

## Regulatory Affairs

# What's Up With Anti-Money Laundering?

In the aftermath of September 11, 2001, President Bush issued Executive Order 13224 prohibiting transactions with those involved in terrorist financing, which broadened existing rules and regulations enforced by the U.S. Treasury Department's Office of Foreign Assets Control (OFAC). The President also signed into law the USA PATRIOT Act of 2001, which made a number of amendments to the anti-money laundering (AML) provisions of the Bank Secrecy Act.

As one would expect, the amendments were designed to promote the prevention, detection, and prosecution of money laundering and the financing of terrorism. The Act also gave the Treasury Department, the SEC, and other federal agencies broad authority to issue regulations under the Act. In May 2003, the Treasury Department issued a proposed regulation that, if adopted, will require certain investment advisors to establish AML programs. However, in the intervening four years, little movement towards adopting the proposed rule has occurred.

In the absence of a final AML program rule, registered investment advisors often wonder where they fit into the U.S. regulatory framework for AML. This article discusses existing AML requirements with which investment advisors must comply and suggests a number of additional steps that advisors should consider taking.

### What investment advisors must do now

It is a common misperception that because advisors are not currently subject to regulations implementing the AML provisions of the Act, they are exempt from compliance with federal regulations that require the creation or maintenance of procedures to detect and deter money laundering or terrorist financing. To the contrary, advisors have been directly subject to certain federal AML requirements for quite some time.

For advisors that manage client assets, OFAC compliance involves two separate categories of reviews: the "client onboarding" process and the selection of new investments. Before entering into a new advisory relationship with a client or making a decision to invest in a new security, and on a periodic basis thereafter, advisors must screen relevant information against the Specially Designated Nationals and Blocked Persons List and List of Sanctioned Countries (OFAC Lists) in order to prevent an OFAC violation. In the case of a new advisory relationship, advisors should screen identifying information regarding the named client as well as its beneficial owners; whereas in the case of proposed investments in new securities, advisors should screen identifying information regarding the issuer of the securities, and for investments in funds, hedge funds, futures and derivatives, identifying information regarding their underlying investments. The Lists are available at <http://www.ustreas.gov/offices/enforcement/lists>.

If the advisor's screening process results in an OFAC match, it should consider performing additional due diligence to determine whether the OFAC match might be a false positive. However, if this reveals a true OFAC match, the advisor must reject the transaction and/or block the investor's assets, and file a Report of Blocked Transactions and/or a Report of Rejected Transactions with OFAC within 10 days of the requested transaction. A comprehensive report of all blocked assets must be filed with OFAC by September 30 of each year.

Although not specified by regulation, OFAC recommends that

entities within the securities industry establish an OFAC compliance program. The advisor should assess the risks presented by its customer base, nature of its business activities or services, and geographical locations in which it operates. The OFAC compliance program should then be developed taking into account the advisor's risk-weighted profile and should be supervised by a designated OFAC compliance officer. OFAC has indicated that where an entity uses a third party to perform OFAC checks on its behalf, the entity retains ultimate responsibility for the performance of those functions.

In addition, various provisions of the Bank Secrecy Act and the Internal Revenue Code require the reporting of certain transfers or transactions in currency or monetary instruments by all U.S. persons. In particular, advisors are required to file Form 8300 with the Internal Revenue Service to report the receipt of more than \$10,000 in cash received in one transaction or two or more related transactions. Further, the Bank Secrecy Act requires all persons, including advisors, to report to the Commissioner of Customs the transportation of currency and monetary instruments of more than \$10,000 into or outside of the U.S., or such smaller amounts structured to avoid the reporting threshold, on Form CMIR.

### Proposed AML requirements

The proposed rule issued by the Treasury Department, which is an amendment to the Bank Secrecy Act §103.150, would require two categories of advisors to establish an AML program. The first category includes U.S. investment advisors registered with the SEC that manage assets, while the second category includes investment advisors that manage assets but are exempt from SEC registration because they have 15 or fewer clients. These advisors would be required to have in place an AML program that includes, at a minimum, the following four elements: (i) the development of internal policies, procedures, and controls; (ii) the designation of an AML compliance officer; (iii) an ongoing employee training program; and (iv) an independent testing function to review the adequacy and effectiveness of the AML program.

As noted above, the proposed rule has not yet been adopted, but recent experience suggests that a rule with these four elements will be formalized. Accordingly, because such advisors will only have 90 days to comply with the new rule, we suggest that advisors consider establishing policies and procedures to comply with the proposed rule.

This decision would, among other factors, take into account the extent to which financial institutions with which the advisor transacts business require letters of representation that the advisor has in place an AML program consistent with the requirements of the USA PATRIOT Act as well as the SEC's no-action letter to the Securities Industry Association. Moreover, the policies and procedures required by the proposed rule simply make good business sense as a risk-mitigation tool and represent the best practices within the industry. **TDA**

This summary was adapted from an article by Beth Kiesewetter, an associate in the Washington, D.C. office of Morgan, Lewis & Bockius LLP. She may be reached at 202-739-5127 or [bkiesewetter@morganlewis.com](mailto:bkiesewetter@morganlewis.com). This summary is provided as a general informational service and it should not be construed as imparting legal advice on any specific matter. Morgan, Lewis & Bockius is not affiliated with TD AMERITRADE and the views expressed herein are its own.

Copyright 2007 Morgan, Lewis & Bockius LLP. All Rights Reserved.