DEPARTMENT OF THE TREASURY
31 CFR Part 103
RIN 1506-AA26

Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Unregistered Investment Companies

AGENCY: Financial Crimes Enforcement Network (FinCEN), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: FinCEN is proposing to amend the Bank Secrecy Act ("BSA") regulations to prescribe minimum standards applicable to certain unregistered investment companies, such as hedge funds, commodity pools, and similar investment vehicles, pursuant to the revised provision in the USA Patriot Act of 2001 (Public Law 107–56) ("USA Patriot Act") or "Act"). Title III of the Act makes a number of amendments to the anti-money laundering provisions of the BSA, which are codified in subchapter II of chapter 53 of title 31, United States Code. These amendments are intended to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. Section 352(a) of the Act, which became effective on April 24, 2002, amended section 5318(h) of the BSA. As amended, section 5318(h)(1) requires every "financial institution" to establish an anti-money laundering program that includes, at a minimum (i) the development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test the program. Section 5318(h)(2) authorizes the Secretary, after consulting with the appropriate Federal functional regulator, to prescribe minimum standards for anti-money laundering programs, and to exempt from the application of those standards any financial institution that is not otherwise subject to BSA regulation.

Under the BSA, the definition of "financial institution" includes an "investment company," a term that is not defined by the BSA or any rule yet adopted by FinCEN. The Investment Company Act of 1940 (codified at 15 U.S.C. 80a) ("1940 Act") defines the term, and subjects registered investment companies to a comprehensive scheme of regulation administered by the Securities and Exchange Commission ("SEC"). In April 2002, FinCEN issued an interim final rule requiring investment companies that are "mutual funds" (i.e., registered open-end management investment companies as described in the 1940 Act) to develop and implement anti-money laundering programs reasonably designed to prevent them from being used to launder money or finance terrorist activities. By separate interim rule, Treasury temporarily exempted investment companies other than mutual funds from the requirement of section 5318(h)(1) of the BSA that they establish anti-money laundering programs. In the interim rule on anti-money laundering programs for mutual funds, Treasury observed that there are a number of entities excluded from the 1940 Act definition of "investment company," and that those entities in the future would likely be required to establish anti-money laundering programs under section 352 of the Act.

Today, FinCEN is proposing a new rule that would define an investment company to include certain investment vehicles not subject to regulation under the 1940 Act, and require these entities to establish anti-money laundering programs in accordance with guidelines included in the rule. These guidelines are substantially the same as those FinCEN has established for mutual funds.

II. Unregistered Investment Companies—General Issues

While Treasury believes it is incumbent upon all United States businesses to be on guard against their use by terrorists or other criminals for money laundering, the BSA imposes financial institutions has required such companies to be on guard against their use by terrorists or other criminals for money laundering, the BSA imposes


Section 3(a)(1) of the 1940 Act defines "investment company" as any issuer that (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percent of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. 15 U.S.C. 80a–3(a)(1).


2 Section 3(a)(1) of the 1940 Act defines "investment company" as any issuer that (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percent of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. 15 U.S.C. 80a–3(a)(1).

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5 Id. at 21117–21118. That process is continuing.

6 By separate interim rule, Treasury temporarily exempted investment companies other than mutual funds from the requirement of section 5318(h)(1) of the BSA that they establish anti-money laundering programs.

7 Id. at n.5. Section 566(c) of the USA Patriot Act requires that the Secretary, the Board of Governors of the Federal Reserve System ("Federal Reserve System") and the SEC jointly submit a report to Congress by October 26, 2002 recommending effective regulations to apply the requirements of the BSA to investment companies as defined in section 2(a)(18) of the 1940 Act, as well as to persons that would be investment companies but for the exceptions provided in sections 3(c)(1) or 3(c)(7) [15 U.S.C. 80a–3(c)(1), 3(c)(7)].
investment under the 1940 Act,\(^\text{9}\) (ii) a commodity pool, and (iii) a company that invests primarily in real estate and/or interests therein. This definition generally would include entities consisting of pools of various asset classes: securities, commodity interests, and real estate. Several types of investment companies that are not registered under the 1940 Act would be covered by this definition, including hedge funds,\(^\text{10}\) private equity funds,\(^\text{11}\) venture capital funds,\(^\text{12}\) commodity pools\(^\text{13}\) and real estate investment trusts (REITs),\(^\text{14}\) in order to protect against their use for possible money laundering.

As noted above, the proposed rule would apply to commodity pools, which are operated by commodity pool operators (“CPOs”).\(^\text{15}\) CPOs that are not exempted under CFTC regulations are registered with, and subject to regulation by, the CFTC and the National Futures Association (“NFA”), the futures industry self-regulatory organization. The USA Patriot Act added CPOs to the BSA definition of “financial institution.”

FinCEN requests comment whether there are other entities, not covered by other rules requiring anti-money laundering programs, that pool assets and provide a similar opportunity for money laundering or terrorist financing, and whether such entities should be required by the final rule to establish anti-money laundering programs.

