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June 13, 2003

VIA EMAIL

Financial Crimes Enforcement Network
Department of the Treasury
regcomments@fincen.treas.gov
Attention: Section 352 Investment Adviser Rule Comments

Ladies and Gentlemen:

This letter is submitted in response to the request for comments from the Financial Crimes Enforcement Network ("FinCEN"), Department of the Treasury, on its proposed amendment to the Bank Secrecy Act ("BSA") regulations concerning Anti-Money Laundering Programs for Investment Advisers. We will refer to FinCEN's proposed rule §130.150 as the "IA Proposed Rule."

While we support the general approach taken by FinCEN with respect to establishing and coordinating a comprehensive anti-money laundering program, we are deeply concerned that the IA Proposed Rule inadvertently regulates persons who do not provide an opportunity for money laundering or terrorist financing activities.

Modification of Definition of Investment Adviser

The IA Proposed Rule would require all registered and unregistered investment advisers to maintain anti-money laundering programs under the BSA rules. We believe that adoption of the IA Proposed Rule as currently drafted would subject a far-reaching group of persons to unnecessary regulation under the BSA. Many unregistered investment advisers who engage in activities which do not provide an opportunity for money laundering or terrorist financing activities would be needlessly subject to the BSA under the IA Proposed Rule. Because many of these persons are small businesses, any increased regulation would have a material impact on their operations. We believe that the all-encompassing approach presented by the IA Proposed Rule fails to properly balance the need for a comprehensive national program to prevent money laundering against the burdens imposed by the BSA on businesses, including small businesses. FinCEN's proposed implementation of a registration requirement on unregistered investment advisers undermines Congress's purpose when it permitted an exemption from registration provided by section 203(b)(3) of the Investment Advisers Act of

1940. This federal *de minimis* exemption was purposely aimed at reducing the regulatory burden placed on small advisers, specifically those with less than 15 clients in the previous 12 months.

On September 26, 2002, FinCEN published a notice of proposed rulemaking intended to address anti-money laundering programs for unregistered investment companies (the "IC Proposed Rule"). In this notice, FinCEN proposed a tailored approach to the application of the BSA to unregistered investment companies. Instead of suggesting that each unregistered investment company be required to maintain an anti-money laundering program, FinCEN distinguished between the operations of various unregistered investment companies. Because hedge funds, private equity funds, venture capital funds, commodity pools and real estate investment trusts represent a broad scope of the type and nature of businesses that rely on the exceptions to the Investment Company Act of 1940, we believe FinCEN appropriately proposed to narrow the definition of an "unregistered investment company" under the BSA to exclude those entities that do not give an investor a right to redeem any portion of his or her ownership interest within two years after that interest was purchased.

The IA Proposed Rule's expansive application to all unregistered investment advisers completely eliminates the balanced approach previously proposed by FinCEN. Just as the definition of an "unregistered investment company" was narrowed in the IC Proposed Rule to exclude appropriate organizations, so should the definition of "unregistered investment adviser" in the IA Proposed Rule. As a result, we ask that the IA Proposed Rule be revised to provide that if a person serves as an investment adviser solely to entities excluded from the definition of an "unregistered investment company" pursuant to the exception provided by §103.132(6)(i)(B) of the IC Proposed Rule, such person should be excepted from the definition of an investment adviser for purposes of the BSA. Specifically, we request that §103.150(a)(2) of the IA Proposed Rule be modified to read:

> (2) Is exempt from registration with the SEC pursuant to section 203(b)(3) of the Investment Advisers Act (15 U.S.C. 80b-3(b)(3)) and that would be required, if it were registered with the SEC, to report in Part 1A of SEC Form ADV that it has $30 million or more of assets under management, unless:
>
> (i) such person is otherwise required to have an anti-money laundering program pursuant to another provision of this subpart, and is subject to examination by a Federal functional regulator; <u>or</u>
>
> <u>(ii) such person's clients consist solely of one or more unregistered investment companies, none of which permits an owner to redeem his or her interest within two years of the purchase of that interest</u>.

