

# Anti-Money Laundering Compliance for Investment Advisers – What You Can Do Right Now

## I. INTRODUCTION

Investment advisers in the United States today control approximately \$43.8 trillion in assets.<sup>1</sup> Advisers often have critical knowledge of the movement of large amounts of financial assets through U.S. and global financial markets. In some cases, the investment adviser may be the only person with access to the identity of the customer, the source of the invested assets and the customer's investment objectives.<sup>2</sup> As a result, investment advisers can have an important role to play in preventing the use of their services for money laundering and terrorist financing.<sup>3</sup>

Most investment advisers are not currently subject to affirmative anti-money laundering ("AML") requirements, but they may still have AML obligations stemming from counterparty expectations, broker-dealer or custodial bank requirements or customer requirements. The Financial Crimes Enforcement Network ("FinCEN") first raised the possibility of an AML compliance rule for investment advisers in 2003, when it issued a Notice of Proposed Rulemaking that would have required certain investment advisers to establish AML compliance programs.<sup>4</sup> FinCEN is the Department of the Treasury bureau responsible for the administration of the Bank Secrecy Act ("BSA"), the U.S. anti-money laundering compliance requirements. FinCEN withdrew the proposed rule in 2008. On November 15, 2011, James H. Freis Jr., the Director of the FinCEN, announced in a speech that FinCEN was working on a proposed rule requiring investment advisers to establish anti-money laundering compliance programs and file suspicious activity reports.<sup>5</sup> While Director Freis did not announce the specific provisions of the rule, there are steps that advisers can take to prepare.

## II. HOW WILL THE RULE LOOK?

Director Freis did not provide much detail on the rule that FinCEN is writing except to say there would be an AML compliance requirement and the requirement to file suspicious activity reports.<sup>6</sup> FinCEN strives to apply the same rules to all entities covered by the BSA. Based on the rule that was withdrawn, the rule for investment advisers would look a lot like

### CONTACT »

Ellen Zimiles  
646.227.4612  
ellen.zimiles@navigant.com

Alma Angotti  
202.481.8398  
alma.angotti@navigant.com

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1. See <http://www.nrs-inc.com/company/pdfs>

2. 68 Federal Register 68, No. 86 (May 5, 2003) at 23647.

3. *Id.*

4. *Id.*

5. Remarks of James H. Fries, Jr., American Bankers Association / American Bar Association Money Laundering Enforcement Conference. See [http://www.fincen.gov/news\\_room/speech/pdf/20111115.pdf](http://www.fincen.gov/news_room/speech/pdf/20111115.pdf)

all of the other AML program requirements under the BSA. The AML compliance program requirement is likely to rest on the same “Four Pillars” of compliance that apply to all financial institutions under the BSA:

#### **A. Policies, Procedures and Internal Controls<sup>7</sup>**

To set the appropriate “tone at the top” the BSA requires each financial institution to adopt written policies, procedures and internal controls that senior management must approve. Even without a formal customer identification requirement, the advisers will probably need to obtain all relevant customer-related information necessary for an effective anti-money laundering compliance program. In the adopting release for the recently finalized AML program rule for mortgage originators and lenders, who do not have a customer identification requirement, FinCEN reiterated its expectation that those entities would conduct significant customer due diligence to support a robust risk-based compliance program.<sup>8</sup>

#### **B. AML Compliance Officer**

FinCEN will likely require the adviser to designate an AML compliance officer responsible for ensuring that the program is implemented effectively, for monitoring compliance with the program and for arranging for appropriate training of personnel.

#### **C. Ongoing Training**

All financial institutions with AML program requirements must provide “on-going” training of appropriate persons about their responsibilities.

#### **D. Independent Test**

All AML compliance program rules require the financial institutions to conduct an independent test to monitor and

maintain an adequate compliance program.<sup>9</sup> The independent test is an institution’s “last line of defense” against abuse by criminals and money launderers in that a good test will detect weakness in the program before the criminals or the regulators do. The testing must also be risk-based, and a knowledgeable third party or any officer or employee of the institution independent from the designated AML compliance officer, may conduct the test.

### **III. WHAT YOU CAN DO TO PREPARE**

#### **A. Conduct a Risk Assessment**

The necessary foundation of any risk-based AML compliance program is a detailed knowledge of the money laundering, terrorist financing, and financial crime risk inherent in your business. Once you identify the particular risks of your business, you can design an appropriate AML program to mitigate that risk. In addition, you can better identify and mitigate gaps in your internal controls.<sup>10</sup> You should identify the specific risk categories applicable to your business: customer risk, products and services risk, transaction risk and geographic risk. Then when you design an AML compliance program, you can focus limited compliance resources on the parts of the business that present the most risk.