Because of the broad scope of the type and nature of businesses that may rely on the exceptions to the 1940 Act, may be commodity pools, or that may invest in real estate, we propose to narrow the closed to further investment so that the fund has a fixed capital pool from which to make its investments. Investors typically are not able to redeem their investments from the fund matures or expires. These funds do not register under the 1940 Act in reliance on the exemptions relied on by hedge funds.\(^\text{16}\)

REITs, in general, are investment vehicles in which the contributions of the participants are pooled and invested in a portfolio of securities, commodity futures contracts, or other assets. In 1999, the President’s Working Group on Financial Markets described a hedge fund as: “any pooled investment vehicle that is privately organized, administered by professional investment managers, and not widely available to the public.” Working Group Report, supra note 8, at 1. Hedge funds are not registered under the 1940 Act because they are offered in a manner that makes them eligible for exceptions to the definition of “investment company” in sections 3(c)(1) or 3(c)(7) of the 1940 Act. See supra notes 7–8. These funds are generally only offered to persons who qualify as “accredited investors” or “qualified purchasers” under the federal securities laws. See 17 CFR 240.501(a) (definition of “accredited investor”); 15 U.S.C. 80a-11a(51) (definition of “qualified purchaser”). Hedge funds may be operated by CPOs. Some hedge funds also may be advised by investment advisers registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b) or commodity trading advisors registered under the CEA. See 7 U.S.C. 1a(5)–(6). Investors in a hedge fund are typically able to redeem their investments on a quarterly, semi-annual, or annual basis.

Private equity funds are privately offered investment vehicles in which the contributions of institutions and wealthy individuals are pooled and invested in a portfolio of unregistered equity securities (of public or private companies) managed by a professional investment adviser. Private equity funds usually have a limited lifespan of 8 to 12 years, and investors are able to redeem their investments when the funds liquidate. These funds also do not register under the 1940 Act in reliance on the same exemptions relied on by hedge funds. See supra note 8.

Venture capital funds are privately offered investment vehicles in which the contributions of the participants are pooled to invest in start-up companies. Venture capital funds provide substantial managerial assistance to the start-up companies in which they invest. Venture capital funds typically have a fixed life (usually 10 years). Once the fund has reached its target size, it is

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definition of unregistered investment company through three limitations and three exceptions described below.

(i) Limitations
(A) Redemption Rights. Under the proposed definition, an “unregistered investment company” would include only those companies that give an investor a right to redeem any portion of his or her ownership interest within two years after that interest was purchased. Because these investment vehicles rarely receive from or disburse to investors significant amounts of currency, they are not as likely to use other means of financial institutions (e.g., banks) to be used during the initial or “placement” stage of the definition.

Money laundering is more likely to occur through these entities at the “layering” stage of the money laundering process, which generally requires the money launderer to be able to redeem his or her interests in the company. Moreover, companies that offer interests that are not redeemable or that are redeemable only after a lengthy holding or “lock-up” period lack the liquidity that makes certain financial institutions attractive to money launderers in the first place. This “redeemability” requirement is likely to exclude publicly traded REITs, and entities that require lengthy investment periods without the ability to redeem assets, including private REITs, a large number of special purpose financing vehicles, and many private equity and venture capital funds. These types of illiquid companies are not likely to be used by money launderers.

FinCEN requests comment on whether a two-year limit is appropriate, given the purpose of the rule. Should the limitation be for a longer or shorter period? FinCEN assumes that most hedge funds would be required to adopt anti-money laundering programs under the rule because they have only a one-year “lock-up” period. Is this assumption correct? Would the limit result in some companies being excluded that may nonetheless be susceptible to use by money launderers? What is the likelihood that hedge funds or other entities will adopt two-year lock-up periods to avoid being subject to the rule?

(B) Minimum Assets. The proposed rule would be limited to companies that, as of the most recently completed calendar quarter, have total assets of $1,000,000 or more. This threshold is designed to exclude investment pools that are owned by one family (“family companies”) from the definition of such investment clubs and other small entities that are unlikely to be used for money laundering.

As a result, a fund would be excepted from the definition only if it precluded an investor from redeeming an investment (i.e., imposed a “lock-up” period) for two years from the day the investment was made. Most hedge funds have one-year lock-up periods and, thus, would likely be covered by the definition (assuming they meet the other terms of the definition and the other requirements of the proposed rule) and would be required to have anti-money laundering programs under the rule. Furthermore, any unregistered investment company that “permits an owner to redeem” (and meets the other requirements of the proposed rule) would be covered, regardless of whether its investors have the opportunity to (or do) sell the fund’s securities in secondary market transactions. The existence of an informal or formal secondary market for the fund’s securities would not affect the applicability of the definition.

Some unregistered investment companies may offer dividend reinvestment plans. For the purposes of this rule, we would not consider an investor to “purchase” an interest in an unregistered investment company if the investor acquires such interest pursuant to a dividend reinvestment plan offered by the company. Cf. Securities Act Release No. 929 (July 29, 1936) (describing conditions under which the issuance of securities pursuant to a dividend reinvestment plan is not a sale for value subject to section 5 of the Securities Act of 1933 [15 U.S.C. 77e]). The two-year lock-up provision does not apply to interests acquired with reinvested dividends. Thus, an unregistered investment company that does not permit redemptions within two years of investment would not become subject to the proposed rule solely because it permits investors to redeem interests acquired through the company’s dividend reinvestment plan that have been held for less than two years, so long as such redemption is not permitted within two years of the investment that produced the reinvested dividends.

