Dechert LLP

ONPOINT / A legal update from Dechert's Financial Services Group

# FinCEN Proposes Anti-Money Laundering Regulation for Investment Advisers

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# FinCEN Proposes Anti-Money Laundering Regulation for Investment Advisers

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a notice of proposed rulemaking on August 25, 2015,[1] pertaining to all investment advisers registered or required to be registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (Advisers Act). FinCEN's proposed rules (Proposed Rules) would require such advisers to:

- Establish anti-money laundering (AML) compliance programs;
- Report suspicious activity to FinCEN pursuant to the Bank Secrecy Act (BSA); and
- Comply with certain reporting and recordkeeping requirements under the BSA.

FinCEN proposes to delegate to the SEC the authority to examine such advisers for compliance with these requirements.

Over a decade earlier, FinCEN had proposed requiring the establishment of AML programs by unregistered investment companies[2] and certain investment advisers (2003 Advisers Proposal),[3] but these proposals were subsequently withdrawn.

This *Dechert OnPoint* describes FinCEN's current proposed requirements and makes several observations against the backdrop of prior FinCEN proposals, explanations and guidance.

## Summary of Proposed Rules

### *Scope of Advisers Covered*

The Proposed Rules apply to each "investment adviser," which is defined as "[a]ny person who is registered or required to register with the SEC under section 203 of the Investment Advisers Act of 1940" (RIAs).[4]

FinCEN notes that the proposed definition of "investment adviser" would include sub-advisers, as well as: investment advisers dually-registered as broker-dealers; advisers that are affiliated with or subsidiaries of other entities subject to AML regulation; certain foreign investment advisers; investment advisers to registered investment companies (which are subject to AML regulation); certain financial planners; pension consultants; and entities providing only securities-related newsletters or research reports.[5] While all RIAs would be subject to the

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[1] Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, (2015 Advisers Proposal).

[2] Anti-Money Laundering Programs for Unregistered Investment Companies.

[3] Anti-Money Laundering Programs for Investment Advisers, (2003 Advisers Proposal).

[4] 31 C.F.R. § 1010.100(nnn) (proposed rule).

[5] 2015 Advisers Proposal at 52,684. Commodity trading advisors and commodity pool operators that are not otherwise registered with the SEC as investment advisers are not covered by the Proposed Rules. *Cf. id.* at 52,682 n.18.

proposed requirements, as discussed in greater detail below, the scope of an RIA's AML compliance program would depend upon the nature of its advisory activities.[6]

As noted in the preamble to the Proposed Rules (Preamble), with limited exceptions, investment advisers with less than $100 million in regulatory assets under management[7] are prohibited from registering with the SEC. Accordingly, such advisers would not come under the definition of "investment adviser" proposed for the BSA's implementing regulations and therefore would not be subject to FinCEN's proposed requirements.[8] The Preamble notes several additional types of investment advisers that would not fall within the definition of "investment adviser" proposed for the BSA's implementing regulations: foreign private advisers;[9] exempt reporting advisers (ERAs);[10] family offices;[11] and certain types of financial planners.[12] However, this list of types of advisers that would not fall within the definition of "investment adviser" proposed for the BSA's implementing regulations is not exhaustive.[13]

### *Establishment of an AML Compliance Program*

RIAs would be required to 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."[14] An RIA's AML compliance program "must cover all of its advisory activities." The Preamble also provides that AML compliance programs should take into account the AML risks posed by "a particular client that maintains an account with the adviser."[15]

As noted above, both primary advisers and sub-advisers are RIAs required to implement AML compliance programs under the Proposed Rules, as are RIAs that do not manage client assets – such as certain pension consultants, financial research and news services, and financial planners. The Preamble specifically provides that RIAs to real estate fund clients must implement an AML compliance program for advisory services to such

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[6] See id. at 52,686-89 and nn.69-70.

[7] Regulatory assets under management is calculated in accordance with Form ADV Part 1A Instruction 5.b.

[8] Any investment adviser to a SEC-registered investment company is required to register with the SEC regardless of the amount of its regulatory assets under management. In addition, an investment adviser with a principal office and place of business in New York is, in the absence of an exemption, required to register with the SEC if it has $25 million or more in regulatory assets under management.

[9] *See* Advisers Act §§ 202(a)(30), 203(b)(3) and Advisers Act Rule 202(a)(30)-1.

