INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

November 2, 2015

By Electronic Transmission

Jennifer Shasky Calvery
Director, Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, VA 22183

Re: Docket Number FinCEN 2014-0003;
RIN 1506-AB10

Dear Director Shasky Calvery:

The Investment Company Institute ("ICI")[1] appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Financial Crimes Enforcement Network ("FinCEN") regarding anti-money laundering ("AML") program and suspicious activity report ("SAR") filing requirements for certain investment advisers (the "NPRM").[2] ICI strongly supports FinCEN's efforts to protect the U.S. financial system from money laundering and terrorist financing activities, and broadly supports the objective outlined in the NRPM.

As discussed below, we believe the NRPM offers a unique opportunity for FinCEN to rationalize and harmonize the manner in which investment companies are subject to regulation under the Bank Secrecy Act ("BSA").[3] We also offer comments on several other elements of the NPRM, focusing on

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.1 trillion and serve more than 90 million U.S. shareholders.

[2] *Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Registered Investment Advisers*, 80 Fed. Reg. 52,680 (Sept. 1, 2015).

[3] 31 U.S.C. 5311 *et seq.*

those aspects of the proposed rules that impact investment companies registered with the U.S. Securities and Exchange Commission ("SEC").

I. FinCEN Should Take the Opportunity to Rationalize and Harmonize BSA Regulation of Investment Companies

FinCEN proposes to require each SEC-registered investment adviser ("RIA") to develop and implement an AML program reasonably designed to prevent the RIA from being used to facilitate money laundering or the financing of terrorist activities, and to achieve and monitor compliance with the applicable provisions of the BSA and FinCEN's implementing regulations thereunder.[4] An RIA's AML program would be required to assess the money laundering and terrorist financing risks posed by its clients, including the investment companies sponsored by the RIA.[5]

Most forms of investment company—notably hedge funds and other private funds not registered with the SEC—are not subject to separate BSA regulations. In the NPRM, FinCEN proposes to regulate these investment companies by subjecting them to the AML program of their RIA sponsor. Only SEC-registered open-end funds (*i.e.*, mutual funds) separately are required to comply with "the full panoply of FinCEN's rules implementing the BSA."[6]

We support FinCEN's proposal to regulate investment companies through an RIA's AML program. This approach recognizes that an investment company is a financial product sponsored by the RIA, and is appropriately covered by the RIA's AML program.

However, we do not believe there is any basis in law or policy to subject one particular type of investment company—mutual funds alone—to duplicative regulation under the BSA. Mutual funds do not pose greater money laundering or terrorist financing risks than other types of investment companies. Indeed, mutual funds arguably pose *less* risks than other types of investment companies, given that mutual funds (i) already are subject to comprehensive regulation by the SEC under the 1940 Act, register their shares with the SEC under the Securities Act of 1933, as amended, and (iii) sell their

[4] 31 C.F.R. 1031.210(a)(1) (proposed rule).

[5] In this letter, the term "investment company" includes those entities that meet the definition of "investment company" under the Investment Company Act of 1940, as amended ("1940 Act"), entities that would be investment companies under the 1940 Act but for the exceptions provided in certain sections of the 1940 Act, and certain other pooled investment vehicles that are not subject to the 1940 Act because they do not invest primarily in securities. This is the same definition used in a 2002 report to Congress discussing the appropriate regulation of investment companies under the BSA. *See* Report to Congress in Accordance with Section 356(c) of the USA PATRIOT Act (Dec. 31, 2002), at 10 ("2002 Investment Company Report").

[6] NPRM, 80 Fed. Reg. at 52,687.

shares principally through financial intermediaries that themselves are subject to BSA regulation.[7] A mutual fund should be regulated for AML purposes in the same manner as any other investment company sponsored by an RIA.

Accordingly, we request that FinCEN take this opportunity to rescind the separate BSA regulations applicable to mutual funds, and instead subject mutual funds to the same treatment as other forms of investment companies under an RIA's AML program.