There is some risk that money launderers will use unregistered investment companies during the “placement” stage of the money laundering process. Suspicious activity observed in the purchase of investment company interests includes the use of money laundering, and travelers checks in structured amounts to avoid currency reporting by the issuing financial institution. Similarly, a money launderer could pay for the initial purchase of an investment with several wire transfers, each in an amount under $10,000, from different banks or brokerage firms to evade currency reporting. “Layering” involves the distancing of illegal proceeds from their criminal source through the creation of complex layers of financial transactions.

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20 The proposed rule excepts companies that are owned by one family (“family companies”) from the definition of
unregistered investment company. The rule also excepts employees’ securities
companies, which are investment companies established by employers for the
benefit of employees. The rule further excepts employee benefit plans that are
designed to be pools in CFTC Rule 4.5(a)(4). None of these types of companies is likely to be used
for money laundering purposes by third parties given their size, structure and
purpose. Finally, the rule would except companies that are also another type of
“financial institution” under the BSA (such as a broker-dealer) to prevent
duplicative application of the BSA anti-money laundering rules to the same
financial institution.

FinCEN requests comment on
whether these exceptions from the
definition are appropriate and whether
there are other entities that should be
specifically included in or specifically
excluded (through additional
limitations or exceptions) from the
definition of “unregistered investment
company.”

III. The Anti-Money Laundering
Program

The proposed rule follows recent
regulatory actions concerning the
establishment of anti-money laundering
programs by financial institutions. The
proposed rule sets forth minimum
requirements for an anti-money laundering
program for unregistered investment companies that implement the
standards outlined in BSA section
5318(b)(1). The proposed rule would require that, by 90 days following
publication of a final rule, unregistered investment companies develop and
implement anti-money laundering programs reasonably designed to
prevent them from being used to
launder money or finance terrorist activities and achieve and monitor
compliance with the applicable
requirements of the BSA and Treasury’s
implementing regulations.

The legislative history of the BSA
explains that the requirement to have an
anti-money laundering program is not a
one-size-fits-all requirement. The
general nature of the requirement
reflects Congress’s intent that each
financial institution should have the
flexibility to tailor its program to fit its
business, taking into account factors such as size, location, activities and
risks or vulnerabilities to money laundering. This flexibility is designed to
ensure that all firms subject to the
statute, from the largest to the smallest
firms, have in place policies and
procedures that are both effective and
appropriate to guard against money
laundering. To assure that this
requirement receives the highest level of
attention throughout these diverse
industries, the proposed rule requires that each unregistered investment
company’s program be approved in
writing by the board of directors or
trustees, the general partner or, if the
foregoing do not exist, senior
management. The four required
elements of the anti-money laundering
program are discussed below.

(1) Establish and Implement Policies,
Procedures, and Internal Controls
Reasonably Designed To Prevent
Unregistered Investment Companies
From Being Used To Launder Money
or Finance Terrorist Activities, Including
But Not Limited To Achieving
Compliance With The Applicable
Provisions of the BSA and the
Implementing Regulations Thereunder

Written policies and procedures,
which form the basis of any compliance
program, should set forth clearly the
details of the program, including the
responsibilities of the individuals and
departments involved. Because unregistered investment companies operate
through a variety of different business models, one generic anti-
money laundering program for this
industry is not possible; rather, each
unregistered investment company must
develop a program based upon its own
business structure. This provision
requires that each unregistered
investment company identify its
vulnerabilities to money laundering and
terrorist financing activity, understand
the BSA requirements applicable to it,
determine the risk factors relating to these
requirements, design the procedures
and controls that will be required to
reasonably assure compliance with
these requirements, and periodically
assess the effectiveness of the
procedures and controls. Policies, procedures, and internal controls
should be reasonably designed to detect
activities indicative of money
laundering. Transactions that could
indicate potential money laundering
include the use of questionable checks
and unusual wire activity. For example,
an investment in an unregistered
investment company by check drawn on
the account of a third party, or by one
or more wire transfers from an account
of a third party, in each case unrelated
to the investor, could be indicative of
attempted money laundering. Other
examples of “red flags” that may
indicate potential illegal activity
include investor difficulty in describing
the reasons for frequent wire transfers
to unfamiliar bank accounts or
jurisdictions other than the investor’s
home country; frequent purchases of
interests in unregistered investment
companies followed by redemptions,
particularly if the resulting proceeds are
wired to unrelated third parties or bank
accounts in foreign countries; non-
unusual transfers, such as the
purchase of an interest for a large dollar
amount followed by redemption with
indifference as to penalty amounts
charged by the company for engaging in
such a transaction; transfers to accounts
in countries where drug trafficking is
known to occur or other high-risk
countries; and the transfer of a monetary
instrument or an investment interest
from a foreign government to a private
person. An unregistered investment
company that identifies suspicious
activity should take reasonable steps to
determine if its suspicions are justified and
respond accordingly, including
refusing to enter into a transaction that
appears designed to further illegal
activity.

charitable organizations, or trusts established by or
for the benefit of such persons”). The exception for
family companies would be available without
regard to the amount of assets owned by the
company.