[10] *See* Advisers Act §§ 203(l), 203(m) and Advisers Act Rules 203(l)-1, 203(m)-1 and 204-4.

[11] *See* Advisers Act § 202(a)(11)(G) and Advisers Act Rule 202(a)(11)(G)-1.

[12] *See generally Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,* SEC Rel. No. IA-1092 (Oct. 8, 1987) (setting forth the views of the SEC Staff on financial planners' and others' status as an investment adviser).

[13] For example, the following additional types of investment advisers (among others) are exempt from SEC registration and, therefore, would not fall within the definition of "investment adviser" proposed for the BSA's implementing regulations: intrastate advisers; advisers whose only clients are insurance companies; charitable organizations; church plans; certain commodity trading advisors registered with the Commodity Futures Trading Commission; and certain advisers who advise solely certain small business investment companies.

[14] 2015 Advisers Proposal at 52,686 and 52,699.

[15] *Id*. at 52,687.

funds, although the real estate funds themselves are not required create an AML program. Advisory services to open-end and closed-end funds, private funds, and separate account clients are also included.[16]

***Substance of the AML Compliance Program.*** In the Preamble, FinCEN indicates that the substance of an RIA's AML compliance program should be based on a risk assessment by the RIA, which should take into account all relevant factors, including the type of advisory activities performed and the type of advisory client. FinCEN specifically notes that relevant risk factors should include the source of client funds and the jurisdiction where the client is located (including, for clients that are non-U.S. located entities, jurisdictions identified by the Financial Action Task Force).[17]

Although the Proposed Rules do not provide any exemption for advisory services to registered funds, the Preamble states that mutual funds may present lower AML risk than other types of clients (such as private funds), because mutual funds are also "financial institutions" subject to full AML requirements under the BSA. The Preamble also states that closed-end funds may present lower risk 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."[18]

RIAs that are the primary advisers to private funds or other unregistered pooled investment vehicles must assess the AML risks presented by investors in such funds "by considering the same types of relevant factors, as appropriate, as the adviser would consider for clients for whom the adviser manages assets directly."[19] The Preamble further states that if any investors in the private fund or pool are themselves private funds or unregistered pools, then the RIA must assess the AML risks of the investing funds or pools. Furthermore, the Preamble states that "regardless of offshore formation or offering, an investment adviser should apply the same policies and procedures as discussed above." However, the Preamble indicates that FinCEN does not expect RIAs that are dually registered as broker-dealers to create multiple, separate AML programs.

According to Preamble, FinCEN expects RIAs to incorporate the requirements of the Proposed Rules by adapting existing compliance policies, procedures and internal controls under the Advisers Act.[20] RIAs will need to obtain approval for the AML program in writing by the RIA's board of directors, or by other persons who have functions similar to a board of directors, and make the written AML program available to FinCEN or the SEC for inspection upon request.

***Independent Testing of AML Program.*** The Proposed Rules require RIAs to provide for independent testing of their AML compliance program and for such testing "to be conducted by the investment adviser's personnel or by a qualified outside party." The Proposed Rules do not specify how frequently an RIA must independently test the AML program. In the Preamble, FinCEN states that the testing should be done "on a periodic basis," and further indicates that the frequency of testing "will depend on the investment adviser's assessment of the risks posed." According to FinCEN, employees of the RIA, its affiliates, or unaffiliated service providers may conduct the "independent testing" so long as the employees are (i) not involved in the AML program and (ii) are "knowledgeable" of BSA requirements.[21]

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[16] *Id*. at 52,687-89.

[17] *Id.*

[18] *Id.*

[19] *Id.* at 52,688.

[20] *Id*. at 52,686.

[21] *Id.*

***AML Compliance Officer.*** The Proposed Rules require RIAs to "[d]esignate a person or persons responsible for implementing and monitoring the operations and internal controls of the program."[22] According to the Preamble, the person or persons designated as responsible for the AML program (AML compliance officers) should be "knowledgeable and competent" about AML requirements and the RIA's AML risks and have "full responsibility and authority" to address those risks. FinCEN states in the Preamble that an AML compliance officer "should be an officer of the investment adviser" and that the time required to be devoted by such officers to AML matters would depend on the "size and type of advisory services" and the clients of the RIA.