This approach is grounded in the text of the BSA and is consistent with past statements from the federal financial regulators. The BSA authorizes FinCEN to regulate "an investment company," without reference to any particular type of fund.[8] With the adoption of the USA PATRIOT Act in 2001, Congress directed the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, and the SEC to report on "effective regulations" to apply the provisions of the BSA to both "investment companies" under the 1940 Act and to those entities that would be investment companies but for the exemptions in Sections 3(c)(1) and 3(c)(7) of the 1940 Act—the exemptions commonly relied upon by hedge funds and certain other private funds.[9] The resulting 2002 Investment Company Report recommended that BSA regulations apply to mutual funds, hedge funds and other types of "unregistered investment companies." The report noted that, of the different types of unregistered investment companies," hedge funds "may be the most susceptible to abuse by money launderers because of the liquidity of their interests and their structure."[10] It concluded by recommending that both mutual funds and unregistered investment companies be subject to comprehensive regulation under the BSA, including a requirement to implement an AML program and a customer identification program.[11]

We understand that FinCEN has spent a number of years considering how best to apply BSA regulations to unregistered investment companies, and we support the approach taken in the NRPM to regulate such investment companies through an RIA's AML program. However, we see no reason to subject mutual funds and unregistered investment companies to fundamentally different regulatory frameworks under the BSA.

---

[7] For additional information about the structure of mutual funds and the distribution of mutual fund shares through regulated intermediaries, *see* Letter from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute, to Jennifer Shasky Calvery, Director, Financial Crimes Enforcement Network, dated October 2, 2014, on FinCEN's customer due diligence rule proposal, available at www.ici.org/pdf/28441.pdf.

[8] 31 U.S.C. 5312(a)(2)(I).

[9] USA PATRIOT Act sec. 356(c).

[10] 2002 Investment Company Report at 23.

[11] *Id.* at 36.

Rescinding the BSA regulations applicable to mutual funds is appropriate for several reasons. First, it would not create any regulatory gaps. Under the 1940 Act, any investment adviser to a mutual fund must be an RIA. Accordingly, every mutual fund would remain subject to BSA regulation through the operation of the AML program of its RIA sponsor, similar to the treatment proposed for other investment companies sponsored by an RIA.

In addition, our proposal avoids duplicative regulation that would subject a mutual fund to BSA regulations directly, as well as through the operation of the AML program of its RIA sponsor. Requiring mutual funds to comply with two separate layers of regulation under the BSA is impractical, unnecessary, and wholly inconsistent with the approach proposed for other types of investment companies sponsored by an RIA.

Finally, our proposed approach avoids some arbitrary distinctions that currently exist in the BSA regulatory framework for investment companies. For example, FinCEN has stated that closed-end funds present lower money laundering risks because purchases and sales of their shares are executed through broker-dealers or banks subject to AML requirements, and their shares are typically traded on a public exchange.[12] However, certain closed-end funds permit investors to purchase and redeem shares directly. By contrast, exchange-traded funds ("ETFs"), whose shares trade on public exchanges, and do not permit non-institutional investors to transact directly with the fund, technically are subject to BSA regulation because they meet the BSA's definition of a "mutual fund." Rather than creating arbitrary distinctions between similar types of investment companies, our proposal would require an RIA to assess the money laundering and terrorist financing risks of each fund it sponsors based on the particular attributes of the fund. For example, we would expect an RIA's AML program to provide more scrutiny of a closed-end fund that periodically offers to purchase and redeem shares directly, and to regard as lower risk an ETF whose shares trade on a public exchange.

For all the reasons noted above, we recommend that FinCEN take this opportunity to rationalize and harmonize the BSA regulations applicable to investment companies by rescinding the BSA regulations applicable to mutual funds, and instead subject mutual funds to the same standards as other investment companies sponsored by an RIA.

II. Alternatively, FinCEN Should Exempt Mutual Funds From an RIA's AML Program

If FinCEN determines not to rescind the BSA regulations applicable to mutual funds, then FinCEN should exempt mutual funds from the scope of an RIA's AML program. In the NPRM, FinCEN notes that "[t]he BSA requirements to which mutual funds are subject may mitigate the money laundering

[12] NPRM, 80 Fed. Reg. at 52,687; *cf.* 2002 Investment Company Report at 15-16.

risks."[13] Nevertheless, FinCEN does not propose to allow an RIA to exclude mutual funds subject to BSA requirements from an RIA's AML program.