80a–2(a)(13)]. An employees’ securities company is “any investment company or similar issuer all of
which is an affiliated company of the other, (B) by
former employees of such employer or employers,
(C) by members of the immediate family of such
employees, persons on retainer, or former
employees, (D) by any two or more of the
foregoing
classes of persons, or (E) by such employer or
employees together with any one or more of the
foregoing classes of persons.”

See USA Patriot Act of 2001; Consideration of
H.R. 3162 Before the Senate [October 25, 2001]
(statement of Sen. Sarbanes), 147 Cong. Rec.
S10990–92; Financial Anti-Terrorism Act of 2001;
Consideration Under Suspension of Rules of H.R.
3004 Before the House of Representatives [October
17, 2001] (statement of Rep. Kelly) (provisions of
the Financial Anti-Terrorism Act of 2001 were
corporated as Title III in the Act), 147 Cong. Rec.
H6924–01.

27 The approval could be given at the company’s
first regularly scheduled meeting after the program
is adopted.

28 18 U.S.C. 1956 and 1957 make it a crime for
any person, including an individual or company, to
engage knowingly in a financial transaction with
the proceeds from any of a long list of crimes or
"specified unlawful activity." Although the
standard of knowledge required is "actual
knowledge," actual knowledge includes "willful
blindness." Thus, a person could be deemed to
have knowingly that proceeds derived from
illegal activity if he or she ignored "red flags" that
indicated illegality. Unregistered investment
companies with offshore operations in or with
investors from jurisdictions on lists maintained by
the Office of Foreign Asset Control (sanctioned
countries), FinCEN (country advisories), or the
Financial Action Task Force on Money Laundering
(non-cooperative countries and territories) should
Policies, procedures, and internal controls should also be reasonably designed to assure compliance with BSA requirements. The only BSA requirement currently applicable to unregistered investment companies is the obligation to report on Form 8300 the receipt of cash or certain noncash instruments totaling more than $10,000 in one transaction or two or more related transactions.\(^{29}\)

We also note that unregistered investment companies may become subject to additional BSA requirements, including customer and investor identification and verification under section 326 of the Act and filing suspicious activity reports. If unregistered investment companies become subject to additional requirements, their compliance programs will need to be updated to include appropriate policies, procedures, training, and testing functions.

Unregistered investment companies typically conduct their operations, as do mutual funds, through separate entities such as fund administrators, investment advisers, CPOs, commodity trading advisors, broker-dealers (including prime brokers), and futures commission merchants. Some elements of the compliance program will best be performed by personnel of these separate entities, in which case it is permissible for an unregistered investment company to contractually delegate the implementation and operation of those aspects of its anti-money laundering program to such an entity. Any unregistered investment company that delegates responsibility for aspects of its anti-money laundering program to a third party, however, remains fully responsible for the effectiveness of the program, as well as ensuring that federal examiners are able to obtain information and records relating to the anti-money laundering program and to inspect the third party for purposes of the program. In addition, an unregistered investment company would remain responsible for assuring compliance with this regulation. The unregistered investment company is still responsible for taking reasonable steps to identify the aspects of its operations that may give rise to BSA regulatory requirements or that are vulnerable to money laundering or terrorist financing activity; developing and implementing a program reasonably designed to achieve compliance with such regulatory requirements and to prevent such activity; monitoring the operation of its program; and assessing its effectiveness. For example, it would not be sufficient for an unregistered investment company simply to obtain a certification from its delegate that the company “has a satisfactory anti-money laundering program.”

Investors in unregistered investment companies may include individuals and institutional investors (such as pension funds and corporations), as well as other registered and unregistered investment companies (i.e., “funds of hedge funds”).\(^{30}\) The diversity and complexity of unregistered investment company structures, particularly those with offshore operations may result in a lack of transparency regarding the entities that invest in the unregistered investment company.\(^{31}\) An unregistered investment company would need to analyze the money laundering risks posed by any entity that invests in it, by using a risk-based evaluation of relevant factors regarding the investing entity. Those factors include the type of entity, its operator or sponsor, its location, the type of regulation to which that entity or its operator is subject, whether the entity has an anti-money laundering program, and the terms of any such program. Unregistered investment companies should account for any risks posed by any offshore operations and affiliates in developing their policies, procedures, and internal controls.

Outside Party

(2) Provide for Independent Testing for Compliance To Be Conducted by Company Personnel or by a Qualified Outside Party

It is necessary that unregistered investment companies conduct periodic testing of their programs to assure that the programs are functioning as designed. Such testing should be accomplished by personnel knowledgeable about the business’ money laundering risks as well as BSA requirements. Such testing may be accomplished by employees of the unregistered investment company, its affiliates, or unaffiliated service providers so long as those same employees are not involved in the operation or oversight of the program. The frequency of such a review would depend upon factors such as the size and complexity of the unregistered investment company’s operations and the extent to which its business model may make it more vulnerable to money laundering than other institutions. A written assessment or report should be a part of the review, and any recommendations resulting from such review should, of course, be promptly implemented or submitted to the general partner, board of directors or trustees, or, if the foregoing do not exist at the unregistered investment company, senior management for consideration.

