MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

November 2, 2015

VIA FEDERAL E-RULEMAKING PORTAL

Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183
Attn: Director Jennifer Shasky Calvery

Re: AML Program and SAR Filing Requirements for Registered Investment Advisers (RIN: 1506-AB10)
Docket Number FinCEN-2014-003

Dear Director Shasky Calvery:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Financial Crimes Enforcement Network ("FinCEN") with respect to its proposed rulemaking on "Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers" (the "Proposed Rule").[2] The Proposed Rule requires investment advisers registered or required to be registered with the U.S. Securities and Exchange Commission ("RIAs") to establish an anti-money laundering ("AML") program, report suspicious activity, and comply with certain other provisions applicable to financial institutions under the Bank Secrecy Act,[3] as amended by the USA PATRIOT Act[4] (collectively, the "BSA").

MFA and its members have a vital interest in the Proposed Rule. The overwhelming majority of MFA's members are RIAs. While the Proposed Rule is addressed to

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[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the global alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns.

[2] Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 80 Fed. Reg. 52,680 (Sept. 1, 2015). We use the term "Proposed Rule" in referring not only to the proposed regulations to be codified in Part 1031 of the Code of Federal Regulations, but also to FinCEN's preamble.

[3] Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (1970), 31 U.S.C. §§ 5311-5314; 5316-5330.

[4] Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism ("USA PATRIOT") Act of 2001. Pub. L. No. 107-56, 115 Stat. 272, 296 (2001).

all types of RIAs (including RIAs that are dually registered as a broker-dealer, RIAs that manage registered open-end investment funds (*i.e.*, mutual funds), and stand-alone RIAs), MFA's membership predominately consists of RIAs that sponsor and manage affiliated private investment funds, commonly known as hedge funds, that are exempt from registration under the Investment Company Act of 1940. MFA's RIA members represent a significant portion of the funds invested in these alternative investment vehicles. This letter, accordingly, addresses the operation of RIAs in this context.

MFA strongly supports the U.S. government's efforts to combat money laundering and the financing of terrorist activities. For more than a decade MFA has assisted the industry in promoting AML initiatives, by, among other things, recommending that investment advisers voluntarily adopt AML compliance programs and providing its members with comprehensive and detailed guidance as to the elements of an AML compliance program, which in many respects mirror the requirements of the Proposed Rule.

MFA also strongly supports adoption of the Proposed Rule. In fact, MFA expressed its support of FinCEN's earlier AML rulemaking initiatives affecting investment advisers and unregistered investment companies at the time they were first proposed in 2002 and 2003.[5] We submit these comments in order to enhance the Proposed Rule and make it more effective in reaching its goals. In this regard, we believe that certain provisions of the Proposed Rule merit clarification, and in a few limited instances modification, in light of the specific characteristics of the hedge fund industry. In addition, we have responded to various questions posed by FinCEN in the Proposed Rule.

In order to assist FinCEN in further developing its understanding of this industry, MFA is available to meet with FinCEN to provide additional background with respect to RIAs managing hedge funds and their existing AML practices. We believe that a more fulsome presentation could be of assistance to FinCEN.

A. EXECUTIVE SUMMARY

Below we first provide relevant background on the operation of RIAs and hedge funds, their AML risk profile, and the industry's existing efforts to implement policies and procedures to detect and deter potential money laundering. We then provide detailed comments on specific provisions of the Proposed Rule. Our principal comments on the Proposed Rule may be summarized as follows:

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[5] In November 2002, MFA commented on the Proposed AML Compliance Program for Unregistered Investment Companies and, in July 2003, MFA commented on the proposed Anti-Money Laundering Programs for Commodity Trading Advisers and Proposed AML Compliance Program for Investment Advisers. *See* letter from John G. Gaine, President, MFA, to FinCEN (Nov. 25, 2002), *available at* https://www.managedfunds.org/wp-content/uploads/2015/10/352-USA-PATRIOT-FINAL.pdf and letter from John G. Gaine, President, MFA, to FinCEN (July 7, 2003), *available at* https://www.managedfunds.org/wp-content/uploads/2015/10/FINCEN_CTA_IA_AMLRules.pdf. These comment letters, and others responding to FinCEN rulemaking initiatives, are also available on FinCEN's website at: www.fincen.gov.

- **Definition of "Investment Adviser."** MFA believes that subadvisers should not be included in the definition of "investment adviser"; RIAs acting as primary advisers will be subject to the Proposed Rule.

- **Delegation of AML Program Requirement.** MFA suggests that FinCEN should provide guidance as to what measures RIAs should undertake to ensure effective implementation of an AML program by a third party. Further, we recommend that FinCEN clarify the permissibility of the delegation of the AML program requirement to offshore administrators, which have effectively implemented RIA's AML compliance programs for many years.

- **Risk Assessment.** For purposes of assessing risk, MFA requests that FinCEN acknowledge, in the adopting release or other guidance, that RIAs may take into consideration the AML procedures performed by (1) financial institutions from which investor funds originate, including those located in Financial Action Task Force ("FATF")-member jurisdictions, and (2) investor intermediaries, such as fund-of-funds or other pooled investment vehicles, that provide representations with respect to their AML procedures. RIAs currently rely on these entities in assessing money laundering risks presented by investors and believe these practices are sound and should continue.

- **Scope of AML Program.**

    - We recommend that FinCEN clarify that the intent of the Proposed Rule is to cover activities involving investors, and not other aspects of an RIA's operations, such as investment activity.

    - MFA also requests clarification that FinCEN does not expect RIAs to incorporate existing non-AML procedures relating to securities laws into their AML programs or SAR monitoring systems.

    - It would also be helpful if FinCEN were to clarify that the risk assessment and due diligence requirements of an RIA's AML program can appropriately be applied to new investors and additional investments made by existing investors, and not require RIAs to reassess the due diligence previously conducted on existing investors.

- **AML Compliance Officer Designation.** FinCEN should permit appropriately knowledgeable and responsible personnel to be designated as the AML compliance officer. In addition, FinCEN should clarify that, if a committee is designated, not all members of the committee need be employees of the RIA.

- **AML Program Approval.** FinCEN should permit senior management to approve the RIA's AML program, and not require written board of director approval.

- **SAR Obligations.**

- MFA asks for clarification regarding the application of the proposed SAR filing language "by, at, or through" to RIAs, as this language does not correspond well with how RIAs interact with investors or funds. Further, MFA requests that FinCEN clarify that the SAR reporting obligation applies only to activities involving investors, and not to other aspects of the RIA's operations.

- Sharing of SARs and SAR-related information (subject to the obligation of SAR confidentiality) should be permitted within an RIA's corporate organizational structure and between an RIA and the directors and officers of the hedge funds managed by the RIA and the funds' administrator.

- MFA endorses FinCEN's recognition that RIAs should be permitted to delegate their SAR filing obligations to third parties, and asks for clarification that such third parties may include entities (such as administrators) that are based outside the U.S. or are not considered "financial institutions" under the BSA.

- **Recordkeeping and Travel Rules.** We recommend that RIAs not be subject to the BSA's Recordkeeping and Travel Rules as they do not, as a general matter, receive funds from, or send funds to, investors, nor do they hold investor funds. If these rules are required for RIAs, FinCEN should, at a minimum, provide clarifying guidance regarding how RIAs should implement these rules, with specific examples relevant to RIAs managing private investment funds.

- **CTR Filing Obligation.** MFA endorses the use of the CTR for large currency transactions.

- **Section 314 of the USA PATRIOT Act.** MFA endorses the application of Section 314 to RIAs. MFA requests, however, that FinCEN clarify that Section 314 requests may be directed by the RIA to a hedge fund's administrator or third-party service provider, even when such third parties are located outside the U.S. or are not considered a "financial institution" under the BSA.

- **Sections 326, 313, 319(b), and the correspondent account rules of 311 and 312 of the USA PATRIOT Act.** MFA believes that imposing these requirements on RIAs would be quite burdensome without materially furthering the goals of AML enforcement. At the very least, we urge FinCEN to provide additional clarification as to how these requirements would apply in the RIA context so that MFA can provide more meaningful comment before any such requirements are imposed.

- **Delegation of Examination Authority to the SEC.** MFA recommends that FinCEN require that the SEC publicly release a copy of its relevant AML examination manual.

