuers or institutions. In addition, an adviser's procedures would identify unusual transactions upon the subsequent withdrawal of assets from management with the firm, such as payments in numerous separate monetary instruments, transfers to unrelated or numerous accounts,<sup>22</sup> or to accounts in countries in which drugs are known to be produced or other countries at high-risk for money

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<sup>22</sup> Securities account custodians typically handle the actual deposit and withdrawal of funds in a client's account. In most cases, these custodians are broker-dealers, banks, or other entities that are "financial institutions" under FinCEN's BSA rules. Commonly, the client selects and contracts for account services with the custodian and instructs the custodian to permit the adviser to trade securities in the account. In such cases, the custodian's personnel may have exclusive access to the information needed to assess whether the source or destination of funds transfers in and out of the account are unusual. If the adviser selects and retains the account custodian, however, the adviser should coordinate review of these transactions with the custodian, as is discussed in connection with service providers, below.

laundering or terrorist financing.<sup>23</sup>

An adviser's vulnerability rises further with respect to clients who make frequent additions to or withdrawals from their advisory accounts with the firm. An adviser would need to establish procedures to identify which clients engage in such activity, and assess the reasonableness of the additions or withdrawals in light of the clients' investment objectives and the firm's existing knowledge of the clients' personal finances or business operations.

An investment adviser faces the highest degree of vulnerability when clients place or attempt to place assets under management in the form of cash, or require investment options or brokerage, banking, or other custodial arrangements that allow the client to remain anonymous to other intermediaries. The adviser would need to establish procedures to assess whether there are legitimate circumstances underlying the client's request before proceeding with the relationship.

An adviser's program should also take into account the extent to which the adviser provides investment advice to, and creates or administers, pooled investment vehicles, as well as whether the adviser provides advice to pooled investment vehicles that are created and administered by the adviser or by a third party. As discussed above, investment advisers to pooled investment vehicles that are subject to anti-money laundering program requirements under BSA rules may exclude the vehicles from their anti-money laundering programs. However, an investment adviser must include other pooled vehicles it advises in its anti-money laundering program, using different

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<sup>23</sup> See, e.g., [www.state.gov](http://www.state.gov) for International Narcotics Control Reports evaluating the effectiveness of countries' controls against narcotics trafficking and for lists of state sponsors of terrorism, and [www.fincen.gov](http://www.fincen.gov) for FinCEN Advisories identifying countries whose anti-money laundering regimes do not meet international standards.

approaches depending on whether the adviser is also the entity creating or administering the pooled vehicle.

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 have little or no information about the investors in the pooled vehicle or their transactions. In this situation, the adviser 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. 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 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.

In contrast, if the adviser also creates or administers a pooled investment vehicle not subject to BSA anti-money laundering program requirements, then the adviser's program would need to address the investors in the vehicle under the same type of criteria as the adviser uses for non-pooled vehicle clients, as discussed above. If, however, any of the investors are themselves pooled investment vehicles (e.g., hedge funds or pension funds), the adviser would need to address the money laundering risks posed by the pooled entity investing in the adviser's vehicle (and any other intermediary that may be involved), under the same type of criteria an adviser would use for pooled entities it advises directly, as described above.<sup>24</sup>

Anti-money laundering programs at larger firms would allocate the responsibility for carrying out these procedures among affected departments, managers, and employees, whereas implementation responsibilities at smaller firms would typically be more centralized. In either case, 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. Accordingly, the adviser would still be required to identify the particular procedures appropriate to address its vulnerability to money laundering and terrorist financing, and

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<sup>24</sup> See 67 FR 60617, 60621 (Sept. 26, 2002) (Treasury's UIC NPRM, *supra* note 17, provides for similar treatment for "funds of hedge funds"), and 67 FR 21117, 21119-21120 (April 29, 2002) (Treasury's interim final rule requiring mutual funds to establish anti-money laundering programs provides for similar treatment for omnibus accounts).

then undertake reasonable steps to assess whether the service provider would carry out such procedures effectively. For example, 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.”

Some investment advisers, such as advisers that are dually-registered as broker-dealers, may already have anti-money laundering programs in place. FinCEN does not require that such investment advisers establish multiple anti-money laundering programs. The same program may apply to an entity that functions as more than one type of financial institution, so long as the program is appropriately designed to address the different risks posed by the different aspects of the entity’s business and satisfies each of the anti-money laundering program requirements to which it is subject in each of its capacities.