(3) Designate a Person or Persons Responsible for Implementing and Monitoring the Operations and Internal Controls of the Program

The unregistered investment company must charge an individual (or committee) with the responsibility for overseeing the anti-money laundering program. The person (or group of persons) should be competent and knowledgeable regarding BSA requirements and money laundering issues and risks, and empowered with full responsibility and authority to develop and enforce appropriate policies and procedures throughout the company. Whether the compliance officer is dedicated full time to BSA compliance would depend upon the size and complexity of the company. Although in some cases the implementation and operation of the compliance program will be conducted by entities (and their employees) other than the unregistered investment company, the person responsible for the supervision of the overall program should be an unregistered investment company’s officer, trustee, general partner, organizer, operator, or sponsor, as appropriate.

(4) Provide Ongoing Training for Appropriate Persons

Employee training is an integral part of any anti-money laundering program. In order to carry out their responsibilities effectively, employees of an unregistered investment company...
(and of any affiliated and third-party service providers) must be trained regarding the BSA requirements that are relevant to their functions and the signs of money laundering that could arise in the course of their duties. Such training could be conducted by outside or in-house seminars, and could include computer-based training. The level, frequency, and focus of the training would be determined by the responsibilities of the employees and the extent to which their functions bring them in contact with BSA requirements or possible money laundering activity. Consequently, the training program should provide both a general awareness of overall BSA requirements and money laundering issues, as well as more job-specific guidance regarding the particular employee’s role and function in the anti-money laundering program.32 For those employees whose duties bring them in contact with BSA requirements or possible money laundering activity, the requisite training should occur when the employee assumes those duties. Moreover, these employees should receive periodic updates and refreshers regarding the anti-money laundering program.

(5) Notice Requirement

Unlike many other financial institutions subject to the anti-money laundering regime in the BSA, such as banks, savings associations, and mutual funds, unregistered investment companies are not necessarily registered with or identifiable by Treasury or another Federal functional regulator. Without a methodology for identifying or locating these unregistered entities, there would be virtually no way for Treasury or the appropriate Federal functional regulators to assure, with any degree of certainty, through examination or enforcement, that covered unregistered investment companies are in compliance with the rule. Furthermore, while certain companies, particularly larger hedge funds, REITs, private equity funds and venture capital funds, may be identified through trade associations or other relatively simple search methods, other, smaller, less public or offshore entities could escape scrutiny. For the rule to operate and be enforced effectively there must be a practical means of identifying and locating companies subject to the rule.

The BSA authorizes the Secretary of the Treasury to prescribe (after consultation with the appropriate Federal functional regulator) minimum standards for anti-money laundering programs established under the BSA and to require a class of financial institutions to maintain appropriate procedures ensure compliance with the BSA.33 Notice of the identity of the members of a regulated class is a key procedure in the effective monitoring and enforcement of compliance with the BSA. Therefore, the proposed rule requires that each unregistered investment company file a short notice (“Notice”) identifying itself and providing some very basic information about the company.

The notice filing requirement is implicitly authorized by the BSA as a “legitimate, reasonable, and direct adjunct” to the Secretary’s explicit statutory authority to require financial institutions to adopt compliance programs to detect and prevent money laundering in 31 U.S.C. 5318(a)(2), as well as the Secretary’s broad powers under the BSA to require reports and records useful to criminal tax and regulatory uses.34 Because many unregistered investment companies lack a federal functional regulator, without a notice requirement of some kind, Treasury (or its designee) would lack the means to examine for and enforce compliance with the rule. The notice requirement is therefore a direct adjunct to the Secretary’s enforcement authority.35 Indeed, there are a number of agency regulations requiring notice filings and other types of filings that Congress did not explicitly authorize. For example, the Office of the Comptroller of the Currency, under its general authority regulatory authority in 12 U.S.C. 93a, has promulgated regulations governing the issuance of investment securities of national banks that are expressly exempt from certain registration requirements of the federal securities laws.36 Similarly, the CFTC has issued rules that require CPOs that Congress did not explicitly authorize. For example, the Office of the Comptroller of the Currency, under its general authority regulatory authority in 12 U.S.C. 93a, has promulgated regulations governing the issuance of investment securities of national banks that are expressly exempt from certain registration requirements of the federal securities laws.37 Similarly, the CFTC has issued rules that require CPOs that are exempt from registration to file a notice claiming eligibility for the exemption.38

The Notice would be required to include—

- The name, address, e-mail address and telephone number of the unregistered investment company;
- The name, address, e-mail address, telephone number and registration number of any investment advisor, commodity trading advisor, CPO, organizer or sponsor of the unregistered investment company;
- The name, e-mail address and telephone number of the designated anti-money laundering program compliance officer;
- The dollar amount of assets under management held by the unregistered investment company; and
- The number of participants, interest holders or security holders in the unregistered investment company.

Filing Procedures. An unregistered investment company would have to file with FinCEN a Notice described in Appendix C of subpart I of 31 CFR part 103. Completed Notices may be submitted to FinCEN by accessing FinCEN’s Internet Web site, http://www.fincen.gov, and entering the appropriate information as directed, or by mail to: FinCEN, PO Box 39, Mail Stop 100, Vienna, VA 22183.