We believe the better approach is the one taken by FinCEN in 2003, when FinCEN first proposed AML program obligations for certain investment advisers.[14] The 2003 Advisers Proposal would have allowed advisers "to exclude from their [AML] programs any investment vehicle they advise that is subject to an [AML] program requirement under BSA rules."[15] FinCEN observed then that such an exclusion would "prevent overlap and redundancy."

For the same reasons, we believe an RIA should be allowed to exclude from its AML program advisory services provided to BSA-regulated mutual funds. Because they already are subject to BSA regulation, an exclusion is consistent with the stated purpose of the NPRM, which is to "regulate investment advisers that may be at risk for attempts by money launderers or terrorist financiers seeking access to the U.S. financial system *through a financial institution type not required to maintain AML programs or file [SARs].*"[16]

III. FinCEN Should Exempt Sub-Advisory Services from an RIA's AML Program

The NRPM would require an RIA providing sub-advisory services "to address these services in its AML program and to monitor such services for potentially suspicious activity."[17]

When an RIA acts as sub-adviser, it has limited or no access to information about the primary adviser's underlying clients. Accordingly, as a practical matter, an RIA acting as sub-adviser will not be in a position to apply most aspects of its AML program to the sub-advisory relationship, and generally will be unable to monitor the relationship for suspicious activity.

We request that FinCEN permit an RIA to exclude its services as sub-adviser from the RIA's AML program in cases where the primary adviser also is an RIA subject to AML program requirements. This approach is consistent with a risk-based approach and avoids duplication of regulatory responsibilities, since the primary adviser with direct access to the advisory client itself is subject to AML program and SAR-reporting requirements. Like the exclusion we request for mutual funds above, this exclusion also is consistent with the stated purpose of the NPRM—to regulate RIAs that "may be at risk for money launderers and terrorist financiers seeking access to the U.S. financial system through a financial

---

[13] NPRM, 80 Fed. Reg. at 52,687.

[14] *Anti-Money Laundering Programs for Investment Advisers*, 68 Fed. Reg. 23,652 (May 5, 2003) ("2003 Advisers Proposal").

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

[16] NPRM, 80 Fed. Reg. at 52,680 (emphasis added).

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

institution type not required to maintain AML programs or file [SARs]."

If FinCEN is unwilling to allow the requested exclusion, we alternatively request confirmation that an RIA acting as sub-adviser is expected to apply its AML program only to the limited information available to it as sub-adviser, and is not expected to "look through" to the primary adviser's relationship with its advisory client. We note that, in the context of wrap fee programs sponsored by unaffiliated broker-dealers, the NPRM acknowledges that an RIA "may have more limited access to investor information and transactions," and suggests that an AML program could take into account this more limited information.[18] Similarly, FinCEN should confirm that an RIA acting as sub-adviser has limited access to investor information and transactions, and thus may take into account this more limited role in the context of its AML program.

IV. RIAs May Be Unable to "Look Through" to Investors in Funds

In the context of unregistered investment companies, the NRPM sets forth an expectation that an RIA assess the AML risks of not only its investment company clients, but of any investors in such investment company clients. Specifically, the NPRM states that an RIA must consider "risks presented *by the investors* in such investment vehicles by considering the same types of relevant factors, as appropriate, as the [RIA] would consider for clients for whom the [RIA] manages assets directly."[19] Indeed, the NPRM states that "[i]f any of the investors in the private fund or other unregistered pooled investment vehicle for which the investment adviser is acting as the primary adviser are themselves private funds or some other type of unregistered pooled investment vehicles . . . the investment adviser will need to assess the money laundering or terrorist financing risks associated with these investing pooled entities."[20] These proposals are based on FinCEN's understanding that an RIA "should have access to information about the identities and transactions of the underlying or individual investors."[21]

The NPRM raises the expectation to "look through" to investors solely in the context of unregistered investment companies, and not in the context of SEC-registered funds. We request confirmation that FinCEN would *not* expect an RIA to an SEC-registered investment company to "look through" to investors in the registered funds it advises. An RIA to an SEC-registered fund generally does not have access to information about fund investors, particularly given the highly intermediated nature of the registered fund business.[22]

---

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

[19] *Id.* at 52,688 (emphasis added).