The adviser’s anti-money laundering program should also be reasonably designed to ensure compliance with BSA requirements. The BSA currently requires investment advisers to report on Form 8300 the receipt of cash totaling more than \$10,000 in one transaction or two or more related transactions.<sup>25</sup> In order to develop a compliant anti-money laundering program, the program should be reasonably designed to detect and report not only transactions required to be reported on Form 8300, but also to detect activity designed to evade such requirements. Such activity, commonly known as “structuring,” may involve making deposits into a trading or investment account of

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<sup>25</sup> See Financial Crimes Enforcement Network; Amendments to the Bank Secrecy Act Regulations – Requirement that Nonfinancial Trades or Businesses Report Certain Currency Transactions, 66 FR 67679 (Dec. 31, 2001). The reporting requirement also covers cashier’s checks, bank drafts, traveler’s checks, or money orders having a face amount of not more than \$10,000 received in certain retail sales or in any transaction in which the recipient knows that such instrument is being used in an attempt to avoid the reporting of the transaction.



\$10,000 or more with multiple money orders, travelers' checks, or cashier's checks or other bank checks, each with a face amount of less than \$10,000. Such methods of payment may be indicative of money laundering, particularly when the payment instruments were obtained from different sources or the payments were made at different times on the same day or on consecutive days or close in time.

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 Act. If advisers become subject to additional requirements, they will need to update their compliance programs to include appropriate procedures, training, and testing functions. In addition, FinCEN encourages investment advisers to implement promptly procedures for voluntarily filing suspicious activity reports with FinCEN and for reporting suspected terrorist activities to FinCEN using its Financial Institutions Hotline (1-866-566-3974).

(2) Provide for Independent Testing of Compliance to be Conducted by Company Personnel or by a Qualified Outside Party.

An investment adviser would be required to provide for testing of its program periodically, to assure that the program is functioning as designed. Personnel conducting the testing – whether a third party, an affiliate of the firm, or an employee of the firm – should have a working knowledge of applicable BSA requirements, but should not be the person designated to implement and monitor the program under requirement (3) below. The frequency of such a review would depend upon factors such as the size and complexity of the adviser's business and the extent to which its business model may be

subject to a higher risk of money laundering than other business models. A written assessment or report should be a part of the review, and any recommendations resulting from such review should be promptly addressed.

(3) Designate a Person or Persons Responsible for Implementing and Monitoring the Operations and Internal Controls of the Program.

The investment adviser would be required to charge an individual (or group of individuals) with the responsibility for overseeing the anti-money laundering program. The person or group of persons should be competent and knowledgeable regarding applicable requirements and money laundering risks, and empowered with full responsibility and authority to develop and enforce appropriate policies and procedures. The person or group should also have adequate time and resources to carry out these oversight duties, taking into account the nature and complexity of the firm's program and their other responsibilities. In addition, a person responsible for overall supervision of the program should be an officer of the investment adviser.

(4) Provide Ongoing Training for Appropriate Persons.

Employee training is an integral part of an anti-money laundering program in any firm that has multiple employees involved in managing client assets. Employees of the adviser must be trained in BSA requirements relevant to their functions and in recognizing possible signs of money laundering that could arise in the course of their duties, so that they can carry out their responsibilities effectively. Such training could be conducted by outside or in-house seminars, and could include computer-based training. The level, frequency, and focus of the training would be determined by the responsibilities of the employees and the extent to which their functions bring them in

contact with BSA requirements or possible money laundering activity. Consequently, the training program should provide both a general awareness of overall BSA requirements and money laundering issues, as well as more job-specific guidance regarding particular employees' roles and functions in the anti-money laundering program.<sup>26</sup> For those employees whose duties bring them in contact with BSA requirements or possible money laundering activity, the requisite training should occur when the employee assumes those duties. Moreover, these employees should receive periodic updates and refreshers regarding the anti-money laundering program.

### **C. Administration**

The proposed rule includes a provision under which FinCEN would generally delegate examination authority to the SEC, to enable the SEC to examine investment advisers' compliance with the anti-money laundering program requirement. In addition, because certain investment advisers subject to the rule are not necessarily registered with the SEC or otherwise identifiable to FinCEN, the proposed rule contains a notice provision requiring the firms subject to the rule that are not SEC-registered to file a brief notice with FinCEN providing identifying information about the firm. Without a methodology for identifying these unregistered entities, there would be no way for FinCEN to assure that they are in compliance with the rule.<sup>27</sup>

### **V. Request for Comment**

FinCEN requests comment on all elements of the proposed rule. FinCEN

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<sup>26</sup> Appropriate topics for an anti-money laundering program include, but are not limited to: BSA requirements, a description of money laundering, how money laundering is carried out, what types of activities and transactions should raise concerns, what steps should be followed when suspicions arise, and the Office of Foreign Assets Control and other government lists of suspected terrorists and terrorist organizations.

