PRIVATE EQUITY GROWTH CAPITAL COUNCIL

Submitted via **web: http://www.regulations.gov**

November 2, 2015

Ms. Jennifer Shasky Calvery
Director
FinCEN
P.O. Box 39
Vienna, VA 22183

Re: ANTI-MONEY LAUNDERING PROGRAM AND SUSPICIOUS ACTIVITY REPORTING REQUIREMENTS FOR REGISTERED INVESTMENT ADVISERS, RIN 1506-AB10, 80 FED. REG. 52680 (SEPT. 1, 2015)

Dear Director Calvery:

The Private Equity Growth Capital Council ("PEGCC") appreciates the opportunity to provide comments to the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") on the notice of proposed rulemaking, "Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Registered Investment Advisers" (the "Proposed AML Rules").[1]

The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.

The PEGCC supports FinCEN's efforts to safeguard the U.S. financial system from illicit use and to combat money laundering and terrorist financing. Our comments focus on questions posed by FinCEN related to the appropriateness of making the Proposed AML Rules applicable to certain classes of investment advisers. As discussed further below, we believe that, as FinCEN has recognized in the past, pooled investment vehicles that do not offer investors an opportunity to redeem their interests present negligible risks of money laundering. For this reason, we believe FinCEN should exempt

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1 80 Fed. Reg. 52680 (Sept. 1, 2015).

those vehicles, which include private equity funds, and advisers that exclusively provide advisory and other services to such vehicles, from the scope of any final anti-money laundering ("AML") requirements. Doing so would accord with the approach FinCEN has taken in the past and allow both supervisors and advisers to focus their efforts on those areas that present real risks of money laundering and terrorist financing.

We would welcome further opportunities to assist FinCEN in its consideration of the appropriate treatment of the low-risk advisory activities of the private equity and growth capital industry.

I. Private Equity Funds Are Poor Vehicles for Money Laundering and Terrorist Financing and, Consequently, Such Funds and the Investment Advisers that Manage Such Funds Should Be Excluded from the Final Rules.

In 2002 and 2003, FinCEN first proposed AML requirements for, respectively, certain unregistered funds and investment advisers. At that time, FinCEN deliberately chose to exclude from the scope of its proposed AML requirements those funds that did not offer their investors the right to redeem any portion of their ownership interests within two years after those interests were acquired. FinCEN did so because it recognized that "[t]hese type of illiquid [investment] companies are not likely to be used by money launderers."[2] FinCEN explained further that these funds "lack the liquidity that makes certain financial institutions attractive to money launderers in the first place." Id.

By FinCEN's calculation in 2002, the exclusion of private funds with lengthy lock-up periods was justified on a cost-benefit basis:

> [a]n overly expansive definition of 'unregistered investment company' [to include low-risk private funds] would unnecessarily burden businesses not likely to be used to launder money. Moreover, it would bring within the scope of the BSA's anti-money laundering requirements so many entities as to tax resources of the federal regulatory agencies charged with oversight of the financial institutions, diminishing the effectiveness of that oversight.[3]

FinCEN's current proposal, however, does not contain a similar exclusion for advisers to funds – such as private equity funds – that impose extended lock-up periods; rather, FinCEN proposes to cover all SEC-registered investment advisers (even those that provide advice exclusively to funds with such lock-up periods). The PEGCC knows of

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2 67 Fed. Reg. 60617, 60619 (Sept. 26, 2002).

3 Id. at 60618.

no facts or circumstances that would change FinCEN's prior analysis, and FinCEN has not cited any rationale or presented a different cost-benefit calculus to support its changed approach in the Proposed AML Rules. In fact, FinCEN has implicitly acknowledged its earlier conclusions by noting in the current rulemaking that certain private funds "present lower risks for money laundering or terrorist financing."[4] We firmly believe FinCEN was correct in its earlier determination that the money laundering risks presented by funds that restrict investors' redemption rights are so low that imposing the significant costs of managing a mandatory AML program for these types of funds is not warranted.

To this end, the PEGCC notes that Executive Orders 13563 and 12866, which FinCEN cites in its rulemaking proposal, require regulatory agencies to "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs."[5] FinCEN has not made a sufficient showing in seeking to impose AML compliance burdens on advisers to low-risk private funds, like private equity funds. FinCEN's earlier assessment that such funds pose a low money laundering risk counsels for excluding such funds from AML rules on a cost-benefit basis.