***Training for "Appropriate Persons."*** The Proposed Rules require all RIAs to "[p]rovide ongoing training for appropriate persons."[23] In the Preamble, FinCEN indicates that "appropriate persons" must include "employees of an investment adviser (and of any agent or third party service provider)." According to the Preamble, the nature, scope and frequency of the AML 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." FinCEN specifies, however, that training programs should "provide 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 AML program." According to the Preamble, training should occur at the time when an employee assumes duties that "bring them in contact with BSA requirements or possible money laundering" and employees should receive "periodic updates and refreshers" on AML responsibilities.

Under the Proposed Rules, RIAs would be required to develop and implement an AML compliance program within six months from the regulation's effective date.[24]

### *Suspicious Activity Reports (SARs)*

The Proposed Rules would require RIAs to file "a report of any suspicious transaction relevant to a possible violation of law or regulation."[25] As with respect to other financial institutions, RIAs satisfy this reporting requirement by filing a Suspicious Activity Report (SAR) with FinCEN no later than 30 calendar days after the date of the initial detection of the facts that constitute a basis for filing a SAR.[26] The Preamble specifies that a transaction must be reported if:

1. the transaction is "conducted or attempted by, at, or through an investment adviser;"
2. the transaction "involves or aggregates funds or other assets of at least $5,000;" and
3. the adviser "knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions):"
    a. involves money laundering;[27]

[22] *Id.* at 52,689 and 52,699.

[23] *Id.* at 52,690 and 52,699.

[24] *Id.*

[25] *Id*. at 52,700 (setting forth the proposed SAR requirements for investment advisers at 31 C.F.R. § 1031.320.) The 1992 Annunzio-Wylie Money Laundering Act authorizes the Department of Treasury, through FinCEN, to require financial institutions to file SARs. *See* 31 U.S.C. § 5318(g).

[26] 2015 Advisers Proposal at 52,690-91 and 52,700.

[27] *Id.* Specifically, as stated in the Proposed Rules, the transaction is reportable if it "[i]nvolves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets)

b. is designed to evade regulations promulgated under the BSA;

c. "has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the investment adviser knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction;" or

d. "[i]nvolves use of the investment adviser to facilitate criminal activity."

Under the Proposed Rules, if more than one RIA, or an RIA and another "financial institution" that is required to file SARs, each becomes obligated to file an SAR for the same transaction, then only one SAR must be filed for that transaction, "provided that the report filed contains all relevant facts, including the name of each financial institution and the words 'joint filing' in the narrative section, and each institution maintains a copy of the report filed, along with any supporting documentation."[28]

In addition to filing SARs, the Proposed Rules require RIAs to collect and maintain a copy of the SAR, as well as supporting documentation, for a period of five years from the date of filing. Under the Proposed Rules, RIAs are required to make supporting documentation available to regulatory or law enforcement authorities upon request.[29]

As set out in the Proposed Rules, SARs, as well as any information that would reveal the existence of a SAR, are confidential, subject to certain exceptions. In 2010, FinCEN provided guidance that certain financial institutions could share SARs with other persons and entities within their corporate structure. However, as proposed, RIAs would be unable to rely on this guidance. FinCEN has requested comment on whether RIAs should be allowed to share SARs within their corporate structure as permitted for financial institutions such as banks and mutual funds.

An RIA that violates its SAR obligations may face civil monetary penalties and cease and desist proceedings. According to the Proposed Rules, SAR filings will be required by RIAs for any relevant transactions "occurring after full implementation of an anti-money laundering program" as discussed above.[30]

### *RIAs Designated as "Financial Institutions" Under the BSA*

Under the BSA, the Secretary of the Treasury has authority to designate as "financial institutions" any person who engages in "an activity which is similar to, related to, or a substitute for any activity" in which any of the financial institutions enumerated in the BSA engage.[31] FinCEN proposes to designate RIAs as financial institutions under the statute,[32] which would make RIAs subject to the information-sharing requirements of section 314(a) and the safe harbor provisions of section 314(b) of the USA PATRIOT Act.[33] Becoming subject to section 314(a) would require RIAs to search their records at FinCEN's request to determine if the RIA has

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as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation." *Id*. at 52,700.

[28] *Id*. at 52,691.

[29] *Id.* at 52,692 and 52,700.