- **Effective Date.** MFA asks that FinCEN expand the time frame for RIAs to implement the rule to 18 months.

B. BACKGROUND

1. Description of the Hedge Fund Industry

Generally speaking, hedge funds are pooled investment vehicles sponsored and managed by a single investment adviser registered with the SEC. In the typical hedge fund structure, there will be both a domestic fund organized under U.S. law and an offshore fund organized under the laws of another country such as the Cayman Islands.[6] The same general investment strategy will be followed for both the domestic and offshore fund.[7] Investors in the domestic fund tend to be U.S. individuals and entities subject to taxation in the U.S., while the offshore fund's investors generally tend to be comprised of non-U.S. individuals and entities and tax-exempt U.S. investors including pension plans, endowments, foundations and other charitable organizations.[8] It is typical for an RIA to be affiliated with the hedge funds and to manage several affiliated funds (referred to below as a "Fund" or "Funds").

To be eligible to invest in hedge funds under the federal securities laws, an investor generally must qualify either as an "accredited investor" or a "qualified purchaser," depending on the type of fund. An accredited investor is defined as individuals with a net worth of at least $1 million (not including the individual's primary residence) or annual income of at least $200,000 in the past two years, and institutions with assets in excess of $5 million.[9] A qualified purchaser is defined as individuals with at least $5 million in investments or institutions with at least $25 million in investments.[10] Almost all Funds have minimum subscription amounts with a common amount being $1 million.

Investor monies are pooled together and become assets of the Fund, which is usually organized as a limited partnership or limited liability company. In return, an investor acquires an ownership interest (*e.g.*, a limited partnership interest) in the Fund in proportion to its contribution. Investors participate in the gains and losses of the Fund through their respective ownership interests. Liquidity is limited. In contrast to mutual funds, which offer daily liquidity to their investors, investors in hedge funds are permitted to redeem their ownership interest (in whole or in part) only at specified intervals, which vary by hedge fund (*e.g.*, quarterly or

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[6] *See* SEC Division of Investment Management Report, Private Fund Statistics at 10 (Oct. 16, 2015), *available at* http://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2014-q4.pdf.

[7] Some RIAs for hedge funds also advise single-investor funds or managed accounts for a single investor. Generally, the investment strategy employed on behalf of such single-investor vehicles mirrors the strategy followed for the RIA's larger hedge funds.

[8] *See* A Report to Congress in Accordance with § 356 of the USA PATRIOT Act, submitted by the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, and the SEC, at 21-22 (Dec. 31, 2002).

[9] *See* 17 C.F.R. §§ 230.501(a)(5) and (6) (individual investors) and 17 C.F.R. §§ 230.501(a)(3) and (7) (institutions). These qualifications apply for investors in funds that are exempt from registration under Section 3(c)(1) of the ICA.

[10] *See* 15 U.S.C. § 80a-2(a)(51). These qualifications apply for investors in funds that are exempt from registration under Section 3(c)(7) of the ICA.

annually), subject to a minimum notice period generally ranging from 30 to 90 days. Investors also may be subject to an initial "lock up" period (*e.g.*, one or two years), during which they are not permitted to withdraw any portion of their investment.

Hedge fund investors include individuals and entities that are investing for their own account ("direct investors") and also include entities that are investing as intermediaries on behalf of a number of other unrelated investors ("investor intermediaries"). Investor intermediaries may include, by way of example, a fund-of-funds,[11] a U.S. or foreign financial institution offering an alternative investment product to its customers, an asset aggregator, or other type of pooled investment vehicle. The majority of hedge fund assets under management come from institutional investors, predominately funds-of-funds, public pension plans, private pension plans, endowment plans, and foundations.[12]

RIAs that manage hedge funds generally do not have a contractual relationship with the Fund's investors. Rather, the RIA enters into investment advisory agreements with the hedge fund it manages, and is paid management fees by the hedge fund and may also receive incentive-based compensation. While the RIA is responsible for investing and managing the Funds' assets, the adviser does not hold investor funds, which are held at accounts maintained by the Funds at different financial institutions, including prime brokerage accounts.[13] There are no financial transactions directly between the RIA and the investor; rather, when making its investment, the investor sends its money to the Fund's bank account, and when the investor redeems its interest, the Fund wires the redemption proceeds to the investor's bank account. Typically, there are very few transactions between the investor and the Fund during the life of an investment: the initial investment, or "subscription"; in some cases add-on investments; and the payment of redemption proceeds by the Fund when the investor liquidates a portion of its investment or exits the investment entirely.

2. AML Risks Related to Hedge Funds

While, as noted above, MFA fully supports adoption of an AML program rule for RIAs, MFA believes that hedge funds present relatively limited money laundering risks.

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[11] A fund-of-funds is an investment fund that invests its clients' money in multiple underlying funds. *See* GAO 11-901SP at 10 (Aug. 31, 2011), *available at* http://www.gao.gov/assets/90/82457.pdf. *See also* Notice of Proposed Rulemaking, Anti-Money Laundering Programs for Unregistered Investment Companies, 67 Fed. Reg. 60617, 60621, n.30 (Sept. 26, 2002), withdrawn 73 Fed. Reg. 65569 (Nov. 4, 2008) ("Proposed AML Compliance Program for Unregistered Investment Companies").

[12] MFA, "Dodd-Frank at 5: The Role of Alternative Investments in Today's Capital Markets," at 5 ("Today approximately 65 percent of all hedge fund assets under management come from these institutional investors."), *available at* https://www.managedfunds.org/wp-content/uploads/2015/07/Dodd-Frank-at-5-The-Role-of-Alternative-Investments-in-Today%E2%80%99s-Capital-Markets1.pdf.

[13] In fact, the RIA is not permitted to hold investor funds under rule 206(4)-2 of the Investment Advisers Act of 1940, as client funds and securities must be held at a "qualified custodian." *See* 17 C.F.R. § 275.206(4)-2. A "qualified custodian" includes generally any U.S. bank, U.S. registered broker-dealer, U.S. futures commission merchant (limited to holding client funds and security futures and any other securities incidental to client futures transactions) and foreign financial institution that customarily holds customer assets and that segregates customer assets from its own assets. *See* 17 C.F.R. § 275.206(4)-2(d)(6).

Laundering of cash proceeds is not a significant concern, as the minimum subscription amounts make the use of currency impractical for investors and, in any event, most Funds prohibit the receipt of currency. As FinCEN's earlier rulemaking initiative noted: "Because these investment vehicles rarely receive from or disburse to investors significant amounts of currency, they are not as likely as other types of financial institutions (*e.g.*, banks) to be used during the initial or 'placement' stage of the money laundering process."[14] Additionally, subscription funds are typically wired from financial institutions, such as banks and broker-dealers, located in FATF-member jurisdictions and subject to strict AML controls.

Nor are hedge funds efficient vehicles for layering or integration of illegal proceeds. Post-investment transactional activity is extremely limited, occurring only when an investor seeks to (a) transfer the investor's interest in the Fund; or (b) redeem (in whole or in part) the investor's interest in the Fund. Investors generally are not permitted to transfer their interest in the Fund without the express approval of the Fund (or the general partner of the Fund, which is typically an affiliate of the RIA), which affords the RIA the opportunity to conduct diligence on, and obtain appropriate AML representations from, the proposed transferee. Redemptions must be processed by the RIA or the Fund administrator; the investor cannot unilaterally withdraw its funds. As a matter of good practice, most Funds require that, when an investor requests a redemption, the redemption proceeds be wired to an account in the investor's name, unless the investor has provided a satisfactory explanation why the proceeds should be transferred somewhere else.[15] In these instances, it is common for additional due diligence to be conducted. As a result, it is rare for an investor to effectuate a transfer (either of the investor's interest in the Fund or of redemption proceeds) to a third party.

3. Existing AML Practices

MFA has spent considerable time and effort studying AML issues facing Funds and providing our members with practical guidance on developing internal policies and procedures to combat potential money laundering. In March 2002, MFA published its "Preliminary Guidance for Hedge Funds and Hedge Fund Managers on Developing Anti-Money Laundering Program." In 2007, MFA published a separate chapter devoted to AML in the MFA's Sound Practices for Hedge Fund Managers, which was updated in 2009 (the "MFA Sound Practices").[16] The MFA Sound Practices are based, in large part, on the AML rules applicable to broker-dealers.[17]

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[14] Proposed AML Compliance Programs for Unregistered Investment Companies, 67 Fed. Reg. at 60619 .