[20] *Id.*

[21] *Id.*

[22] *See supra*, note 7.

In addition, we request clarification about the circumstances under which an RIA would be expected to "look through" to investors in investment companies not registered with the SEC. While an RIA to a closely-held private fund may have access to some information about fund investors, it is unreasonable to expect RIAs to have access to information about fund investors in all cases. As an example, a public fund registered under the UCITS regime in the European Union is not registered with the SEC, but an RIA to such fund generally would not have access to information about investors in those public funds. In fact, privacy laws and other local requirements may prevent an RIA from conducting these assessments and pose challenges to obtain information about investors in funds organized under foreign law.

V. The Rules Should Not Extend to Non-U.S. RIAs

Because of its bright-line definition of "investment adviser," FinCEN's proposal would extend AML program and SAR-reporting requirements to RIAs located outside the United States. This action conflicts with the well-recognized jurisdictional limitations of the BSA. When Congress passed the BSA in 1970, it intended to apply BSA requirements only to those financial institutions within the United States. The Department of Treasury historically has embraced this view. For example, in a 1987 report, Treasury noted that the BSA's requirements "do not apply to foreign branches of United States financial institutions or to any other type of financial institution physically located outside of the United States."[23] Moreover, for other financial institutions, FinCEN specifically has limited the application of BSA rules to entities located within the United States. For example, the AML program and SAR filing requirements for broker-dealers apply only to broker-dealers within the United States.[24] Finally, the proposal's reach is inconsistent with the 2003 Advisers Proposal, which proposed to extend AML program obligations only to those advisers "whose principal office and place of business is located in the United States."[25]

Extending BSA-regulation to non-U.S. RIAs will present significant challenges for these firms, because an RIA's obligations under the BSA may not be consistent with local privacy rules and other requirements. For example, local law may restrict the ability of a non-U.S. RIA to report suspicious activity to FinCEN. We urge FinCEN to reconsider this approach and instead apply the final rules only to RIAs in the United States.

---

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

[24] *See, e.g.*, 31 C.F.R. § 1023.320 (applying the SAR filing requirement to "[e]very broker or dealer in securities ***within the United States***....") (emphasis added).

[25] 2003 Advisers Proposal, 68 Fed. Reg. at 23652.

VI. RIAs Should Have Broader Latitude to Share SAR-Related Information

The NPRM does not authorize an RIA to share SARs, or information that would reveal the existence of a SAR (collectively, "SAR-related information"), within the RIA's corporate organizational structure. We urge FinCEN to allow RIAs to rely on existing guidance that permits banks, broker-dealers, mutual funds, futures commission merchants, and introducing brokers in commodities to share SAR-related information within their corporate organizations, subject to certain specified limitations ("SAR-Sharing Guidance").[26]

Limiting an RIA's ability to share SAR-related information within its corporate organizational structure serves no purpose, and conflicts with existing FinCEN guidance. RIAs often are part of a diversified financial services organization that includes broker-dealers, banks, mutual funds, and other regulated entities that already are permitted to share SAR-related information under the SAR-Sharing Guidance. If an RIA is treated differently from these other entities, it will lead to confusion about compliance obligations, and will fundamentally impede the ability of diversified financial services firms to develop enterprise-wide BSA compliance programs.

We note that when FinCEN issued the SAR-Sharing Guidance in 2010, it specifically limited application of the guidance to those financial institutions with a federal functional regulator. Because all RIAs, by definition, are registered with the SEC and subject to SEC oversight, RIAs should be afforded the same treatment as other federally regulated financial institutions.

Moreover, FinCEN already has allowed RIAs to share SAR-related information regarding its mutual fund clients within an RIA's corporate organizational structure. In 2006, FinCEN issued guidance confirming that a mutual fund may share SAR-related information "with the investment adviser that controls the fund, whether domestic or foreign…"[27] FinCEN further stated that "[i]n the event that the corporate structure of an investment adviser includes multiple parent companies, the filing institution's [SAR] may be shared with each entity in the chain of control." We see no reason why an RIA should be allowed to share SAR-related information about its mutual fund clients within the RIA's corporate organization, and not be allowed to share SAR-related information regarding other advisory clients within the RIA's corporate organization.