[30] *Id.* at 52,692 and 52,701.

[31] 31 U.S.C. § 5312(a)(2)(Y).

[32] 2015 Advisers Proposal at 52,684-85.

[33] *See* 31 U.S.C. §§ 1010.520 and 1010.540.

maintained an account or conducted a transaction with a person suspected of money laundering or terrorist financing activity. Section 314(b) would provide a safe harbor for RIAs to share information with other financial institutions or associations of financial institutions to better report potential money laundering or terrorist financing activity.

### *RIAs Defined as "Financial Institutions" in BSA Implementing Regulations*

Currently, RIAs are required to report certain receipts of cash and cash equivalents on FinCEN/IRS Form 8300.[34] Under the Proposed Rules, RIAs would be added to the general definition of "financial institution" in the BSA implementing regulations.[35] As a result, the Preamble states that RIAs would be no longer required to file Form 8300. Rather, RIAs would be required to submit currency transaction reports (CTRs) for transfers involving "more than $10,000 in currency by, through, or to the investment adviser." It should be noted, however, that most RIAs do not hold client funds or securities and are unlikely themselves to transact in cash.

RIAs would also be subject to the so-called "Recordkeeping and Travel Rules" of the BSA implementing regulations, which require financial institutions to create and retain records of transmittals of funds, and ensure that certain information pertaining to such transmittals "travels" to the next financial institution in the transaction.[36]

## Observations for RIAs

### *Scope of Investment Adviser Definition*

As discussed above, by defining "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," the scope of application of the proposed AML and SAR requirements is expanded beyond the scope of application under the 2003 Advisers Proposal and, in some ways, the traditional application of BSA requirements to financial institutions. In some instances, this expanded scope contradicts prior FinCEN explanations and guidance, as well as FinCEN's stated goal for its current proposal.

In the Preamble, FinCEN notes that the proposed definition of "investment adviser" would capture:

- investment advisers dually-registered as broker-dealers, and advisers affiliated with, or subsidiaries of, entities required to establish AML programs;
- certain foreign investment advisers;
- investment advisers to registered investment companies; and
- certain financial planners, pension consultants, and entities that provide only securities newsletters and/or research reports.[37]

Below, the broad proposed definition of "investment adviser" is considered by examining the inclusion of specific types of advisers within that definition against the backdrop of prior FinCEN proposals, explanations and guidance.

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[34] *See* 31 C.F.R. § 103.30.

[35] 2015 Advisers Proposal at 52,684-85.

[36] *Id*. at 52,685.

[37] *Id*. at 52,684.

**Dually-Registered RIAs/Broker-Dealers, and RIAs Affiliated With, or Subsidiaries of, Entities Required to Establish AML Programs.** FinCEN's 2003 Advisers Proposal specifically excluded from the definition of "investment adviser" entities otherwise falling under such definition that were "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."[38] As FinCEN explained at the time, "[t]his 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."

Under the Proposed Rules, an RIA that already is subject to BSA regulation as a result of dual registration as a broker-dealer or other affiliation would still need to comply with the BSA rules applicable to RIAs. The Preamble states that RIAs also registered as broker-dealers may have a single AML program as long as (i) the program addresses the AML risks posed by each aspect of the entity's business, and (ii) the broker-dealer activities are subject to BSA requirements appropriate to broker-dealers and the investment advisory activities are subject to BSA requirements appropriate to investment advisers under the Proposed Rules.[39] A similar approach is proposed for bank-affiliated RIAs.[40] Based on this guidance, it would appear that a financial institution regulated as both an investment adviser and a broker-dealer would not need to apply the more comprehensive BSA requirements applicable to broker-dealers to the financial institution's investment advisory activities. If this is the intent of Proposed Rules, then it may impact how many such financial institutions currently interpret their existing BSA obligations.