[15] Moreover, the SEC Identity Theft Red Flags Rule further incentivizes RIAs to take measures to ensure that investor money is not directed to third parties. The Rule requires those RIAs that do permit investor funds to be directed to third parties to implement a written identity theft prevention program. *See* Identity Theft Red Flags Rules, 78 Fed. Reg. 23638, 23642 (Apr. 19, 2013) (codified at 17 C.F.R. Part 248).

[16] *See* MFA's Sound Practices for Hedge Fund Managers 2009 (Chapter 6 and Appendix IV); MFA's Due Diligence Questionnaire; and MFA's Sound Practices for Hedge Fund Managers 2007 (Appendix IV). This guidance is available on MFA's website at: www.managedfunds.org.

[17] *See* 31 C.F.R. Part 1023 for AML rules applicable to broker-dealers.

The MFA Sound Practices set forth guidance urging Fund managers to adopt and implement AML programs consistent with Section 352 of the USA PATRIOT Act as a matter of sound business practice, and include specific recommendations with regard to the development of internal policies, procedures, and controls; the designation of an AML compliance officer; ongoing employee training; an independent testing function to test the effectiveness of the program; investor due diligence and risk-based monitoring; filing of voluntary SARs; OFAC compliance; performance of AML procedures by third parties; and recordkeeping and reporting. The MFA Sound Practices also include proposed templates for managers to use in adopting AML policies, procedures and controls and in obtaining AML-related contractual representations from direct investors, investor intermediaries and Fund administrators.[18]

It is MFA's understanding that the vast majority of its RIA members have had AML programs in place for a number of years. While some investment advisers have an in-house AML function, many others delegate the implementation and operation of certain aspects of their AML program to a third party. Most often the delegation is made to the Fund's administrator, which is an independent third-party that provides valuation, administrative and other services to the Fund and its investors, such as, for example, calculating the management and performance fee; maintaining books and records; acting as the registrar and transfer agent for shares held by investors; and handling the receipt of subscriptions and the payment of redemptions. Such administrators are typically subject to AML oversight in their home country, and therefore implement AML procedures both as a contractual matter on behalf of the Fund and as a regulatory requirement.[19] The MFA Sound Practices include specific recommendations with respect to such delegation.

At the outset of the relationship with an investor, the administrator or RIA will conduct initial due diligence on the investor at the time of subscription. Industry practice takes into account whether the investor is sending its funds from an account in the investor's name at a financial institution that is located in a FATF-member jurisdiction and subject to customer identification procedures and AML requirements of that jurisdiction.[20] If the investment funds do not originate from financial institutions located in FATF-member jurisdictions, it is customary for enhanced due diligence to be performed.

Investors are required to complete subscription documents, which include certain AML-related representations and warranties, including that the investor is not a senior political figure or a foreign shell bank, and that the investment funds are not derived directly or indirectly from illegal activities. The investor is also subject to various screening procedures related to sanctions; negative news; and potential status as a senior foreign political figure. Such screening is also generally conducted on the investor at the time of redemption.

[18] *See* MFA's Sound Practices for Hedge Fund Managers 2009 (Appendix IV).

[19] For example, Cayman Islands administrators are regulated by the Cayman Islands Monetary Authority and are subject to The Proceeds of Crime Law (2008 Revision); The Companies Management Law (2003 Revision), The Monetary Authority Law (2013 revision); and the Companies Law (2013 Revision).

[20] A list of thirty-four FATF-member jurisdictions can be found at [http://www.fatf-gafi.org/about/membersandobservers/.](http://www.fatf-gafi.org/about/membersandobservers/) MFA members frequently make their own risk assessment of FATF-member jurisdictions, treating certain jurisdictions as high-risk.

C. COMMENTS ON THE PROPOSED RULE

Outlined below are MFA's specific comments on aspects of the Proposed Rule.

1. Definition of Investment Adviser - Subadvisers

The Proposed Rule defines "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 (15 U.S.C. 80b-3(a))."[21] This definition would include: both primary advisers and subadvisers[22] who have more than $100 million or more in regulatory assets under management.[23]

MFA believes that RIAs should not be subject to the Proposed Rule when acting as a subadviser. A subadviser is engaged by a primary adviser to recommend investment strategies and, in some instances, direct trading on behalf of a Fund or account managed by the primary adviser. A subadviser does not interact with the Fund's investors or handle investor subscriptions, transfers or redemptions and, therefore, is not in a position to conduct due diligence or identify suspicious transactions by investors. Accordingly, subadvisers would not have information useful in carrying out the objectives of the Proposed Rule or expose the Fund to money laundering and terrorist financing risks. In any event, RIAs acting as primary adviser would be subject to the Proposed Rule. Requiring an AML program and SAR filing for subadvisers would, therefore, duplicate the efforts of those primary advisers and their administrators, who do interact with investors and would be subject to the Rule. Such a requirement thus would result in significant expenditure of resources while doing little to further the objectives of the Proposed Rule.[24]

2. Delegation of AML Program Requirements to Third Parties

In the Proposed Rule, FinCEN acknowledges that it may be appropriate for an RIA to delegate contractually the implementation and operation of some elements of an AML program to "agents or third-party service providers, such as broker-dealers in securities (including prime brokers), custodians, and transfer agents."[25] However, the RIA would "remain fully responsible for the effectiveness of the program" and for "ensuring that FinCEN and the SEC are able to obtain information and records relating to the AML program."[26]

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[21] Proposed Rule, 80 Fed. Reg. at 52699.

[22] FinCEN defines primary adviser and subadviser as follows: "Generally, the primary adviser contracts directly with the client and a subadviser has contractual privity with the primary adviser." Proposed Rule, 80 Fed. Reg. at 52683, n.21.

[23] *See* Proposed Rule, 80 Fed. Reg. at 52683.

[24] It is also MFA's view that foreign-based RIAs should not be included in the Proposed Rule's definition of "investment adviser" if they are already subject to regulation in the jurisdiction in which they are located, as the imposition of the Proposed Rule could impose conflicting regulatory obligations on such RIAs.

[25] Proposed Rule, 80 Fed Reg. at 52689.

[26] *Id*.

MFA appreciates that FinCEN has permitted an RIA to delegate implementation of some elements of the RIA's AML program. Such delegation is consistent with FinCEN's AML program requirements for mutual funds.[27] And, as noted above, it is consistent with the current practice in our industry, as many RIAs delegate the administration of AML activities to their Fund administrator. Such administrators are experienced at implementing AML controls, identifying red flags, conducting due diligence on investors and the source of funds, and processing subscriptions, transfers and redemptions. Some administrators are nonbank subsidiaries of U.S. bank holding companies and, as such, subject to the global AML policies and procedures of these U.S. institutions, while others are required to have AML policies and procedures under the laws of their home country jurisdictions. Fund administrators are thus in a better position than RIAs in many instances to most effectively implement the AML program requirements of the Proposed Rule. In order to ensure that RIAs are able fully to avail themselves of the delegation option, we believe that FinCEN should clarify the parameters of delegation in the following respects, either in the rule itself or in an adopting release.

a. Delegation to Administrators

As noted above, the relevant passage of the proposing release, in discussing delegation, lists only broker-dealers, custodians, and transfer agents as examples of third-party service providers to whom AML program responsibilities may be delegated.[28] We request that when issuing its final rule FinCEN specifically refer to administrators as another example of such a third-party service provider, in order to dispel any possible doubt that delegation of these AML responsibilities to administrators is permissible.[29]

b. Program Elements That May Be Delegated

The Proposed Rule does not specify which elements of the RIA's AML program may be delegated to a third party. We suggest that FinCEN clarify that, while RIAs are responsible for developing the firm's AML compliance program, all aspects of the implementation and operation of the program may be delegated where appropriate, including, to the extent required by an RIA's program, among other things, conducting due diligence on prospective investors, determining when enhanced due diligence is required on high-risk investors and conducting such enhanced due diligence, processing subscription documents from investors, processing redemptions and transfers, updating due diligence on investors, monitoring for suspicious activity, and preparing and filing suspicious activity reports.