In its current rulemaking, FinCEN inquires as to whether there are "classes of investment advisers included in the definition of investment adviser that are not at risk, or present a very low risk for money laundering, terrorist financing, or other illicit activity such that they could be excluded from the definition."[6] For all the reasons that FinCEN cited in the past, the PEGCC considers it appropriate for FinCEN to exclude certain funds from investment adviser AML program requirements. In particular, the final rules should exclude any investment fund that, in the ordinary course, restricts its investors from redeeming any portion of their ownership interests in the fund within two years after that interest was initially purchased (a standard that would be in line with FinCEN's previous proposal).[7] In addition, an investment adviser that advises only such funds should not be required to adopt an AML program. There would be no benefit to imposing AML compliance costs on an investment adviser whose only investment advisory activities have been deemed to present such a low risk from a money laundering or terrorist financing perspective. Advisers that advise such funds as well other vehicles and accounts should be permitted to exclude low-risk private funds from their AML program

[4] 80 Fed. Reg. at 52688.

[5] 80 Fed. Reg. at 52694; Executive Order 12866 § 1(b)(1), 76 Fed. Reg. 3821 (Jan. 21, 2011); Executive Order 12866 § 1(b)(6), 58 Fed. Reg. 51735 (Oct. 4, 1993).

[6] 80 Fed. Reg. at 52693.

[7] The PEGCC believes, and asks FinCEN to make clear in its final rules, that funds should qualify for this exclusion even if they permit transfers of interests or redemptions within two years in special cases, such as when a continued investment by an investor may be illegal.

requirements (including the suspicious activity monitoring requirements), while focusing their AML efforts on those products and clients that present greater risks.

Our suggested exclusion of low-risk funds from AML requirements would follow the risk-based precedent adopted by FinCEN in other contexts. For example, in promulgating AML program requirements for insurance companies, FinCEN specifically excluded certain insurance products – and insurers that only offered those products – from the scope of AML requirements because of the lack of susceptibility to money laundering and terrorist financing risks.[8] FinCEN should take the same approach in the case of investment advisers that offer private equity and other fund products that similarly pose negligible AML risk.

II. FinCEN Should Provide Clear Guidance Regarding the Advisory Activities that Are Low Risk and Clarify how Advisers' AML Programs May Be Tailored Accordingly.

As noted above, FinCEN has acknowledged that "certain private funds and other unregistered pooled investment vehicles may present lower risks for money laundering or terrorist financing than others."[9] FinCEN goes on to say that, where "different types of investment advisers . . . present varying degrees of money laundering and terrorist financing risks. . . the burden of establishing an AML program would also correspondingly be reduced due to the risk-based nature of the program and the types of advisory services these entities provide."[10]

For the reasons described above, the PEGCC strongly believes that private equity funds, which do not offer investors ordinary-course short-term redemption rights, should be excluded entirely from AML program requirements. We do not see any reason to stretch AML program requirements artificially to include funds (and advisers to such funds) that do not present money laundering risks. Beyond this step, PEGCC believes FinCEN should (a) identify more clearly which funds and other advisory clients present low risks; and (b) clarify the reduced nature of the AML program requirements that apply in the case of low-risk products and clients. Doing so will allow advisers, and federal supervisors, to calibrate compliance and supervisory efforts appropriately.

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8 *See* 70 Fed. Reg. 66754 (Nov. 3, 2005) (noting that the "final rule focuses on those covered insurance products possessing features that make them susceptible to being used for money laundering or the financing of terrorism . . . [t]hese risks do not exist to the same degree" in insurance products excluded from the final rule).

9 80 Fed. Reg. at 52688.

10 Id. at 52684.

To begin with, the PEGCC believes the following funds should be identified as low risk in the final rulemaking (to the extent that any of the following are covered by the AML requirements of a final rule):

- Investment funds that restrict investors from redeeming any portion of their ownership interests, absent unique circumstances, within two years of when the interest was initially purchased;

- Privately offered closed-end investment funds; and

- Investment funds that invest primarily in illiquid securities.

The PEGCC also believes other advisory activities present low risk and should be acknowledged as such by FinCEN. In particular, advisory relationships established for low-risk investors, such as publically traded companies, pension funds (including state pension plans) or another private fund or pooled fund that is itself advised by an investment adviser subject to the final AML rules, should be treated as low-risk activities. Similarly, advisory activities taken in coordination with financial institutions already subject to requirements under the Bank Secrecy Act ("BSA"), such as broker-dealers and banks, should also be considered low risk.

Recognizing the low risks of these advisory activities, FinCEN should be clear in its final rulemaking that, if AML program requirements attach at all to these funds and other advisory clients, those requirements can be appropriately risk-calibrated, and FinCEN should explain the tailoring that is permitted. For example, FinCEN should explain that advisers' obligation under the final rules to monitor the low-risk activities described above for suspicious activity reporting ("SAR") purposes can be satisfied through appropriate training of personnel and would not require expensive and resource-intensive automated transaction monitoring systems. Similarly, FinCEN should clarify that training of personnel who provide services to these low-risk funds and other clients can be appropriately calibrated and can occur every several years (rather than annually) and testing of AML programs – or aspects of AML programs – that touch on low-risk clients can be similarly conducted on a five-year cycle.