It is also notable that bank-affiliated RIAs would not be subject to the FinCEN regulations applicable to their affiliate banks. As stated in the Preamble, "FinCEN would not expect a bank, which is subject to the full panoply of FinCEN's regulations implementing the BSA that is affiliated with or owns an investment adviser to design an enterprise-wide AML compliance program that would subject the [bank-affiliated] investment adviser to BSA requirements that would not be required by the rules FinCEN is proposing today."[41] This guidance does not appear to be consistent with long-standing positions taken by the federal banking agencies. For example, the federal banking agencies take the position that implementation of customer identification programs by subsidiaries of banks (including investment adviser subsidiaries) is appropriate as a matter of safety and soundness and protection from reputational risks.[42]

***Non-U.S. RIAs***. Proposing to require entities with principal offices and places of business outside the United States to comply with FinCEN's AML and SAR requirements solely because such entities are registered or required to register with the SEC as investment advisers represents an expansion of FinCEN's ordinary and previously-proposed jurisdictional boundaries.

When Congress passed the BSA in 1970, it intended to apply BSA requirements only to those financial institutions located in the United States. The House report accompanying the BSA stated that "[i]t is not feasible and it is not the purpose of this bill to attempt to apply American law in foreign countries."[43] The Department of

[38] 2003 Advisers Proposal at 23,648.

[39] 2015 Advisers Proposal at 52,688 & n.69.

[40] *Id.* at 52,688-89 & n.70.

[41] *Id.*

[42] *Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act (Apr. 28, 2005), available here.*

[43] H.R. Rep. No. 91-975 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4402.

Treasury historically has embraced this view. For example, in a 1987 report, Treasury noted that the BSA's requirements "do not apply to foreign branches of United States financial institutions or to any other type of financial institution physically located outside of the United States."[44]

Although some jurisdictional nexus with the United States is necessary for SEC registration requirements to apply to an investment adviser,[45] the definition of "investment adviser" in FinCEN's 2003 Advisers Proposal was strictly limited to persons "whose principal office and place of business is located within the United States."[46] Such a jurisdictional limitation is consistent with FinCEN's industry guidance regarding SARs, which states that "foreign-located operations of U.S. organizations are not required to file SARs."[47] It is also consistent with FinCEN's industry guidance on related regulations.[48]

The Proposed Rules represent potentially significant challenges for non-U.S. RIAs, as such rules may not be consistent with local requirements.[49] At best, non-U.S. RIAs face the challenge of complying with multiple regulatory regimes; in some cases, local requirements may prevent non-U.S. RIAs from complying with the Proposed Rules entirely. For example, compliance with the proposed SAR requirements may be challenging for RIAs principally located in European Union member states that have adopted data privacy regulations consistent with the European Union's Data Protection Directive.[50]

***RIAs to Registered Investment Companies.*** "To prevent overlap and redundancy," FinCEN's 2003 Advisers Proposal specifically would have permitted advisers "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."[51] FinCEN listed mutual funds, bank common or collective trust funds and insurance company separate accounts, among others, as entities already subject to AML requirements, which advisers could therefore exclude from their AML programs. Although FinCEN notes that "[t]he BSA requirements to which mutual funds are subject

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[44] Secretary of the Treasury, Money Laundering and the Bank Secrecy Act: The Question of Foreign Branches of Domestic Financial Institutions (1987).

[45] *See* Advisers Act Section 203(a) ("[I]t shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.") (emphasis added).

[46] 2003 Advisers Proposal at 23,652; *see also id.* at 23,648 (". . . the proposed rule defines two groups of advisers located within the United States required to have anti-money laundering programs") (emphasis added).

[47] FinCEN, *Answers to Frequently Asked Bank Secrecy Act (BSA) Questions, available here.*

[48] *See, e.g.*, FinCEN, *Guidance on Customer Identification Regulations (Jan. 2004), available here* ("The [Customer Identification Program] rule does not apply to any part of [a] bank located outside of the United States."). FinCEN has expanded BSA requirements to non-U.S. money services businesses that engage in business activities within the United States. *See* 31 C.F.R. § 1010.100 (ff). However, for reasons noted herein, this is a significant departure from the long-standing jurisdictional limitations of the BSA.

[49] In other contexts, FinCEN has accommodated differences between its regulations and the local laws of non-U.S. jurisdictions. *See id.* ("Nevertheless, as a matter of safety and soundness, banks are encouraged to implement an effective [Customer Identification Program] throughout their operations, including in their foreign offices, except to the extent that the requirements of the rule would conflict with local law.") (emphasis added).

[50] *See* Directive 95/46/EC of the European Parliament and of the Council of 24 Oct. 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, art. 25-26, 1995 O.J. (L 281) (requiring, among other things, member states to prevent transfers of personal data to third countries found to have an inadequate level of protection of personal data).