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[27] "Because mutual funds typically conduct their operations through separate entities, which may or may not be affiliated, some elements of the compliance program will best be performed by personnel of these separate entities. It is permissible for a mutual fund to contractually delegate the implementation and operation of its anti-money laundering program to another affiliated or unaffiliated service provider, such as a transfer agent." Anti-Money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21117, 21119 (Apr. 29, 2002).

[28] Proposed Rule, 80 Fed Reg. at 52689.

[29] We note that the proposing release does specify administrators as among those third-party service providers to whom an RIA may delegate its suspicious activity reporting requirements. *See* Proposed Rule, 80 Fed. Reg. at 52693.

c. Criteria for Delegation

The Proposed Rule states that, notwithstanding a permitted delegation to a third party, the RIA "will remain fully responsible for the effectiveness of the program."[30] Notably, FinCEN's adopting release accompanying the AML rule for mutual funds does not contain such a statement, but instead provides only that the mutual fund "remains responsible for assuring compliance with this regulation."[31] The mutual fund release further explains: "That means that [the mutual fund] must take reasonable steps to identify the aspects of its operations that may give rise to BSA regulatory requirements or are vulnerable to money laundering or terrorist financing activity, develop and implement a program reasonably designed to achieve compliance with such regulatory requirements and prevent such activity, monitor the operation of its program and assess its effectiveness."

We submit that it would be appropriate for FinCEN to adopt a similar approach in the RIA context by providing guidance concerning minimum criteria that RIAs must meet to effect a proper delegation reasonably designed to assure compliance by the third party. Consistent with the mutual fund guidance, we believe that RIAs that delegate to third parties should be deemed to have met their AML program responsibilities so long as the RIA takes reasonable steps to assure compliance by the third party. Criteria that FinCEN could look to in providing guidance as to what steps an RIA should take for this purpose include: the RIA should conduct due diligence on the third party's AML policies and determine whether they meet the RIA's standards; the RIA's agreement with the third party should contain appropriate representations and covenants, including that the third party will maintain and adhere to effective AML policies, procedures and controls; and the RIA should periodically monitor the third party's compliance.

d. Offshore Administrators

Currently, many RIAs delegate AML compliance to administrators located outside the United States. Such administrators are generally located in jurisdictions with longstanding AML laws (*e.g.*, Cayman Islands and Ireland), and are regulated entities required to have their own AML policies, procedures and controls under the AML laws and regulations of their home country. In some instances, even though they are located offshore, they are subsidiaries of U.S. bank holding companies or other financial institutions and, as such, are subject to certain U.S. regulation.[32] In the experience of our member firms, such offshore administrators are staffed with qualified AML professionals and have effectively implemented

[30] Proposed Rule, 80 Fed Reg. at 52689.

[31] Anti-Money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21117, 21119 (Apr. 29, 2002). This same language appears in FinCEN's guidance relating to delegation by a mutual fund of its SAR reporting responsibilities. *See* FIN-2006-G013, Frequently Asked Questions Suspicious Activity Reporting Requirements for Mutual Funds at 4 (Oct. 4, 2006) (stating that the mutual fund "remains responsible for assuring compliance with the regulation").

[32] *See, e.g.*, 12 C.F.R. § 225.4(f) ("A bank holding company or any nonbank subsidiary thereof, or a foreign bank that is subject to the BHC Act or any nonbank subsidiary of such foreign bank operating in the United States, shall file a suspicious activity report in accordance with the provisions of § 208.62 of the Board's Regulation H.").

RIAs' AML compliance programs for many years. In addition, these administrators handle a variety of other administrative duties for Funds (such as processing subscription documents and redemptions and issuing statements to investors), which put them in the best position to identify AML issues and to monitor transactions. We request that FinCEN acknowledge the use of foreign-based administrators to implement these AML procedures.

Under the Proposed Rule, RIAs would be responsible, in the event of a delegation, to "ensur[e] that FinCEN and the SEC are able to obtain information and records relating to the AML program."[33] We do not anticipate that this would be problematic to the extent it refers to information and records in the possession of an administrator (either located in the U.S. or a foreign jurisdiction) describing the general operation of the AML program with respect to the particular Fund the RIA manages – *e.g.*, the AML policies and procedures followed by the administrator, the form of subscription documents, independent testing conducted of the administrator's compliance, etc. To the extent it may encompass customer-specific information, we anticipate that some foreign administrators may need to consider the laws and regulations of their jurisdictions. We anticipate that administrators would share such information with the RIA. We therefore request clarification that, in the case of a delegation, the information and records to which FinCEN and the SEC must have access may be provided either directly by the third party or through the RIA. Such an approach is consistent with that taken by the SEC in its no-action letters relating to reliance by broker-dealers upon an investment adviser's AML compliance procedures, which provide for the investment adviser to agree to provide its books and records relating to its performance of the customer identification program ("CIP") to the SEC or other authorized law enforcement agencies "either directly or through the broker-dealer."[34]

e. Authorization in Part 1031

The Proposed Rule authorizes delegation only in the proposing release, and not in the proposed regulations themselves. Given the importance of delegation for RIAs, we suggest that this concept be incorporated in the text of the regulations at proposed 31 C.F.R. § 1031.210(a)(2).

3. Risk Assessment

a. AML Procedures of Other Financial Institutions Located in FATF Jurisdictions

The Proposed Rule expressly endorses a "risk-based approach" to the AML program requirement.[35] Consistent with that approach, and with the MFA Sound Practices, we

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[33] Proposed Rule, 80 Fed Reg. at 52689.

[34] *See* Request for No-Action Relief Under Broker-Dealer Customer Identification Program Rule (31 C.F.R. 1023.220), dated Jan. 9, 2015, to Mr. Ira D. Hammerman, Executive Vice President and General Counsel of SIFMA, from Lourdes Gonzalez, Assistant Chief Counsel, Division of Trading and Markets of the SEC, *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2015/sifma-010915-17a8.pdf.

[35] Proposed Rule, 80 Fed. Reg. at 52686.

request that FinCEN acknowledge, in the adopting release or other guidance, that RIAs may rely on AML procedures performed by other financial institutions in appropriate circumstances for purposes of assessing risk. It is common for subscription funds to originate from financial institutions, such as banks and broker-dealers, located in FATF-member jurisdictions, and for redemption and distribution payments to be made back to these financial institutions. Such financial institutions are subject to significant AML controls and conduct customer identification verification and due diligence on account holders. Accordingly, investors (including individual and institutions who invest directly rather than through an intermediary) whose funds originate from accounts at financial institutions located in FATF-member jurisdictions are currently viewed by RIAs as low-risk for money laundering (absent some other indication that the investor presents a greater risk).

MFA's Sound Practices, for example, provide that an RIA may take into consideration the AML procedures performed by other regulated financial institutions where (1) the investor is a customer of either a U.S.-regulated financial institution or a regulated foreign financial institution organized in a FATF-member jurisdiction; and (2) the investor's investment funds are wired from its account at the financial institution. In such circumstances, where the investor has already been approved from an AML perspective by a regulated financial institution (either U.S. or foreign) under its own AML requirements, and the investment funds are being wired from an account in the investor's name at the institution, we submit that additional AML due diligence by the RIA, absent facts suggesting that the investor presents a heightened risk for money laundering, is unnecessary and would not materially mitigate money laundering risks associated with the investment. Relying on banks and broker-dealers located in FATF-member jurisdictions is a well-established feature of our members' current AML due diligence practice, and we believe this practice should continue.

This same rationale would apply when investors, or investor assets, are introduced to Funds via placement agents and asset aggregators that are subject to AML rules in their own jurisdictions. Placement agents and asset aggregators typically conduct due diligence on investors and fund sources and provide the Fund with representations with respect to their AML procedures. Further, it is important to note that Fund investors that are regulated financial institutions pose a decreased risk of money laundering as they are already subject to AML controls. Accordingly, MFA requests that FinCEN acknowledge, in the adopting release or other guidance, that for purposes of conducting an AML risk-assessment, RIAs may rely on AML procedures performed by other financial institutions in appropriate circumstances.

b. Risk-Based Due Diligence on Investor Intermediaries

As noted above, many Fund investors are intermediaries, such as a fund-of-funds or other pooled investment vehicles, that act on behalf of underlying investors and beneficial owners, and such investments may comprise a significant portion of the assets managed by an RIA. As noted in the Proposed Rule, RIAs "will need to assess the money laundering or terrorist financing risks associated with these investing pooled entities using a risk-based approach."[36] Consistent with this risk-based approach, we request that FinCEN clarify its expectations

[36] Proposed Rule, 80 Fed Reg. at 52688.

concerning the due diligence to be performed by RIAs on such investor intermediaries for purposes of assessing risk, in two respects.