Filing Date. An unregistered investment company would have to file a Notice within 90 days after it first becomes subject to the provisions of this rule.

Amendments. An unregistered investment company would have to file an amendment to its Notice not later than 30 days after any change to the information in the Notice other than the amount of assets under management or the number of participants, interest holders or security holders.

Withdrawal. An unregistered investment company would have to withdraw its Notice within 90 days after ceasing to be subject to the provisions of this rule.

Finally, unregistered investment companies would be encouraged to adopt procedures for voluntarily filing Suspicious Activity Reports with FinCEN and for reporting suspected terrorist activities to FinCEN using its Financial Institutions Hotline (1-866-566-3974).

FinCEN requests comment regarding whether the proposed notice requirement is appropriate. Is there any other means by which FinCEN could readily identify all the unregistered investment companies subject to the proposed rule? Should those commodity pools that are identified in the database...
of the NFA be exempt from this requirement? 39

IV. Regulatory Flexibility Act

It is hereby certified that this proposed regulation will not have a significant economic impact on a substantial number of small entities. The costs associated with the development of anti-money laundering programs are attributable to the mandates of section 352 of the Act. Moreover, because the proposed rule applies only to those unregistered investment companies with assets of $1,000,000 or more and also excludes family companies, employees' securities companies, and certain employee benefit plans that are not construed to be pools, it is unlikely that many small unregulated investment companies will be subject to the rule. In addition, the proposed rule will not impose significant burdens on those small unregistered investment companies covered by the rule because they are already subject to Form 8300 reporting and may build on their existing risk management procedures and prudential business practices to ensure compliance with this rule as well as anti-money laundering risk management. Similarly, the procedures currently in place at mutual funds to comply with existing BSA rules should assist unregistered investment companies in establishing their anti-money laundering programs. Finally, the unregistered investment companies subject to the rule will not be compelled to obtain more sophisticated legal or accounting advice than that already required by such companies to run their businesses.

V. Executive Order 12866

The Department of the Treasury has determined that this proposed rule is not a significant regulatory action under Executive Order 12866. Accordingly, a regulatory impact analysis is not required.

VI. Paperwork Reduction Act

The collections of information contained in this proposed rule are being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent (preferably by fax (202–395–6974) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to jlackey@omb.eop.gov), with a copy to FinCEN by mail or the Internet at the addresses previously specified. Comments on the collection of information should be received by November 25, 2002.

The collections of information in this proposed rule are in 31 CFR 103.132(b) and (d). The information will be used by federal agencies to verify compliance by unregistered investment companies with the provisions of 31 CFR 103.132. The collections of information are mandatory.

Description of Recordkeepers and Respondents: Unregistered investment companies as defined in 31 CFR 103.132(a).

Estimated Number of Recordkeepers: 5,000.

Estimated Average Annual Burden Per Recordkeeper: The estimated average burden associated with the recordkeeping requirement in this proposed rule is 1 hour per recordkeeper.

Estimated Total Annual Recordkeeping Burden: 5,000 hours.

Estimated Number of Respondents: 5,000.

Estimated Average Annual Burden Per Respondent: The estimated average burden associated with the notice requirement in this proposed rule is 30 minutes per respondent.

FinCEN specifically invites comments on the following subjects: (a) Whether the collections of information are necessary for the proper performance of the mission of FinCEN, including whether the information shall have practical utility; (b) the accuracy of FinCEN’s estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on unregistered investment companies, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

List of Subjects in 31 CFR Part 103

Banks, Banking, Brokers, Commodities futures, Counter money laundering, drugs, unregistered investment companies, Currency, Foreign banking, Reporting and recordkeeping requirements.

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

1. The authority citation for part 103 continues to read as follows:


2. In subpart I, add new § 103.132 to read as follows:

§ 103.132 Anti-money laundering programs for unregistered investment companies.

(a) Definitions. For purposes of this section and Appendix C to this subpart I—

(1) The terms company, director, issuer, person, security, and value have the same meanings as provided in section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2).

(2) The term investment adviser has the same meaning as provided in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)).

(3) The term commodity pool means a pool as defined in 17 CFR 4.10(d).

(4) The term commodity pool operator has the same meaning as provided in section 1(a)(5) of the Commodity Exchange Act (7 U.S.C. 1(a)(5)).

(5) The term commodity trading advisor has the same meaning as provided in section 1(a)(6) of the Commodity Exchange Act (7 U.S.C. 1(a)(6)).

(b) [Reserved]

(c) [Reserved]

§ 103.133 Financial recordkeeping and reporting of currency and foreign transactions.

