

THE
LONG
VIEW

ADIL RAZA

What US hedge funds need to know about the new AML rule



“ALTHOUGH MORE THAN A YEAR HAS PASSED SINCE THE COMMENT PERIOD ON THE RULE ENDED, RIAs SHOULD TAKE SEVERAL STEPS TO ENSURE THEY ARE PREPARED TO IMPLEMENT ITS COMPONENTS”

Registered investment advisers (RIAs) have been awaiting the finalisation of the proposed anti-money laundering (AML) rule since it was proposed in August 2015.

The rule, if finalised, would require RIAs to establish AML programmes and report suspicious activity to the Treasury Department’s financial crimes enforcement network (FinCEN) under the Bank Secrecy Act (BSA).

Although more than a year has passed since the comment period on the rule ended, RIAs should take several steps to ensure they are prepared to implement its components should it be finalised.

The proposed rule covers investment advisers – primary and sub-advisers – that are registered or required to be registered with the SEC under section 203 of the 1940 Investment Advisers Act and in the SEC’s implementing regulations. Under the proposed rule, RIAs would be brought into the definition of “financial institution” as defined in regulations implementing the BSA.

The major requirements of the proposed rule, which will be enforced by the SEC, include: the establishment of an AML program; a requirement to report suspicious activity to FinCEN; participation in special information sharing processes under the USA Patriot Act; and record-keeping and reporting processes, including currency transaction reporting (CTR) and travel

rule requirements.

An effective AML programme would typically consist of four pillars: written policies, procedures and internal controls; independent testing for compliance by company personnel or by a qualified outside party; a designated compliance officer responsible for implementing and monitoring the programme’s operations and internal controls; and ongoing training for appropriate persons.

SUSPICIOUS ACTIVITY REPORTING

Managers will have an obligation to report suspicious transactions conducted or attempted by, at or through an investment adviser within 30 days of determining the activity is considered suspicious.

Activity is considered suspicious when the adviser knows, suspects or has reason to suspect that the transaction (or a pattern or transactions of which the transaction is a part):

- Involve funds derived from illegal activity or is intended or conducted to hide or disguise funds or assets derived from illegal activity;
- Is designed, whether through structuring or other means, to evade the requirements of the BSA;
- Has no business or apparent lawful purpose, and the investment adviser knows of no reasonable explanation for the transaction after

examining the available facts; and,

- Involves the use of the investment adviser to facilitate criminal activity.
- The proposed rule would also subject RIAs to the information sharing requirements under sections 314(a) and 314(b) of the USA Patriot Act.

RECORD-KEEPING AND REPORTING OBLIGATIONS

The proposed rule will subject RIAs to the general reporting and record-keeping requirements of the BSA, which include currency transaction reporting and travel rule requirements.

The proposal calls for the implementation of the requirements by RIAs within six months of issuing the final rule. Managers can take several steps to ensure they are ready:

- Designate an AML officer and conduct a staffing assessment to ensure sufficient AML resources;
- Develop and conduct an AML risk assessment which considers investor base profiles, involvement of third parties, jurisdictions of residence and organisation, applicable regulatory and statutory regimes and types of corporate entities;
- Identify risks and start thinking about what policies and controls would be required to mitigate the risks;
- Determine if existing policies or procedures can be adapted;
- Conduct a gap assessment against the BSA requirements to identify necessary changes;
- Develop an AML programme, policies and procedures and engage in independent testing to ensure readiness;
- Think about training requirements, both general and targeted AML training;
- Determine if current systems can be adopted or if specialist monitoring and “know your customer systems” may be necessary;
- Assess books and records to determine if you will be able to comply with the record keeping, travel rule and information sharing requirements. ■

ADIL RAZA is a senior manager in BDO’s Financial Services Advisory practice