First, consistent with guidance provided to other financial institutions subject to AML program requirements,[37] and with FinCEN's proposed Customer Due Diligence rule,[38] we suggest that FinCEN clarify that the investor intermediary will be viewed as the RIA's customer for AML purposes, and that the RIA will not be required to look through the intermediary to the underlying investors and beneficial owners to conduct due diligence on the underlying investors and beneficial owners. Permitting the RIA to treat the intermediary as its customer is consistent with the Proposed Rule's risk-based approach. Intermediaries often pool together the funds of dozens or hundreds of underlying investors and beneficial owners. Moreover, the identities of those underlying investors and beneficial owners may be subject to certain legal protections, depending upon the jurisdiction in which the intermediary is located. It would be impractical to require RIAs to learn the identities of and conduct AML due diligence on each of the intermediary's underlying investors and beneficial owners. Accordingly, MFA requests that FinCEN make clear that the RIA should focus on the risks presented by the Fund's direct investors (*i.e.*, the intermediaries), and not on the intermediary's underlying investors and beneficial owners.

Second, we suggest that FinCEN expressly permit RIAs to rely on AML procedures performed by investor intermediaries in determining whether to accept an investment from an intermediary investor. The intermediaries, and not the RIAs, are in direct contact with the underlying investors and beneficial owners and consequently are in the best position to "know the investor." RIAs take into account a number of factors in assessing AML risks relating to potential intermediary investors, including the jurisdiction in which the intermediary is based and the existence of applicable AML laws and regulations in that jurisdiction, the intermediary's regulatory status, the intermediary's reputation and history in the investment industry, and the AML and investor due diligence policies, procedures, and controls implemented by the intermediary. Where those factors indicate that the intermediary's own AML due diligence

[37] *See* Customer Identification Programs for Mutual Funds, 68 Fed. Reg. 25131, 25134 (May 9, 2003) ("Similarly, with respect to an omnibus account established by an intermediary, a mutual fund generally is not required to look through the intermediary to the underlying beneficial owners."); Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission, Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 CFR 103.122) (Oct. 1, 2003) ("with respect to an omnibus account established by an intermediary, a broker-dealer is not required to look through the intermediary to the underlying beneficial owners, if the intermediary is identified as the accountholder"); FinCEN Guidance FIN-2006-G004, Frequently Asked Question regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers (31 CFR 103.123) (Feb. 14, 2006) ("[i]f the intermediary is the account holder, such as in the case of an omnibus account, an FCM is not required to look through the intermediary to the underlying beneficiaries").

[38] The proposed CDD rule explicitly recognizes that the risks posed by intermediaries are more effectively managed through proper due diligence and regulation of the intermediaries themselves, and not of the intermediaries' underlying customers. *See* Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45161 (Aug. 4, 2014) (stating that, "for purposes of the beneficial ownership requirement, if an intermediary is the customer, and the financial institution has no CIP obligation with respect to the intermediary's underlying clients pursuant to existing guidance, a financial institution should treat the intermediary, and not the intermediary's underlying clients, as its legal entity customer").

procedures are reasonable, RIAs should be permitted to rely on written representations by the intermediary regarding the investment activity and risk-level of its underlying investors and beneficial owners.

By recognizing the validity, under a risk-based approach, of RIAs' current practices with regard to investor intermediaries, FinCEN would provide important and helpful guidance that would further the objectives of the Proposed Rule.

4. Scope of the Activities Covered by the RIA's AML Program

a. Advisory and Investment Activities

Under the Proposed Rule, an RIA's AML program "must cover all of its advisory activity."[39] To the extent that this can be read to imply that an RIA's AML compliance program must cover not only the activities of investors, but also the RIA's own investment activities, we respectfully request that FinCEN clarify that this is not the intent or effect of the Proposed Rule.

An RIA's primary function is to invest the assets of the Funds it manages. The RIA is responsible for making these investment decisions, not the investors. Such investments take a variety of forms, such as trading in the U.S. and foreign securities markets, participating in initial public offerings and the purchase of private equity positions in portfolio companies both in the U.S. and abroad. While RIAs are and should be attentive in their investment activities to their obligations under the federal money laundering statutes (18 U.S.C. §§ 1956 and 1957), as well as their obligations under the economic sanctions programs administered by OFAC, RIAs should not be subject to AML program requirements with respect to activities that do not involve their investors.[40] Such activities do not present money laundering risks sufficient to justify the extension of the AML program to cover them. MFA therefore respectfully requests FinCEN clarify that the Proposed Rule only applies to activities of an RIA's investors and not to an RIA's investment activity on behalf of the Fund.

b. Information Gathered for Purposes of the Securities Laws

The Proposed Rule states that a risk-based evaluation of relevant factors "could build upon the investment adviser's efforts to comply with the Federal securities laws applicable to investment advisers."[41] This suggests that RIAs may be required to incorporate, into their AML risk assessment, information gathered for the entirely separate purpose of complying with the federal securities laws. MFA is concerned that if its members are required to use information collected pursuant to securities laws for purposes of AML compliance, then even technical violations of the securities laws (*e.g.*, recordkeeping and reporting) could become the basis for a violation of AML regulations, subjecting an RIA to civil and/or criminal penalties under the

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[39] Proposed Rule, 80 Fed. Reg. at 52686-87.

[40] Indeed, the Proposed Rule itself is properly focused on activity involving investors. *See id.* at 52691; *see also* discussion in section 7.a below.

[41] *Id.* at 52687.

BSA.[42] We do not believe that this is appropriate or the intent of the Proposed Rule, and we request the FinCEN make this clear in the final release. If, however, FinCEN expects RIAs to use for AML purposes information obtained by the RIA for purposes of complying with securities laws, FinCEN should be specific about the information that is required to be considered and factored into the AML risk assessment.

Similarly, the Proposed Rule states that "investment advisers should be able to build upon existing policies, procedures, and internal controls they currently have in place to comply with the Federal securities laws to which they are subject in order to report suspicious activity."[43] Here too, MFA is concerned that incorporating existing non-AML procedures into an RIA's SAR monitoring system could lead to RIAs inappropriately being penalized for violations of non-AML rules under the BSA penalty structure.

Incorporating non-AML rules into the AML program and SAR filing requirement, when these non-AML rules were not promulgated in furtherance of the administration of the BSA, may not be consistent with FinCEN's authority. FinCEN's authority is limited to administering the requirements of the BSA, which includes the authority to require the establishment of an AML program and the filing of reports that have been determined to have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings, and certain intelligence and counter-terrorism matters.[44] At a minimum, FinCEN's approach does not provide regulated entities with appropriate notice of a specific non-BSA rule that would be applicable under this Proposed Rule.

c. Under a Risk-Based Approach, The Rule Should Not be Applied to All Existing Investors of an RIA

MFA requests that FinCEN recognize that RIAs will not be required to reconsider the adequacy of their previous onboarding process and due diligence of investors who invested in a Fund prior to the effective date of the Proposed Rule, as doing so would be a costly and inefficient use of limited resources and because existing investors will have already been subject to due diligence under the RIA's voluntary AML program at the time existing investors subscribed to the Fund. Accordingly, it should be unnecessary, under a risk-based approach, for RIAs to conduct investor due diligence a second time. It is our view that the risk assessment and due diligence requirements of the adopting release should apply to new investors in the Fund. The application of the final rule to existing investors could be adopted on an event-driven basis (*i.e.*, additional subscriptions), as appropriate.

5. Designation of an AML Compliance Person or Committee

The Proposed Rule requires RIAs to designate a person or committee to be responsible for implementing and monitoring the operations and internal controls of the AML

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[42] *See* 31 U.S.C. §§ 5321 and 5322.

[43] Proposed Rule, 80 Fed. Reg. at 52691.