1(a)(7)) to the extent provided in paragraphs (1)(ii) and (6)(i) of this section, the term "registered investment company" means an issuer that is a company—

(A) That—

(1) Would be an investment company under the Investment Company Act of 1940 (15 U.S.C. 80a) but for the exclusions provided for in sections 3(c)(1) and 3(c)(7) of that Act (17 U.S.C. 80a–3(c)(1) and (7));

(2) Is a commodity pool; or

(3) Invests primarily in real estate and/or interests therein;

(B) That permits an owner to redeem his or her ownership interest within two years of the purchase of that interest;

(C) That has total assets (including received subscriptions to invest) as of the end of the most recently completed calendar quarter the value of which is $1,000,000 or more; and

(D) That is organized under the law of a State or the United States, is organized, operated or sponsored by a U.S. person, or sells ownership interests to a U.S. person. For purposes of this paragraph (1)(ii)(F)(1), the term U.S. Person has the same meaning as provided in 17 CFR 230.902(k)).
(ii) The term unregistered investment company does not include:

(A) Any person that is otherwise required to have an anti-money laundering program pursuant to this subpart;

(B) A family company described in section 2(a)(51)(A)(ii) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(51)(A)(ii)), but without regard to the amount of assets owned by such company;

(C) An employee benefit plan (as that term is defined in 17 CFR 4.5(a)(4)) that is not construed to be a pool.

(b) Anti-money laundering program required. Effective [the date that is 90 days after publication of the final rule], each unregistered investment company shall develop and implement a written anti-money laundering program reasonably designed to prevent the company from being used for money laundering or the financing of terrorist activities and to achieve and monitor compliance with the applicable requirements of the Bank Secrecy Act (31 U.S.C. 5311 et seq.) (BSA), and this part. The anti-money laundering program must be approved in writing by its board of directors or trustees or, if it does not have one, by its general partner, sponsor, organizer, operator, or other person who has a similar function with respect to the company. To the extent any definition incorporated into this rule by reference requires action by the unregistered investment company’s board of directors, such action may be performed by any of the aforementioned persons if it has no board of directors. The unregistered investment company shall make its anti-money laundering program available for inspection by the Department of the Treasury or its designee upon request.

(c) Minimum requirements. The anti-money laundering program shall at a minimum:

(1) Establish and implement policies, procedures, and internal controls reasonably designed to prevent the investment company from being used for money laundering or the financing of terrorist activities and to achieve compliance with the applicable provisions of the BSA and this part;

(2) Provide for independent testing for compliance to be conducted by the investment company’s personnel or by a qualified outside party;

(3) Designate a person or persons responsible for implementing and monitoring the operations and internal controls of the program; and

(4) Provide ongoing training for appropriate persons.

(d) Notice. Each unregistered investment company must provide information to FinCEN as required by this paragraph (d).

(1) Each unregistered investment company must file with FinCEN a Notice described in Appendix C of this subpart. Completed Notices may be submitted to FinCEN by accessing FinCEN’s Internet Web site, http://www.fincen.gov, and entering the appropriate information as directed, or by mail to: FinCEN, PO Box 39, Mail Stop 100, Vienna, VA 22183.

(2) The Notice required by paragraph (d)(1) of this section must be filed not later than 90 days after the date an unregistered investment company first becomes subject to this section. If an unregistered investment company ceases to be subject to this section, it must so advise FinCEN not later than 90 days after ceasing to be subject to this section.

(3) Each unregistered investment company must include the following information in the Notice required by paragraph (d)(1) of this section:

(i) The name of the unregistered investment company, including all family or complex names, trade names and doing-business-as names;

(ii) The complete street address, telephone number and, if applicable, the e-mail address of the unregistered investment company;

(iii) The name, complete street address, telephone number, and if applicable, the e-mail address and registration number of any investment adviser, commodity trading advisor, commodity pool operator, organizer or sponsor of the unregistered investment company;

(iv) The name, telephone number and, if applicable, e-mail address of the person or persons designated pursuant to paragraph (c)(3) of this section;

(v) The total assets under management held by the unregistered investment company as of the end of the unregistered investment company’s most recent fiscal year; and

(vi) The total number of participants, interest holders or security holders in the unregistered investment company.

(4) An unregistered investment company must file a revised Notice with FinCEN if there is a change in any of the information required by paragraph (d)(3)(i), (ii), (iii), or (iv) of this section. The revised Notice must be filed in accordance with paragraph (d)(1) of this section not later than 30 days after the date of any such change.

3. Add appendix C to subpart I of part 103 to read as follows:

Appendix C to Subpart I of Part 103

Unregistered Investment Companies, Notice for Purposes of 31 CFR 103.132(d)

Notice is given, on behalf of (insert all names of unregistered investment company)

that:

(1) The unregistered investment company specified above is an “unregistered investment company” as such term is defined in 31 CFR 103.132(a).

(2) The address, e-mail address (if applicable), and telephone number of the unregistered investment company are as follows:

Name:
Address:
e-mail Address (if applicable):
Telephone Number:
Registration Number:
Type of Entity:

(3) The name, address, e-mail address (if applicable), telephone number, and registration number of any investment adviser, commodity trading advisor, commodity pool operator, organizer or sponsor of the unregistered investment company are as follows:

Name:
Address:
e-mail Address:
Telephone Number:
Registration Number:
Type of Entity:

(4) The name, e-mail address (if applicable), and telephone number of the designated anti-money laundering program compliance officer of the unregistered investment company are as follows:

Name:
e-mail Address:
Telephone Number:

(5) The dollar amount of assets under management held by the unregistered investment company as of the end of its most recent fiscal year is $.

(6) The number of participants, interest holders or security holders in the unregistered investment company is.

