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Implications of FinCEN's proposed rule implementing AML program and suspicious activity reporting requirements for Non-US investment advisers

On August 25, 2015, the Financial Crimes Enforcement Network (FinCEN) issued a notice of proposed rulemaking (the Proposed Rule) which would require investment advisers that are registered (or required to be registered) with the US Securities and Exchange Commission (SEC) (hereinafter, RIAs) to establish an anti-money laundering (AML) program and file suspicious activity reports (SARs) in response to certain indications of illegal activity observed by the adviser.

The Proposed Rule would also bring RIAs within the definition of a 'financial institution' under the Bank Secrecy Act. This would require RIAs to, among other things, file Currency Transaction Reports (CTRs) for transactions over certain monetary thresholds, and maintain records regarding the transmittal of funds. FinCEN intends to delegate examination authority for compliance with the Proposed Rule to the SEC.

History of the Proposed Rule

FinCEN first proposed applying AML and related requirements to registered and unregistered investment advisers in 2002 and 2003. Heavy opposition resulted in neither proposal being finalized. FinCEN withdrew both proposals in October 2008, noting, among other things, that it needed to take a 'fresh look' at the proposals given the passage of time. FinCEN also stated in the withdrawal notice that most transactions related to an adviser's business flowed through financial institutions that already were required to comply with the AML, SAR, and CTR requirements.

Implications of the Proposed Rule for Non-US Investment Advisers

Under the Proposed Rule, AML, SAR, and CTR requirements would directly apply to most RIAs. The following types of investment advisers would be explicitly covered: (i) dually-registered investment advisers and advisers that are affiliated with or subsidiaries of entities already required to establish AML programs; (ii) investment advisers to registered investment companies; (iii) financial planners;(iv) pension consultants; (v) entities that provide only securities and/or research reports; and (vi) certain advisers to public or private real estate funds.

The AML, SAR, and CTR requirements would also apply to certain foreign RIAs. The broad scope of the Proposed Rule may create numerous regulatory issues for non-US advisers in other jurisdictions. For example:

- Non-US RIAs who are subject to AML, SAR, CTR, or similar requirements in non-US jurisdictions would have to comply with the US requirements too[1]. Such advisers will have to analyze their existing compliance programs, identify and address any gaps between their existing protocols and the Proposed Rule's requirements, and determine how to deal with any US requirements that directly conflict with the requirements in other jurisdictions.
- Non-US advisers would have to collect sufficient information from clients and prospective clients to conduct US-compliant AML reviews. This may require primary advisers and even sub-advisers to US- and non-US private funds to perform AML assessments of each investor in the funds they advise. Client information would have to be stored in the non-US adviser's books and records and be provided to FinCEN and the SEC upon request. This may create privacy or other local regulatory issues for non-US advisers in local jurisdictions.
- Non-US RIAs would have an affirmative obligation to report suspicious transactions: (i) that are conducted or attempted by, at, or through the adviser and involve or aggregate at least $5,000 in funds or other assets; and (ii) that the adviser knows, suspects, or has reason to suspect, involve the use of the investment adviser to facilitate criminal activity. SARs must provide detailed information about suspicious activity, which may include: (i) the full name, address, government identification number, and IP address of suspected perpetrators; (ii) the identities of victims; (iii) the type of business involved and any business address; (iv) the relationship of the suspect to the institution; and (v) a detailed description of the suspicious activity that prompted a filing. SARs must also be filed for a wide range of incidents including fraud, terrorist financing, money laundering, account takeovers, embezzlement, identity theft, excessive insurance, market manipulation, and insider trading. Thus, the SAR requirements are likely to raise privacy and other confidentiality concerns for non-US RIAs, their clients, and their investors.

The Proposed Rule's AML, SAR, and CTR requirements would not apply to non-US advisers that are exempt from SEC registration, including non-US advisers that qualify as 'Exempt Reporting Advisers' or 'ERAs'. ERAs include private fund advisers with a principal office and place of business outside the United States that manage less than US$150 million in assets from a place of business within the United States. The decision to exclude ERAs from the Proposed Rule will lessen its impact on many non-US advisers. That said, FinCEN reserves the right to extend AML, SAR, and CTR requirements to ERAs in the final rule or at a later date. Non-US ERAs should closely monitor the Proposed Rule's development - particularly if they are located near, or do business with clients in, jurisdictions deemed high risk by US authorities.

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1 The implications of such an environment will become particularly difficult if FinCEN decides to impose arduous customer identification program (CIP) requirements on non-US advisers similar to the CIP programs required of other US financial institutions. The Proposed Rule does not impose a CIP program requirement on RIAs, but FinCEN explicitly reserves the right to do so in the future

Authors

Megan Gordon
Partner
T: +1 202 912 5021
E: megan.gordon
@cliffordchance.com

Steven Gatti
Partner
T: +1 202 912 5095
E: steven.gatti
@cliffordchance.com

Clifford Cone
Partner
T: +1 21 878 3180
E: clifford.cone
@cliffordchance.com

David Adams
Associate
T: +1 202 912 5067
E: davidg.adams
@cliffordchance.com

Jeff LeMaster
Associate
T: +1 212 878 3206
E: jefferey.lemaster
@cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

www.cliffordchance.com