[44] *See* Treasury Order 108-01 (Sept. 26, 2002), *available at* http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/to180-01.aspx.; 31 U.S.C. §§ 5311, 5318(h).

program. The Proposed Rule states that "a person designated as a compliance officer should be an officer of the investment adviser."[45] RIAs, however, generally have very few individuals holding officer positions. MFA respectfully requests that the final release mirror the guidance applicable to other financial institutions and require only that the person the RIA designates as its AML compliance officer be "competent and knowledgeable regarding applicable Bank Secrecy Act requirements and money laundering risks," and "empowered with full responsibility and authority to develop and enforce appropriate policies and procedures."[46] So long as the person has these qualifications, and is an employee of the RIA, it should not be a requirement that the person is an officer of the RIA.[47]

Additionally, the Proposed Rule does not specify whether all (or any) of the individuals comprising the committee are required to be an officer of the RIA, an employee of the RIA, or located within the United States.[48] For RIAs that wish to establish such a committee, it may be helpful for one of the committee members to be a representative of the Fund administrator or other third-party service provider (who may reside outside the U.S.) or a member of the Fund's board of directors. Such flexibility is necessary for our members, as there are RIAs of varying sizes and resources.

6. AML Program Approval

The Proposed Rule requires each RIA's AML program to be approved in writing by the RIA's "board of directors or trustees, or if it does not have a board, by its sole proprietor, general partner, trustee, or other persons that have functions similar to a board of directors."[49]

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[45] Proposed Rule, 80 Fed. Reg. at 52689.

[46] *See, e.g.*, Anti-Money Laundering Programs for Insurance Companies, 70 Fed. Reg. 66754, 66759 (Nov. 3, 2005) (stating that "[t]he person or persons should be competent and knowledgeable regarding applicable Bank Secrecy Act requirements and money laundering risks, and should be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures"); Anti-Money Laundering Programs for Operators of a Credit Card System, 67 Fed. Reg. 21121, 21125-26 (April 29, 2002) (same).

The mutual fund AML program rule suggests that the AML compliance officer should be an officer. *See* Anti-Money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21117, 21120 (Apr. 29, 2002) ("the person responsible for the supervision of the overall program should be a fund officer"). However, mutual funds do not generally have employees, so it is understandable why the AML compliance officer for a mutual fund should be an officer of the fund. RIAs are not similar to mutual funds in this regard.

[47] *See* FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual at 32 (2014), *available at* http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014_v2.pdf (stating that "[w]hile the title of the individual responsible for overall BSA/AML compliance is not important, his or her level of authority and responsibility within the bank is critical."); Bank Secrecy Act/Anti-Money Laundering Examination Manual for Money Services Businesses at 52 (2008), *available at* https://www.fincen.gov/news_room/rp/files/MSB_Exam_Manual.pdf (same).

[48] Proposed Rule, 80 Fed. Reg. at 52689.

[49] *Id.* While banks must have their AML programs approved by the bank's board of directors, this requirement is imposed by bank regulators and not by FinCEN. *See* 12 C.F.R. § 21.21(c)(1) ("The compliance program must be written, approved by the national bank's or savings association's board of directors, and reflected in the minutes of the national bank or savings association.").

MFA recommends that the final release mirror the requirements applicable to broker-dealers[50] and insurance companies[51] and require that the RIA's AML program be approved in writing by the RIA's senior management. RIAs may not have boards of directors or persons that have functions similar to a board of directors, and it is not entirely clear from the Proposed Rule what characteristic of the board of directors FinCEN is referring to by the phrase "functions similar to a board of directors." It is our view that senior management approval is sufficient, as such individuals have the requisite level of authority and responsibility within the RIA to manage the day-to-day activities of the RIA.

7. SAR-Related Obligations

a. Reporting of Suspicious Activity

The Proposed Rule tracks various other FinCEN rules requiring reporting of suspicious activity by providing for an RIA to report suspicious transactions "conducted or attempted by, at, or through" the RIA, if the transaction involves or aggregates funds or other assets of at least $5,000 and the RIA knows, suspects, or has reason to suspect that the transaction is reportable. The Proposed Rule further requires that "an investment adviser evaluate client activity and relationships for money laundering risks and design a suspicious transaction monitoring program that is appropriate for the particular investment adviser in light of such risks."[52]

Subject to the comments below, MFA supports this proposal. As described above, MFA and its members are committed to preventing money laundering through private investment funds and believe it is appropriate for RIAs to assist law enforcement by filing SARs when an RIA knows or suspects that an investor's activities falls within the reporting requirements. Many RIAs manage Funds that are subject to mandatory SAR reporting rules in foreign jurisdictions, such as the Cayman Islands. MFA's Sound Practices encourage investment advisers to voluntarily file SARs in appropriate circumstances. While some RIAs have done so, they have been concerned that the SAR safe harbor might not apply to them because they were not financial institutions, and they therefore welcome this protection.

MFA asks for clarification, however, regarding the application of the proposed SAR filing language "by, at, or through" to RIAs. Although this language appears in the SAR rule for banks, mutual funds and broker-dealers, this language does not appear to reflect how RIAs interact with investors or Funds. To say that transactions happen "by, at, or through" is not necessarily accurate, as investors transact with Funds, not RIAs, and RIAs do not hold and are not the legal owners of investor assets. Further, in many if not most instances it is the Fund's administrator, and not the RIA, that processes subscriptions and redemptions for investors sending money to, or receiving money from, the Fund. Accordingly, MFA proposes that in the final rule, FinCEN require RIAs to file SARs on suspicious transactions by investors with or

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[50] *See* FINRA Rule 3310 ("Each member's anti-money laundering program must be approved, in writing, by a member of senior management.").

[51] *See* 31 C.F.R. § 1025.210(a) ("The [AML] program must be approved by senior management.").

[52] Proposed Rule, 80 Fed. Reg. at 52691.

through a Fund or managed account for which the RIA acts as adviser (and the transaction involves or aggregates at least $5,000 and the RIA knows, suspects, or has reason to suspect the transaction is reportable).

MFA interprets the proposed SAR filing requirement as intending to capture suspicious activity arising from (as the Proposed Rule characterizes it) "client activity and relationships."[53] Consistent with this interpretation, the money laundering red flags identified in the Proposed Rule all relate to "client" activity.[54] The requirement as drafted could, however, be interpreted to be broader in scope and require the filing of SARs for transactions involving the RIA's investment activity or employee wrongdoing. MFA requests that FinCEN clarify that the scope of the SAR filing requirement is limited to activity involving investors. Such clarification is especially important because, under the Proposed Rule, RIAs will be required to develop transaction monitoring systems to comply with the rule and identify suspicious activity. RIAs can engage in hundreds or thousands of transactions every day on behalf of the Funds they manage, buying and selling securities, derivatives and other instruments. Monitoring these transactions for possible suspicious activity or employee wrongdoing would require an enormous expenditure of resources by RIAs in service of a goal that bears little relationship to FinCEN's mission of combating money laundering.

In this regard, we note that the SAR reporting obligation should be used to further FinCEN's AML mission. Current SEC regulations do not impose an obligation on RIAs, or other members of the securities industry, to self-report to law enforcement suspected securities violations involving their investment activity or employee wrongdoing. If the proposed SAR filing requirement is interpreted by FinCEN and the SEC to require the filing of SARs in such circumstances, a *de facto* form of mandatory self-reporting will have been created, which would be a significant departure from industry practice.

b. Transaction Monitoring

MFA requests that FinCEN clarify that an RIA's transaction monitoring systems do not have to be automated. Employing automated systems would be costly and burdensome and, given the very limited number of investor transactions that take place, would not be necessary to achieve FinCEN's goals. Further, MFA respectfully requests clarification from FinCEN that there is no expectation that information obtained from an investor in furtherance of compliance with securities laws will be, or should be, incorporated into an RIA's transaction monitoring system. Moreover, we do not believe there should be an expectation that such information will be, or should be, used to determine whether a SAR should be filed. (See discussion in section 4.b above.)

[53] *Id*.