<sup>27</sup> The Secretary of the Treasury is authorized to promulgate this notice requirement under the BSA. For a discussion of this authority, see UIC NPRM, supra note 17.

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.

## **VI. Regulatory Flexibility Act**

It is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. The proposed rule will not impose significant burdens on those investment advisers covered by the rule because they are already subject to Form 8300 reporting and may build on their existing risk management procedures and prudential business practices to ensure compliance with this rule. In addition, investment advisers subject to the proposed rule will not be compelled to obtain more sophisticated legal or accounting advice than that already required to run their businesses.

Finally, FinCEN believes that the flexibility incorporated into the proposed rule will permit each investment adviser to tailor its anti-money laundering program to fit its own size and needs. In this regard, FinCEN believes that expenditures associated with establishing and implementing an anti-money laundering program will be commensurate with the size of an investment adviser. If an investment adviser is small, the burden to comply with the proposed rule should be de minimis.

## **VII. Executive Order 12866**

It has been determined that this is not a significant regulatory action for purposes of Executive Order 12866. Accordingly, a regulatory impact analysis is not required.

## **VIII. Paperwork Reduction Act**

The collections of information contained in this proposed rule are being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent (preferably by fax (202-395-6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to [jlackeyj@omb.eop.gov](mailto:jlackeyj@omb.eop.gov)), with a copy to FinCEN by mail or the Internet at the addresses previously specified. Comments on the collections of information should be received by [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information subject to the Paperwork Reduction Act unless it displays a valid control number assigned by the Office of Management and Budget.

The collections of information in this proposed rule are in 31 CFR 103.150(b) and (d). The information will be used by federal agencies to verify compliance by investment advisers with the provisions of 31 CFR 103.150. The collections of information are mandatory.

Description of Recordkeepers and Reporters: Investment advisers as defined in 31 CFR 103.150(a).

Estimated Number of Recordkeepers: 10,000.

Estimated Average Annual Burden Per Recordkeeper: The estimated average burden associated with the recordkeeping requirement in this proposed rule is 1 hour per recordkeeper.

Estimated Total Annual Recordkeeping Burden: 10,000 hours.

Estimated Number of Respondents (Notice Requirement): 3,000.

Estimated Average Annual Burden Per Respondent: The estimated average burden associated with the notice requirement in this proposed rule is 15 minutes per respondent.

Estimated Total Annual Reporting Burden: 750 hours.

FinCEN specifically invites comments on the following subjects: (a) whether the collections of information are necessary for the proper performance of the mission of FinCEN, including whether the information shall have practical utility; (b) the accuracy of FinCEN's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collections of information on investment advisers, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

### **List of Subjects in 31 CFR Part 103**

Administrative practice and procedure, Authority delegation Government agencies), Investment advisers, Counter money laundering, Counter-terrorism, Currency, Reporting and recordkeeping requirements, Securities.

**PART 103--FINANCIAL RECORDKEEPING AND REPORTING OF  
CURRENCY AND FOREIGN TRANSACTIONS**

1. The authority citation for part 103 is amended to read as follows:

**Authority:** 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, secs. 312, 313, 314, 319, 321, 352, Pub. L. 107-56, 115 Stat. 307, 12 U.S.C. 1818, 12 U.S.C. 1786(q).

2. In subpart E, revise § 103.56(b)(6) to read as follows:

**§ 103.56 Enforcement.**

\* \* \* \* \*

(b) \* \* \*

(6) To the Securities and Exchange Commission with respect to brokers and dealers in securities; investment companies as that term is defined in the Investment Company Act of 1940 (15 U.S.C. 80-1 et seq.); and investment advisers as that term is defined in §103.150(a) of this part.

\* \* \* \* \*

3. In subpart I, add new § 103.150 to read as follows:

**§ 103.150 Anti-money laundering programs for investment advisers.**

(a) Definition. For purposes of this section, the term investment adviser means a person whose principal office and place of business is located in the United States that:

(1) Is registered or required to be registered with the Securities and Exchange Commission (SEC) under section 203(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(a)) and reports or is required to report in Part 1A of SEC Form ADV (see 17 CFR 279.1) that it has assets under management; or

(2) Is exempt from registration with the SEC pursuant to section 203(b)(3) of the Investment Advisers Act (15 U.S.C. 80b-3(b)(3)) and that would be required, if it were registered with the SEC, to report in Part 1A of SEC Form ADV that it has \$30 million or more of assets under management, unless such person is otherwise required to have an anti-money laundering program pursuant to another provision of this subpart, and is subject to examination by a Federal functional regulator.