[51] 2003 Advisers Proposal at 23,648.

may mitigate the money laundering risks,"[52] FinCEN does not propose excluding mutual funds or other investment vehicles subject to AML program requirements from an RIA's AML program. This does not appear to be consistent with FinCEN's stated goal of "regulat[ing] investment advisers that may be at risk for attempts by money launderers or terrorist financers seeking access to the U.S. financial system through a financial institution type not required to maintain AML programs or file [SARs]."[53] However, in its request for comment, the FinCEN does ask whether an express exclusion should be provided for advisory activities provided to mutual funds.[54]

The Preamble also states that closed-end funds may present lower risk 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."[55] However, not all closed-end fund shares are traded through such entities. For example, certain closed-end fund shares may be sold and repurchased through periodic offerings and tender offers directly by the closed-end fund. It is unclear whether FinCEN took these types of closed-end fund structures into account in the Preamble.

***Financial Planners, Pension Consultants, and Entities that Provide only Securities Newsletters and/or Research Reports.*** FinCEN explained in the 2003 Advisers Proposal that certain "advisory firms, such as financial planners or pension consultants, do not manage clients' assets" and that "[b]ecause [they] do not accept funds or hold financial assets directly . . . these firms are unlikely to play a significant role in money laundering."[56] As a result, in the 2003 Advisers Proposal, FinCEN proposed excluding such entities from the "investment advisers" FinCEN would have subjected to AML requirements under the 2003 Advisers Proposal.[57] Moreover, in the 2003 Advisers Proposal, FinCEN recognized that some advisers had multiple lines of business, which posed varying degrees of risk with respect to money laundering activities:

> 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.[58]

In that context, FinCEN's 2003 Advisers Proposal endorsed a compromise: "[I]n designing its anti-money laundering procedures, an adviser could exclude clients for whom the firm does not manage assets."[59]

Neither approach was adopted by FinCEN in its current proposal. Under the Proposed Rules, financial planners, pension consultants and entities that provide only securities newsletters and/or research reports would fall within the definition of "investment adviser" and be subject to AML and SAR requirements.[60]

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[52] 2015 Advisers Proposal at 52,687.

[53] *Id.* at 52,680 (emphasis added).

[54] *Id.* at 52,694.

[55] *Id.* at 52,687-88.

[56] 2003 Advisers Proposal at 23,648 n.14 and text following n.15.

[57] *Id.* at 23,648.

[58] *Id.* at 23,649.

[59] *Id.*

[60] 2015 Advisers Proposal at 52,684. This assumes, of course, that any such adviser is required to register with the SEC (which, as discussed above, involves meeting certain regulatory assets under management

On the other hand, the Preamble does suggest that an RIA's AML program must address its "advisory activity."[61] Although the term "advisory activity" is not defined in the Proposed Rules, the language used in the Preamble suggests that non-advisory business operations of RIAs – such as fund administration businesses – may not need to be addressed in an RIA's AML compliance program.

### *Look-Through Private or Unregistered Fund Clients to Underlying Investors*

The Preamble indicates that FinCEN expects RIAs to assess the AML risks of not only clients, but - in cases of private fund clients or unregistered investment pools - any investors in such fund clients. It states that RIAs to private funds or other unregistered pooled investment vehicles must assess the risks presented by investors in such funds "by considering the same types of relevant factors, as appropriate, as the adviser would consider for clients for whom the adviser manages assets directly." Based on the text of the Preamble, funds registered under the UCITS regime in the European Union may be considered unregistered funds, and RIAs to such funds would be expected to examine the risks to investors in these funds. As noted above, privacy laws and other local requirements may pose challenges to the assessment of risks from investors in these funds. Furthermore, "[i]f any of the investors in the private fund or other unregistered pooled investment vehicle for which the investment adviser is acting as the primary adviser are themselves private funds or some other type of unregistered pooled investment vehicles . . . the investment adviser will need to assess the money laundering or terrorist financing risks associated with these investing pooled entities."[62] This suggests that FinCEN may expect RIAs to assess the risks of all investors, including investors through "funds-of-funds" structures.