[54] *Id.*

c. SAR Confidentiality / SAR Sharing

The Proposed Rule does not permit RIAs to share SARs within their corporate organizational structures in the absence of further guidance.[55] We note that FinCEN has specifically asked for comments on whether RIAs should be permitted to share SARs within their corporate organizational structure in the same way that other financial institutions subject to AML program requirements, such as banks, broker-dealers, futures commission merchants, mutual funds, and introducing brokers, are permitted to share.[56]

We believe that RIAs should be permitted to share SARs and SAR-related information within their corporate organizational structure, in the same way that other financial institutions are permitted to share such information. As FinCEN has previously stated, the sharing of such information offers a number of benefits in connection with the administration of AML programs.[57] For example, some RIAs have affiliated investment advisers or broker-dealers who may have their own relationships with customers of the RIA, and it would be appropriate for the affiliated investment adviser or broker-dealer to be aware of a SAR filed by the RIA on such a customer so that it can either do a look-back on the customer's transactional activity or monitor the customer's transactions more closely going forward. Further, it obviously would be important for an RIA to be able to share SAR information with its parent company or other controlling entity (if it has one).

We also urge that FinCEN make clear that SAR information may be shared between an RIA and the directors and officers of the Funds managed by the RIA and the Funds' administrator. Pursuant to FinCEN guidance, mutual funds are permitted to share SAR filings and SAR information with the mutual fund's investment adviser and with third-party service providers such as transfer agents, and the same should be true with respect to RIAs.[58] It clearly would be important for the board of directors of a Fund managed by the RIA and the Fund's officers to be aware that a SAR has been filed on one of the Fund's investors. Indeed, the investor's contractual relationship is with the Fund, not with the RIA. Similarly, the administrator may be required to process future transactions for the investor in question and also clearly should be aware of the filing of a SAR. Of course, the adopting release should also make

[55] Proposed Rule, 80 Fed. Reg. at 52692.

[56] *Id*. at 52694.

[57] *See* FinCEN Press Release, FinCEN to Expand Financial Institutions' Ability to Share Information Internally on Suspicious Activity (Mar. 3, 2009), *available at* https://www.fincen.gov/news_room/nr/pdf/20090303.pdf ("FinCEN believes the proposed changes offer a number of benefits to industry: 1. The revised rules would help financial institutions better facilitate compliance with the applicable requirements of the BSA and more effectively implement enterprise-wide risk management. 2. SAR sharing also will help financial institutions assess risks based on information regarding suspicious transactions taking place through other affiliates or lines of business within their corporate organizational structures. 3. Enabling a filing institution to share the SAR with certain affiliates would eliminate the present need for a financial institution that wants to provide information to such an affiliate to create a separate summary document, which has to be crafted carefully to avoid revealing the existence of the SAR itself.").

[58] *See* FIN-2006-G013, Frequently Asked Questions Suspicious Activity Reporting Requirements for Mutual Funds (Oct. 4, 2006).

clear that the Fund's directors and officers and administrators would be subject to the obligation of SAR confidentiality, and receive the protection of the SAR safe harbor as well.

d. Delegation of SAR Filing Obligation

Under the Proposed Rule, RIAs are permitted to delegate their SAR filing obligations to agents or third-party service providers, which may or may not be affiliated with the investment adviser, and may or may not be "financial institutions" under the BSA, such as custodians, administrators, or transfer agents. Such delegation is consistent with the delegation offered to mutual funds to administer their own AML programs and SAR filing requirements.[59] MFA requests that FinCEN clarify that this delegation of the SAR filing requirements is permitted to an RIA's foreign agents or affiliates, such as an offshore administrator. As discussed above, administrators and service providers (including offshore administrators) play a key role in the administration of an RIA's AML controls. It is MFA's belief that in instances in which RIAs have entered into a relationship with an agent or third-party service provider, such entities may be in the best position to file SARs with FinCEN and complete comprehensive SAR narratives.

8. Application of Recordkeeping and Travel Rules

In our view, there is a question as to the utility of subjecting RIAs to the requirements of the BSA's Recordkeeping and Travel Rules. As a general rule, RIAs do not receive funds from, or send funds to, investors and do not hold investors' funds. Rather, investors transact with the Fund, through bank accounts held in the name of the Fund. Sometimes, the RIA will have signature authority over the Fund's account and receive the transmittal order relating to a transfer between the investor and the Fund, but in other instances the Fund's administrator will have signature authority over the account and receive the transmittal order. Moreover, as noted above, investor funds are rarely sent to third parties. To the extent investor funds are sent to a third party, the administrator typically will initiate instructions to the Fund's financial institution to wire funds to the recipient's financial institution. In any event, the investor's bank and the Fund's bank will be involved in the transfer and be subject to the requirements of the Recordkeeping and Travel Rules. It would appear that, even if this information could be easily collected, requiring RIAs separately to maintain this information and ensure that transmittal orders "travel" with the funds would largely result in duplication of efforts and provide little, if any, additional information useful to regulators. We

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[59] "Mutual funds typically conduct many operations through separate entities, which may or may not be affiliated persons of the mutual fund. These separate entities include investment advisers, principal underwriters, administrators, custodians, transfer agents, and other service providers. Personnel of these separate entities may be in the best position to perform the reporting obligation, and a mutual fund may contract with an affiliated or unaffiliated service provider to perform the reporting obligation as the fund's agent. In such cases, however, the mutual fund remains responsible for assuring compliance with the rule, and therefore must actively monitor the performance of its reporting obligations. The fund should take steps to assure that the service provider has implemented effective compliance policies and procedures administered by competent personnel, and should maintain an active working relationship with the service provider's compliance personnel." Amendment to the Bank Secrecy Act Regulations—Requirement That Mutual Funds Report Suspicious Transactions, 71 Fed. Reg. 26213, 26215-6 (May 4, 2006) (footnotes omitted.).

note there is already ample precedent for exempting an entity subject to the AML program requirements from the Recordkeeping and Travel Rules.[60]

Further, given that no CIP requirements are currently in effect for RIAs, it would seem inappropriate at this time to impose on RIAs the obligation to comply with the Recordkeeping and Travel Rules. Those Rules effectively require financial institutions processing transmittal orders over $3,000 to perform CIP on the customer; either the transmittal order will be from an "established customer" (whose identities will already have been verified when opening their account at the financial institution) or it will be from a person "other than an established customer" (in which case the financial institution is required to verify the customer's identity).[61] Because virtually all subscriptions and redemptions by a Fund's investors exceed $3,000, and are effectuated through funds transfers, if RIAs were subject to the Rules, they would effectively be required to verify the identities of all their customers, indirectly imposing a CIP obligation that the Proposed Rule explicitly does not impose, and before FinCEN has assessed the necessity of such a rule. (See discussion in section 11 below.)

If the Recordkeeping and Travel Rules are required for RIAs, FinCEN should, at a minimum, provide guidance on how to implement this rule with specific examples relevant to investor transactions in Funds. With respect to transactions relating to investors, FinCEN should give examples of what would be considered a transmittal order and provide guidance on whether the RIA, the Fund or the bank that holds the Fund's assets is the transmittor's financial institution (and which entities would be intermediary financial institutions). Without such guidance, it is not apparent how RIAs will implement this requirement as they do not accept or hold investor funds. Further, the Rules should not be applicable to the RIA's transactions through the Funds' bank accounts or prime brokerage accounts, as the banks and broker-dealers are already collecting that information.

9. CTR Filing Requirement

MFA endorses the requirement for RIAs to report currency transactions exceeding $10,000 on a currency transaction report ("CTR") instead of on the Form 8300. Because RIAs rarely receive currency from, or disburse currency to, investors, complying with the CTR filing requirement will not be materially different than complying with the Form 8300 requirement.

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[60] *See* FIN-2010-G004, Funds "Travel" Regulations: Questions & Answers (Nov. 9, 2010), *available at* https://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-g004.pdf (clarifying that Recordkeeping and Travel Rules are only applicable to those entities included within the definition of "financial institutions" under 31 C.F.R. § 1010.100(t)) and are not applicable to insurance companies, dealers in precious metals, precious stones, or jewels, operators of credit card systems, loan or finance companies, and housing government sponsored enterprises, all of which are subject to AML program rules).

[61] *See* 31 C.F.R. § 1010.410(e)(2). *See also* Amendment to the Bank Secrecy Act Regulations Relating to Recordkeeping for Funds Transfers and Transmittals of Funds by Financial Institutions, 60 Fed. Reg. 220, 222 (Jan. 3, 1995)("The final rule limits the verification requirements to originators/transmittors and beneficiaries/recipients that are not established customers. An established customer is defined as a person with an account with a financial institution or a person with respect to which the financial institution has obtained and maintains on file the name and address, as well as the customer's taxpayer identification number or, if none, alien identification number or passport number and country of issuance, and to which the financial institution provides financial services relying on that information.").