For all these reasons, we strongly encourage FinCEN to allow RIAs to rely on the SAR-Sharing Guidance.

---

[26] *See Sharing Suspicious Activity Reports by Securities Broker-Dealers, Mutual Funds, Futures Commission Merchants, and Introducing Brokers in Commodities with Certain U.S. Affiliates*, FIN–2010–G005 (Nov. 23, 2010).

[27] *See Frequently Asked Questions: Suspicious Activity Reporting Requirements for Mutual Funds*, FIN-2006-G013 (Oct. 4, 2006), available at www.fincen.gov/statutes_regs/guidance/pdf/guidance_faqs_sar_10042006.pdf.

VII. Other Specific Comments

We offer the following additional comments on the NPRM:

- ***Risk-Rating Individual Customer Relationships.*** The NPRM implies that RIAs "would need to analyze the money laundering and terrorist financing risks posed by a particular client" and suggests factors that RIAs should take into account on a client-by-client basis.[28] We note that financial institutions currently are not required to "risk rate" individual customer relationships, and urge FinCEN to address these expectations through its pending customer due diligence rulemaking rather in an AML program rule for RIAs.[29]

- ***Application of Other BSA Rules.*** The NPRM notes that some RIAs may be subject to BSA obligations under existing law, either because they also are registered as broker-dealers, or because they are affiliated with banks. The NPRM states that FinCEN would not object if an RIA that also is registered as a broker-dealer applies only the more limited BSA requirements applicable to RIAs to its advisory activities.[30] In addition, the NPRM states that "FinCEN would not expect a bank, which is subject to the full panoply of FinCEN's regulations implementing the BSA that is affiliated with or owns an investment adviser to design an enterprise-wide AML compliance program that would subject the [bank-affiliated] investment adviser to BSA requirements that would not be required by the rules FinCEN is proposing today."[31] We request confirmation that an RIA that is dually-registered as a broker-dealer, or is affiliated with a bank, is expected to comply only with the BSA rules applicable to RIAs with respect to its investment advisory activities. We further request confirmation that this position is shared by the Financial Industry Regulatory Authority and the federal banking agencies.

- ***Application to Employees Securities Companies***. An RIA should not be subject to the proposed AML requirements when providing advisory services to employees' securities companies ("ESCs"). ESCs are established pursuant to Section 2(a)(13) of the 1940 Act, and are intended to benefit, reward, and retain employees of a company. In the 2002 proposal to extend AML program requirements to unregistered investment companies, FinCEN proposed to exempt ESCs because they are not likely to be used for money laundering purposes by third parties given their size, structure, and purpose.[32] For the

---

[28] NRPM, 80 Fed. Reg. at 52,687.

[29] *See Customer Due Diligence Requirements for Financial Institutions*, 79 Fed. Reg. 45,151 (Aug. 4, 2014).

[30] NPRM, 80 Fed. Reg. at 52,688 n.69.

[31] *Id.*

[32] *Anti-Money Laundering Programs for Unregistered Investment Companies*, 67 Fed. Reg. 60,617, 60,620 (Sept. 26, 2002).

reasons cited by FinCEN in 2002, and due to the lack of money laundering risk posed to investment advisers by managing ESCs, we request that FinCEN exclude from the final rules those advisory services that RIAs provide to ESCs.

VIII. Compliance Date

FinCEN proposes for the AML program requirement to take effect six months after the effective date of final rules, and that the requirement to file SARs apply to transactions initiated after implementation of the AML program. For the reasons noted above, we believe that RIAs will need additional time to develop the systems necessary to implement an AML program, monitor suspicious activity, and file SARs. Accordingly, we request that FinCEN allow RIAs 18 months to comply with the final rules.

▪ ▪ ▪ ▪ ▪

We appreciate the opportunity to express our views on the NPRM. If you have any questions, please contact me at (202) 326-5815 or Matthew Thornton at (202) 371-5406.

Sincerely,

/s/ David Blass
General Counsel

cc: David W. Grim
Director, Division of Investment Management
U.S. Securities and Exchange Commission