In the Preamble, the rationale for looking through private fund clients to underlying investors is that "the adviser should have access to information about the identities and transactions of the underlying or individual investors."[63] As a practical matter, however, it will likely prove very challenging for an RIA to look through fund clients to assess the risks of investors. The Preamble acknowledges as a general matter that the lack of information may alter the AML risk profile of clients and investors, but FinCEN provides no clear guidance as to expectations for compliance programs in such circumstances. Because of the diversity of fund structures and offerings – which will present unique challenges for RIAs in complying with this aspect of the Proposed Rules – it would seem more reasonable if the final rules clarify that AML programs should focus on risks only presented by advisory clients.

It is notable that FinCEN appears to have different expectations for wrap fee programs. In the discussion of RIAs to wrap fee programs sponsored by unaffiliated broker-dealers, FinCEN acknowledges that such an RIA "may have more limited access to investor information and transactions," and suggests that an AML program could take into account this more limited information.[64]

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thresholds, among other requirements). Moreover, depending upon the facts and circumstances, the Advisers Act's "publisher's exception" may be available to certain entities "provid[ing] only securities newsletters and/or research reports." Under Advisers Act Section 202(a)(11)(D), "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation" is excluded from the definition of "investment adviser" and, thus, is not required to register with the SEC pursuant to Advisers Act Section 203. As a result, an entity successfully relying upon the Advisers Act's "publisher's exception" would not fall within FinCEN's proposed definition of "investment adviser."

[61] *Id.* at 52,686.

[62] *Id.* at 52,688.

[63] *Id.*

[64] *Id.*

### *Potential for Future Rules*

The Preamble indicates that FinCEN is considering whether to require RIAs to comply with certain additional AML compliance procedures that are currently in place for other financial institutions, including: customer identification programs (CIPs); "special measures" against certain jurisdictions and persons identified by FinCEN as a "primary money laundering concern;" due diligence for foreign financial institutions and non-U.S. persons; prohibitions against foreign shell banks; and recordkeeping for correspondent accounts with certain foreign banks.[65]

In addition, as noted above, the Preamble indicates that FinCEN may consider expanding the application of the above AML requirements to investment advisers that are not registered or required to be registered with the SEC.[66]

### *Conclusion*

The Proposed Rules would impose significant new AML compliance, recordkeeping, and reporting obligations on RIAs. The Proposed Rules would apply widely to both U.S. and non-U.S. RIAs, RIAs to registered and unregistered funds, and to RIAs that do not manage client assets. Future rulemakings may impose additional compliance obligations and expand the scope of these rules to other unregistered advisers.

Members of the investment advisory industry should carefully consider the potential impact of FinCEN's proposal on their business and operations and consider submitting comments addressing FinCEN's specific questions and any other aspects of the proposal that appear problematic. FinCEN has requested submission of written comments by November 2, 2015.

[65] *Id.* at 52,694. *See also* sections 311, 312, 313, 319(b), and 326 of the USA PATRIOT Act. We note that it is unclear to what extent FinCEN has statutory authority to extend the application of sections 313 and 319(b) to RIAs, because these sections are expressly limited to "covered financial institutions," which is defined in section 313(a)(j)(1) as a "financial institution described in sub-paragraphs (A) through (G) of section 5312(a)(2)" of title 31 of the United States Code. The financial institutions listed in section 5312(a)(2), paragraphs (A) through (G), are: FDIC insured banks; commercial banks or trust companies; private bankers; agencies or branches of a foreign bank in the United States; credit unions; thrift institutions; and brokers or dealers registered with the SEC. RIAs are being defined as "financial institutions" pursuant to paragraph (Y) of section 5312(a)(2).

[66] *Id.* at 52,684.

This update was authored by:

**Thomas C. Bogle**
Partner
Washington, D.C.
+1 202 261 3360
thomas.bogle@dechert.com

**Michael J. Gilbert**
Partner
New York
+1 212 698 3886
michael.gilbert@dechert.com

**Michael L. Sherman**
Partner
Washington, D.C.
+1 202 261 3449
michael.sherman@dechert.com

**Jeremy B. Zucker**
Partner
Washington, D.C.
+1 202 261 3322
jeremy.zucker@dechert.com

**Paul S. Stevens, Jr.**
Associate
Washington, D.C.
+1 202 261 3353
paul.stevens@dechert.com

**Aaron D. Withrow**
Associate
Washington, D.C.
+1 202 261 3442
aaron.withrow@dechert.com

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