10. Section 314(a) and 314(b)

MFA also endorses the application of Section 314 of the USA PATRIOT Act to RIAs, which would enable RIA to share information with the government and with other financial institutions under a safe harbor from liability in order to identify better and report potential money laundering or terrorist activities. As noted above, administrators frequently implement AML procedures and controls on behalf of the Fund. As a result, these entities are best positioned to respond to Section 314 requests. Accordingly, MFA respectfully requests that FinCEN clarify that an RIA may send Section 314 requests to the Fund's administrator, even if that administrator is based in a foreign jurisdiction, assuming a confidentiality agreement is in place. Moreover, given that RIAs do not engage in transactions with investors, and that investors are not their clients, FinCEN should clarify what information would be requested of the RIA when FinCEN makes a Section 314(a) request. At present, Section 314(a) requests are focused on client information and funds transfers.

11. Application of Other BSA Requirements to RIAs

The Proposed Rule does not require RIAs to establish a CIP pursuant to Section 326 of the USA PATRIOT Act. However, the Proposed Rule poses the question whether RIAs should be required to comply with this rule, as well as with other FinCEN rules implementing the BSA, including the correspondent account rules of BSA Sections 311 and 312[62] and the rules implementing BSA Sections 313 and 319(b).[63] In our view, the extension of these rules to RIAs is premature given that the industry is diverse and FinCEN has yet to assess how the AML program rules will apply to RIAs and given the current industry practice among RIAs (as discussed herein). Moreover, FinCEN has not yet developed a factual basis for the need for implementing such rule.

Currently, not all of these rules presently apply to all financial institutions: Sections 326, 311 and 312 apply only to banks, broker-dealers, futures commission merchants or introducing brokers in commodities, and mutual funds; Sections 313 and 319 apply only to banks and broker-dealers.[64] Moreover, insurance companies and money services businesses are not subject to any of these rules. Given that not all financial institutions are subject to these requirements, and in light of the measures already undertaken by RIAs in the hedge fund industry, it is MFA's position that such requirements should not be imposed on RIAs.

With respect to Section 326 and the requirement to conduct customer identification and verification, MFA believes that the rules applicable to RIAs should mirror those applicable to insurance companies, as both entities are inefficient vehicles for money laundering. Although the rules applicable to insurance companies contemplate that certain customer information will be obtained by insurance companies to maintain an effective AML program and file SARs, to date insurance companies are not subject to a rule requiring them to implement a CIP and obtain minimum mandatory information verifying the identity of a

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[62] 31 C.F.R. §§ 1010.610, 1010.620 & 1010.651 – 655.

[63] *Id*. §§ 1010.630 & 1010.670.

[64] *See id*. §§ 1010.605(e) & 1010.605(f) (defining "covered financial institution").

customer.[65] Also, as discussed above, RIAs do not hold investor funds, which are kept at accounts maintained by the Funds at different financial institutions, including banks and broker-dealers, which are already subject to CIP. Transactions are conducted between the Fund and the investor, not between the RIA and the investor. Moreover, the RIA's client is the Fund. Accordingly, it is not clear how the definitions of "customer" and "account" in the various CIP rules would be applicable to RIAs.[66]

With respect to Sections 311 and 312, currently, as a matter of practice, RIAs who adhere to the MFA Sound Practices undertake appropriate due diligence efforts with respect to each prospective investor to ensure that prospective investors are permitted to invest in the Fund the adviser manages. Specifically, advisers, among other things, screen prospective investors to determine whether they are residents in, or organized or charted under the laws of, a jurisdiction warranting special measures due to money laundering concerns under Section 311 of the BSA; or are a prohibited foreign shell bank; or are senior foreign political figures. Additionally, advisers following MFA Sound Practices conduct enhanced due diligence on certain investors that the adviser determines to be "high risk."[67]

With respect to Sections 313 and 319, although RIAs following the MFA Sound Practices, as a matter of good practice, currently obtain representations from all investors that such investors are not foreign shell banks and do not directly or indirectly provide services to foreign shell banks (as discussed above), advisers do not obtain from investors certificates identifying ownership of the foreign bank or designating agents for service of process. Obtaining and maintaining such certificates would provide little, if any, additional information useful to regulators, as nearly all of these foreign banks have filed them with banks or broker-dealers, or have them on their website. Requiring RIAs to obtain this same information would be duplicative of requirements already imposed on banks and broker-dealers. As not all financial institutions (including mutual funds and FCMs) are subject to these rules, we believe that FinCEN should not expand them to include RIAs at this juncture.[68]

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[65] 31 U.S.C. § 5318(h); 31 C.F.R. §§ 1025.210 and 1025.320. *See* Anti-Money Laundering Programs for Insurance Companies, 70 Fed. Reg. 66754 (Nov. 3, 2005); FIN-2006-G010, Frequently Asked Questions Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Insurance Companies, Q. 2 (May 31, 2006), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/insurance_companies_faq.pdf.

[66] *See, e.g.*, 31 C.F.R. § 1020.100(a) and (c).

[67] The list of High Risk Investors includes: (a) investors not located in a FATF-member jurisdiction; (b) non-U.S. private investment companies; (c) a senior foreign political figure or politically exposed person; (d) any investor resident in, or organized or chartered under the laws of, a FATF non-cooperative jurisdiction; (e) any investor whose subscription funds originate from, or are routed through, an account maintained at a prohibited foreign shell bank, an offshore bank, a bank organized under the laws of a non-cooperative jurisdiction, or a bank or financial institution subject to special measure under Section 311 of the BSA; (f) any investor that is a foreign bank subject to enhanced due diligence under Section 312 of the BSA; or (g) any investor who gives the RIA reason to believe that the source of its subscription funds may not be legitimate. MFA's Sound Practices for Hedge Fund Managers 2009 (Chapter 6).

[68] It does not appear that FinCEN intends for the private banking provisions of Section 312 of the USA PATRIOT Act to cover RIAs. *See* 80 Fed. Reg. at 52694 (discussing only compliance with the correspondent account rules of Section 311 and 312 of the USA PATRIOT Act).

FinCEN has not indicated how it would apply Sections 326, 311, 312, 313 or 319 to RIAs. Accordingly, MFA requests FinCEN to provide clarity on how it would apply these rules to an RIA, and whether the existing definition of correspondent account used in these sections should be applied to RIAs.[69] Without knowing how FinCEN would apply these BSA Sections to RIAs, it is difficult to provide meaningful and adequate comment.

12. Delegation of Examination Authority to the SEC

The Proposed Rule delegates to the SEC examination authority over an RIA's compliance with the rule's requirements.[70] As FinCEN is aware, the FFIEC's BSA/AML examination manual, used in examinations of other financial institutions, is publicly available. In order for RIAs to best meet supervisory expectations, MFA urges FinCEN to require that the SEC publicly release a copy of its relevant AML examination manual as well.

13. 6-Month Applicability Date

FinCEN is proposing that RIAs must develop and implement an AML program that complies with the requirements of the Proposed Rule on or before six months from the effective date of the regulation.[71] Similarly, it states that the new SAR filing requirement applies to transactions initiated after the implementation of an AML program.[72] We believe that RIAs should be afforded more time to implement these requirements. After the final rule is issued, RIAs will need to assess the risks posed by their investors and adopt written AML policies, procedures and internal controls that satisfy the rule's requirements. For a great many RIAs, implementation of the new rule also will require updating systems and close coordination with other parties, including, in particular, Fund administrators. In addition, RIAs will have to designate an AML compliance officer and train relevant personnel on the final rule's requirements before they go into effect. Accordingly, we suggest that the proposed implementation date be extended to eighteen (18) months after issuance of the final rule.

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[69] 31 C.F.R. § 1010.605(c).

[70] Proposed Rule, 80 Fed. Reg. at 52684.

[71] *Id.* at 52690.

[72] *Id.* at 52692.

MFA appreciates the opportunity to provide comments on the Proposed Rule. We look forward to the continued dialogue to strengthen the regulatory structure surrounding investment advisers. We reiterate our offer to meet with FinCEN to discuss these issues. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Newell, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

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