(b) Anti-money laundering program required. Effective (the date that is 90 days after the date of the final rule):

(1) Each investment adviser shall develop and implement a written anti-money laundering program 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 Bank Secrecy Act (31 U.S.C. 5311 et seq.) (BSA) and this part. The investment adviser may exclude from its anti-money laundering program any pooled investment vehicle it advises that is subject to an anti-money laundering program requirement under another provision of this subpart.

(2) Each investment adviser's anti-money laundering program must be approved in writing by its 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. An investment adviser shall make its anti-money laundering program available for inspection by FinCEN or the SEC upon request.

(c) Minimum requirements. The anti-money laundering program shall at a minimum:

(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 this part;

(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.

(d) Notice requirement for unregistered advisers. Each investment adviser described in paragraph (a)(2) of this section (unregistered adviser) must provide information to FinCEN as required by this paragraph (d).

(1) Each unregistered adviser must file with FinCEN a Notice described in Appendix D of this subpart. Completed notices may be submitted to FinCEN:

(i) By accessing FinCEN's Internet Web site, <http://www.fincen.gov>, and entering the appropriate information as directed; or

(ii) By mail to: FinCEN, P.O. Box 39, Vienna, VA 22183.

(2) The Notice required by paragraph (d)(1) of this section must be filed not later than 90 days after the unregistered adviser first becomes subject to this section, and thereafter annually not later than 90 days after the end of the fiscal year of the unregistered adviser. If an unregistered adviser subsequently terminates its advisory business or ceases to be subject to this section, the unregistered adviser must so advise FinCEN not later than 90 days thereafter indicating such termination or cessation.

(3) Each unregistered adviser must include the following information in the Notice required by paragraph (d)(1) of this section:

(i) The name of the unregistered adviser, including all family or complex names, trade names, and doing-business-as names;

(ii) The complete street address, telephone number, and, if applicable, the e-mail address of the unregistered adviser;

(iii) The name, telephone number, and, if applicable, e-mail address of the person or persons designated pursuant to paragraph (c)(3) of this section;

(iv) The total number of clients of the unregistered adviser; and

(v) The total assets under management of the unregistered adviser, as determined under the instructions to SEC Form ADV, Part 1A, as of the end of the adviser's most recent fiscal year.

(4) An unregistered adviser must file a revised Notice with FinCEN if there is a change in any of the information required by paragraph (d)(3)(i), (ii), or (iii) of this section. The revised Notice must be filed in accordance with paragraph (d)(1) of this section not later than 30 days after the date of any such change.

4. Add appendix D to subpart I of part 103 to read as follows:

**Appendix D to Subpart I of Part 103  
Unregistered Investment Advisers**

**Notice for Purposes of 31 CFR 103.150(d)**

Complete *either* PART I or PART II of this Notice, as appropriate.

Notice is given, on behalf of (insert all names of unregistered adviser) \_\_\_\_\_

\_\_\_\_\_ that:

PART I

(1) The investment adviser is an unregistered adviser described in 31 CFR 103.150(a)(2)

(2) The address, e-mail address (if applicable), and telephone number of the unregistered adviser are as follows:

ADDRESS:

\_\_\_\_\_  
\_\_\_\_\_

E-MAIL ADDRESS (if applicable):

\_\_\_\_\_  
TELEPHONE NUMBER: \_\_\_\_\_

(3) The name, e-mail address (if applicable), and telephone number of the designated anti-money laundering program compliance officer of the unregistered adviser are as follows:

NAME: \_\_\_\_\_

E-MAIL ADDRESS: \_\_\_\_\_

TELEPHONE NUMBER: \_\_\_\_\_

(4) The total number of clients of the unregistered adviser: \_\_\_\_\_

(5) The total amount of assets under management of the unregistered adviser, as determined under the instructions to SEC Form ADV, Part 1A, as of the end of the adviser's most recent fiscal year:

\_\_\_\_\_

PART II

The unregistered adviser is terminating its advisory business or is otherwise no longer an unregistered adviser described in 31 CFR 103.150(a)(2) as of the

following date: \_\_\_\_\_

SUBMITTED BY:

Name:

\_\_\_\_\_

Title:

\_\_\_\_\_

Date:

\_\_\_\_\_

\*\*\*\*\*

Dated: \_\_\_\_\_

\_\_\_\_\_  
James F. Sloan  
Director  
Financial Crimes Enforcement Network