#### **B. Due Diligence**

There is, as yet, no specific requirement to conduct general customer due diligence (“CDD”) in the BSA.<sup>11</sup> FinCEN has stated that the cornerstone of a strong compliance program is the adoption and implementation of internal controls, which include comprehensive CDD policies, procedures, and processes for all customers, particularly those that present a

6. *Id.*

7. 31 CFR 1029.210 (a).

8. 77 Federal Register No. 30 (February 14, 2012).

9. 31 CFR 1029.210(b) (4).

10. FFEIC Bank Secrecy Act/Anti-Money Laundering Examination Manual (2010) at 22. While the FFEIC manual does not apply to advisers, it contains helpful guidance about how to identify and mitigate AML risk that can be applied to other financial services businesses.

11. On March 5, 2012, FinCEN issued an Advanced Notice of Proposed Rulemaking to announce that the agency is considering developing a Customer Due Diligence rule to cover banks, brokers or dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities with the possibility of extending the rule to other financial institutions in the future. 77 Federal Register No. 43 (March 5, 2012). FinCEN is also considering, as part of this effort to increase financial transparency, a categorical requirement for financial institutions to identify beneficial ownership of their accountholders, subject to risk-based verification. *Id.*



high risk for money laundering or terrorist financing.<sup>12</sup> Conducting appropriate CDD also assists an institution in identifying, detecting, and evaluating unusual or suspicious activity.

Now would be a good time to evaluate the customer information you already collect to make sure that you are obtaining sufficient information to understand the risk of your investors. If not, you should think about what additional information you would need to collect if FinCEN finalizes the Rule. You may also want to consider evaluating your customer base as a whole. You can review your existing customers and determine whether some of them present a heightened risk of money laundering and terrorist financing based on what you already know. If so, consider whether you will want to obtain additional due diligence information for those higher risk customers in the event that the rule is finalized.

In some instances, you will want to obtain information on the beneficial owners of the entity accounts or investors. FinCEN has stated that customers that have been identified by an institution's CDD procedures as posing a heightened risk should be subjected to enhanced due diligence ("EDD") that is reasonably designed to enable compliance with the requirements of the BSA. This may include steps to identify and verify beneficial owners to reasonably understand the sources and uses of funds in the account and the relationship between the customer and the beneficial owner.<sup>13</sup> FinCEN has identified certain trusts, corporate entities, shell entities, and personal investment companies ("PICs") as examples of customers that may pose heightened risk.<sup>14</sup>

In addition, FinCEN rules establish particular due diligence requirements concerning beneficial owners in the areas of private banking and foreign correspondent accounts.<sup>15</sup> Even if those particular rules do not apply to investment advisers, they are an indication of the types of accounts that the

regulators and law enforcement believe present a higher risk of money laundering and terrorist financing. So if you have private banking type customers or customers who are foreign financial institutions, the rules and guidance covering the due diligence analysis for banks and broker-dealers that have those kinds of accounts may be helpful.

### **C. Training**

Training your staff is an important step to ensure that your company is ready to implement AML compliance rules. The staff will need training on your program and their roles and responsibilities in its implementation. Your staff should have a good understanding of how "typical" customers behave. You may need to focus their awareness and make sure that they know what to do if they see something suspicious. Training the staff on the red flags they may see in the course of their duties, as well as your escalation procedures for identifying and reporting potentially suspicious activities, will be critical to the success of your program. Employees that will have specific AML responsibilities will require special training.

### **D. Independent Test**

One important step you could take now is to think about who will conduct your independent test. If your company is large enough to have an internal audit department, that may be a good choice. You may have to provide training to the internal auditors to ensure they have a working knowledge of the BSA so that the test is adequate. If you do not have an internal audit department, or choose not to use them for your test, you will need to determine whether to engage an outside auditor or another independent party in your company to conduct the test. There is no right answer, but it is imperative that the tester has both a working knowledge of the BSA and the risk of your business.

12. Joint Guidance on Obtaining and Retaining Beneficial Ownership Information, FIN-2010-G001 (March 5, 2010).

13. Joint Guidance on Obtaining and Retaining Beneficial Ownership Information FIN-2010-G001 (March 5, 2010).

14. *Id.*

15. *Id.*

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