BY:
Name
Title
DEPARTMENT OF THE TREASURY
31 CFR Part 103
RIN 1506-AA28
Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Insurance Companies

AGENCY: Financial Crimes Enforcement Network (FinCEN), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: FinCEN is issuing this proposed rule to prescribe minimum standards applicable to insurance companies pursuant to the revised provision in the Bank Secrecy Act that requires financial institutions to establish anti-money laundering programs.

DATES: Written comments may be submitted on or before November 25, 2002.

ADDRESSES: Commenters are encouraged to submit comments by electronic mail because paper mail in the Washington, DC, area may be delayed. Comments submitted by electronic mail may be sent to regcomments@fincen.treas.gov with the caption in the body of the text, “ATTN: Section 352—Insurance Company Regulations.” Comments (preferably an original and four copies) also may be submitted by paper mail to FinCEN, P.O. Box 39, Vienna, VA 22183, ATTN: Section 352—Insurance Company Regulations. Comments should be sent by one method only. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m., in the FinCEN Reading Room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354–6400 (not a toll-free number).

FOR FURTHER INFORMATION CONTACT: Office of Chief Counsel, FinCEN, (703) 905–3590; Office of the Assistant General Counsel for Enforcement (Treasury), (202) 622–1927; or the Office of the Assistant General Counsel for Banking and Finance (Treasury), (202) 622–0480 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

I. Background

On October 26, 2001, the President signed into law the Unitening and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001 (Public Law 107–56) (the Act). Title III of the Act makes a number of amendments to the anti-money laundering provisions of the Bank Secrecy Act (BSA), which is codified in subchapter II of chapter 53 of title 31, United States Code. These amendments are intended to provide additional tools to prevent, detect, and prosecute international money laundering and the financing of terrorism. Section 352(a) of the Act, which became effective on April 24, 2002, amends section 5318(h) of the BSA. As amended, section 5318(h)(1) requires every financial institution to establish an anti-money laundering program that includes, at a minimum, (i) the development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test programs. Section 352(c) of the Act directs the Secretary to prescribe regulations for anti-money laundering programs that are “commensurate with the size, location, and activities” of the financial institutions to which such regulations apply. Section 5318(h)(1) permits the Secretary to exempt from this anti-money laundering program requirement those financial institutions not currently subject to FinCEN’s regulations implementing the BSA. Section 5318(a)(6) of the BSA further provides that the Secretary may exempt any financial institution from any BSA requirement. Taken together, these provisions authorize the issuance of anti-money laundering program regulations that may differ with respect to certain kinds of financial institutions, and that may exempt certain financial institutions (and, by extension, certain financial institutions within the same industry) from the requirements of section 5318(h)(1).

Although insurance companies have long been defined as a financial institution under the BSA, 31 U.S.C. 5312(a)(2)(M), FinCEN has not previously defined the term or issued regulations regarding insurance companies. In April 2002, FinCEN deferred the anti-money laundering program requirement contained in 31 U.S.C. 5318(h) that would have applied to the insurance industry. 67 FR 21110 (April 29, 2002). The purpose of the deferral was to provide Treasury time to study the insurance industry and to consider how anti-money laundering controls could best be applied to that industry, taking into account differences in size, location, and services within the industry.

Insurance can generally be described as “a contract by which one party (the insurer), for a consideration that is usually paid in money, either in a lump sum or at different times during the continuance of the risk, promises to make a certain payment, usually of money, upon the destruction or injury of ‘something’ in which the other party (the insured) has an interest.” In other words, the purpose of insurance is to transfer risk from the insured to the insurer. Insurance companies act as financial intermediaries by providing a financial risk transfer service that is funded by the payment of insurance premiums that they receive from policyholders.

The insurance industry in the United States can generally be divided into three major sectors based on a company’s line of business: (1) Life; (2) property/casualty; and (3) health. Life insurance provides protection against the death of an individual in the form of payment to a beneficiary. Life insurance may also offer “living benefits” in the form of a cash surrender value or income payments. Recently, life insurers have developed products that offer a variety of investment components, such as interest indexed universal life (which has interest credits linked to external factors) and variable life (where the amount and duration of benefits are linked to investment experience), and that offer the insured the ability to overpay the premium for a fixed rate of return. Such products are marketed to investors as part of a diversified portfolio, often with tax benefits. Annuities, which are generally considered part of the life insurance sector, are purchased to provide a stipulated income stream over a period of time, and are frequently used for retirement planning purposes. Property insurance indemnifies an insured whose property is stolen, damaged, or destroyed by a covered peril. Casualty

2 Lee K. Russ & Thomas F. Segalla, Couch on Insurance § 1:6, at 1–11 (3d ed.).

3 In 2000, the insurance industry in the United States consisted of more than 7000 domestic insurance companies and total gross direct premiums exceeded $565 billion. Net premiums written in both the life and property/casualty sectors grew annually between 1992 and 2000. In 2000, the insurance industry, including insurance companies, agents, brokers, and service personnel, employed approximately 2.3 million people.

Revised regulations implementing the BSA appear at 31 CFR Part 103. The authority of the Secretary to administer the BSA and its implementing regulations has been delegated to the Director of FinCEN.