This clear guidance by FinCEN will help ensure that advisers and the SEC, which has been delegated examination authority under the Proposed AML Rules, remain focused on higher risk in implementing and examining AML programs. The PEGCC's concern is that supervisory "creep" can result, over time, in a deviation from an appropriate focus on higher-risk activities and, regardless of the actual money laundering risks, impose significant compliance costs on advisers engaged in lower-risk entities without realizing corresponding benefits.

III. The PEGCC Requests the Implementation Period Following Publication of Final AML Rules for Investment Advisers Be Extended to at Least One Year.

The PEGCC believes an implementation period of at least one year, and not six months, as proposed by FinCEN, should be incorporated into the final rules. The PEGCC notes that, in another recent notice of proposed rulemaking for customer due diligence requirements, FinCEN proposed an effective date of one year from the publication of the final rule. In so doing, FinCEN explained that one year was appropriate because financial institutions would be required to modify existing written policies, procedures and processes to comply with the new requirements.[11]

We firmly believe that the same rationale applies in the context. The Proposed AML Rules would impose a substantial compliance burden on investment advisers, the most significant of which, the adoption of an AML program, has been severely underestimated by FinCEN at an average annual burden of 3 hours (a more realistic estimate would be, at the least, several multiples of that).[12] As FinCEN well knows, an effective AML program requires developing and testing complex management information systems, implementing policies and procedures and conducting employee training, all of which are time-intensive efforts. Even where an investment adviser already has voluntarily adopted an existing AML program, a thorough review of that program against the requirements of the final rule would be required and remedial actions, if any, would take time to implement. In addition, various requirements, such as suspicious activity monitoring and reporting and information sharing under Section 314 of the Patriot Act, likely will be new to investment advisers and will require considerable attention and care to implement effectively.

Requiring investment advisers to complete these tasks in the space of six months creates significant execution risk and could impair the ultimate quality of the programs adopted by advisers – a result that serves no worthwhile goals. Given the scope of the Proposed AML Rules, the PEGCC submits that at least one year, and possibly more, from publication of the final rule is a far more sensible implementation timeline.

IV. FinCEN Should Clarify that Activities Outside the Scope of Advisory Services Do Not Trigger Requirements, Including Suspicious Activity Reporting Requirements, Under the AML Rules.

The PEGCC requests that FinCEN affirmatively state that non-advisory activities, even if performed by an SEC-registered investment adviser, would fall outside the scope

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[11] *See* 79 Fed. Reg. 45151, 45164 (Aug. 4, 2014).

[12] *See* 80 Fed. Reg. at 52696.

of an investment adviser's AML program. The preamble to the Proposed AML Rules explains that "an investment adviser's [AML] program must cover all of its advisory activity."[13] Conversely, we would expect that non-advisory activities would fall outside of, and would not trigger, any AML obligations.

In the context of an investment adviser to a private equity fund, employees of the investment adviser may perform certain oversight or managerial functions at operating companies owned in whole or in part by the private equity fund, such as serving on the operating company's board of directors. To the extent the final rulemaking imposes AML obligations on advisers to private equity funds, the PEGCC believes, and requests that FinCEN clarify, that these non-advisory activities are outside the scope of the AML program.

This confirmation on the scope of investment advisers' AML programs would ensure that the burden of compliance with the final rules does not inadvertently get extended to non-financial companies wholly outside the scope of the BSA merely because such companies are owned by investment funds advised by investment advisers subject to AML program requirements. For example, we would not expect that an operating company would be required to file currency transaction reports ("<u>CTRs</u>") or meet other BSA-mandated reporting obligations simply because it is owned by a private equity fund and employees of that fund's investment adviser sit on the company's board of directors.

We request that FinCEN confirm this also applies to the scope of investment advisers' SAR filing obligation under the Proposed AML Rules. An investment adviser subject to a SAR filing obligation should not be required to monitor for suspicious activities in the context of their non-advisory activities, such as serving on the board of directors of an operating company. To read the SAR filing obligation otherwise would impose SAR filing obligations on operating companies completely outside the scope of the BSA.

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[13] 80 Fed. Reg. at 52686.

The PEGCC appreciates the opportunity to comment on the proposed rule and would be pleased to answer any questions you might have regarding our comments or regarding the private equity and growth capital industry more generally.

Respectfully submitted,

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