



Legal Risk Management Tip August 2013

ANTI-MONEY LAUNDERING REGULATIONS ON THE HORIZON FOR INVESTMENT ADVISERS

Money laundering is a financial crime that can negatively impact the stability of our economy. Combating money laundering is currently one of the greatest focuses of the U.S. government, and is leading to the proposal of new legislation. Currently, anti-money laundering (“AML”) program requirements for financial institutions are laid out in various laws including the Bank Secrecy Act of 1970 (“BSA”), the Money Laundering Control Act of 1986, and most recently the USA PATRIOT Act (“USAPA”). One group of financial professionals not included in these laws is investment advisers; however, that is soon likely to change.

Currently, investment advisers are not expressly included within the definition of “financial institutions” under the BSA¹ or USAPA², and as such are not subject to the affirmative AML requirements of those regulations.³ However, due to the nature of activities engaged in by investment advisers, the Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”) has tried for over a decade to implement rules imposing AML regulations on investment advisers. In May of 2003, FinCEN published a notice of proposed rulemaking in the Federal Register⁴ proposing that investment advisers establish anti-money laundering programs.⁵ However, this proposal was withdrawn in 2008 due to a lack of any further regulatory action on behalf of FinCEN.

Recent Announcements

As a result of the regulatory changes following the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), FinCEN announced in 2011⁶ that it would be revisiting its 2003 proposal requiring investment advisory firms to establish AML programs. This past February, current FinCEN Director, Jennifer Calvery, reiterated this intention⁷ when she stated that FinCEN “has been working closely” with the Securities and Exchange

¹ See 31 USC § 5312 - Definitions and Application at <http://www.law.cornell.edu/uscode/text/31/5312>

² See <http://www.gpo.gov/fdsys/pkg/PLAW-107publ56/pdf/PLAW-107publ56.pdf>

³ However, since the passage of the USAPA, the Office of Foreign Assets Control (“OFAC”), which is an office of the US Department of Treasury, has provided regulatory obligations for financial institutions, including investment advisers to comply with. OFAC is responsible for administering and enforcing economic and trade sanctions against certain targeted foreign countries that are known for money laundering, terrorists, international drug traffickers and persons facilitating the proliferation of weapons of mass destruction. As such, OFAC is charged with imposing controls on transactions and freezing assets under U.S. jurisdiction. While AML regulations for investment advisers have been proposed but have not as yet been finalized and adopted by the SEC, OFAC regulations set forth certain requirements for investment advisers to block the accounts of specified countries, entities and individuals. Consequently, advisers should consider this when developing their internal control programs.

⁴ See http://www.fincen.gov/statutes_regs/frn/pdf/352investmentadvisers_fedreg050503.pdf

⁵ See http://www.fincen.gov/news_room/speech/pdf/20111115.pdf

⁶ *Id.*

⁷ See http://www.fincen.gov/news_room/speech/pdf/20130227.pdf.

Commission (“SEC”) on a new rule “that would impose an AML program and suspicious activity reporting (“SAR”) requirements on investment advisors.”⁸

Before such rules changes would take effect, there are still several steps that need to occur. The draft rules are currently under an interagency staff-level review, and would next pass to the full Treasury Department, which in turn would submit the proposal to the Office of Management and Budget for a final review before being released to the public for comment.⁹ It is not clear exactly how long this process will take to complete, however, FinCen has not ruled out the possibility that notice of the proposed rules could be made available by the end of this year.¹⁰

Anticipated AML Regulations / Considerations for Advisers

While investment advisers have not legally been required to develop AML policies pursuant to the BSA or USAPA, many have done so as a “best practice” following FinCEN’s first proposal to implement such requirements in 2003. While these advisers will have a head start on any new regulations, they may need to further enhance those policies and procedures to meet the contours of the new rules.

For those advisers who are still without any AML procedures in place, now is the time to start the process. While it is still unclear on the exact new regulatory expectations and requirements, most likely they will mirror those regulations imposed on other financial institutions. As such, advisers developing AML programs will need to start by conducting a risk assessment to evaluate risk exposure inherent to their business. Considerations should be given to the firm’s customer risk, products and services risk, transaction risk and geographic risk.¹¹

Once these risks have been identified, an appropriate AML program can be developed to mitigate these risks. While each AML program should be tailored to the firm’s specific risk factors, Section 352 of USAPA¹² requires these programs include, at the very least, the following:

1. Development of internal AML procedures, policies, and controls designed to detect and prevent money laundering -- this should include a Know Your Customer (“KYC”) program designed to identify prospective customers/clients and the source of their assets;¹³
2. Designation of an internal AML compliance officer;
3. Institution of an ongoing employee training program which covers applicable legal requirements, policies and procedures for monitoring client relationships, acceptable record-keeping measures, and the identification of suspicious transactions or money laundering activities; and

⁸ *Id.*

⁹ See <http://www.financial-planning.com/news/new-anti-money-laundering-rules-for-advisors-2686011-1.html>.

¹⁰ *Id.*

¹¹ See

http://www.navigant.com/insights/library/disputes_and_investigations/2012/aml_compliance_for_investment_advisers/.

¹² See <http://www.gpo.gov/fdsys/pkg/PLAW-107publ56/pdf/PLAW-107publ56.pdf>.

¹³ See <http://www.stepto.com/assets/attachments/1624.pdf>.

4. Implementation of an independent audit to test and maintain adequate AML compliance program(s).

Conclusion

It is imperative that investment advisers have strong knowledge of how money laundering originates and the implications and risks inherent to their business. Next steps may include developing a strong KYC process, training personnel on AML detection techniques, formulating customized AML policies and enhancing internal controls in order to stay ahead of the curve to prepare for the forthcoming regulations.

For more information on these and other considerations, please contact us at info@jackolg.com, or (619) 298-2880. Also, please visit our website at www.jackolg.com.

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