<u>Proposed Modification of Registration Form</u>

While we do not believe that unregistered investment advisers should be required to register with FinCEN, if such registration is ultimately required we request that the registration form be modified. There is no clear nexus between the information requested on the proposed registration form for unregistered investment advisers (Appendix D to Subpart I of Part 103 – Notice for Purposes of 31 CFR 103.150(d) – the "Notice") and FinCEN's enforcement of anti-

money laundering programs. For example, the Notice requires that an unregistered investment adviser affirmatively state its total number of clients. It is unclear how the identification of a number that will necessarily be between one and 14 provides FinCEN with any practical information with which to accomplish its mission in supporting law enforcement investigative efforts and fostering interagency and global cooperation against domestic and international financial crimes. Likewise, it is difficult to see how the Notice requirement that an unregistered investment adviser report the total amount of assets under management will provide FinCen with information relating to law enforcement efforts.

Because such information requested in the Notice provides no tangible benefit to FinCEN, the public disclosure of a person's total assets under management and number of clients is outweighed by such person's right to privacy. We believe that the operational activities of an unregistered investment adviser do not rise to a level that requires public reporting of its financial transactions. Such person's privilege to keep its operations out of the public domain transcends any nominal benefit garnered by the disclosure of its number of clients or total assets under management, which information is likely meaningless to FinCEN's mission. In addition, such requirement undermines Congress's purpose in excluding such persons from having to register under the Investment Advisers Act of 1940. For this reason, we request that to the extent the Department of Treasury ultimately determines that gathering Notices from unregistered investment advisers is essential to FinCEN's mission, the proposed form of Notice be modified to delete the requirements that the unregistered investment adviser must disclose it's number of clients and total assets under management.

Permit Non-affirmation of Investment Adviser Status

A significant number of persons currently engage in activities that do not necessarily rise to the level of being deemed an investment adviser as defined in section 202(a)(11) of the Investment Advisers Act of 1940. While a few federal courts have provided some guidance when addressing specific fact-based questions,[1] the activities of such persons may not fit within any of the previously decided parameters. In addition, because the extent of their activities are limited, these persons would be able to rely on the private investment adviser exemption[2] were such persons conclusively deemed to be statutory investment advisers. We believe that to the extent the Department of Treasury ultimately determines that gathering Notices from unregistered investment advisers is essential to FinCEN's mission, the Notice should be modified to permit these persons to file without making an affirmative statement that such person is a statutory investment adviser for purposes of the Advisers Act. We believe that this will ultimately result in a higher compliance rate.

[1] Wang v. Gordon, 715 F.2d 1187 (7th Cir. 1983) (finding that the general partner of a real estate partnership was not an investment adviser); Zinn v Parrish, 644 F.2d 360 (finding incidental nature of passing securities recommendations of others to a single client pursuant to an unrelated business contract did not constitute engaging in the business of advising others as to securities); In re Loring, 11 S.E.C. 885 (1942) (finding a trustee of a trust not to be an investment adviser); Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1978)(finding that a general partner of an investment partnership, in which the investors could redeem their investment each year, was an investment adviser).

[2] Section 203(b)(3) of the Investment Advisers Act of 1940.

Specifically, we request that the Notice be adjusted such that a filer may check a box to indicate that they do not necessarily affirm being a statutory investment adviser. As the SEC already employs such a concept in public filings (see, for example, Item 2 of SEC Schedules 13D and 13G), its usage with the Notice would be consistent with current practice.

Conclusion

Our foregoing comments are based on the assumption that unregistered investment advisers may, in some manner, ultimately be subject to filing and other regulatory burdens imposed by the IA Proposed Rule. However, we request that FinCEN re-examine the necessity of including unregistered investment advisers in the IA Proposed Rule.

Those persons who rely on the private investment adviser exemption do so primarily because of the relatively small size or scope of their operations. To the extent the limited activities of these persons do not provide an opportunity for money laundering or terrorist financing activities, the additional regulation under the IA Proposed Rule is not only unnecessary, but also disproportionately burdensome to small businesses. Further, inclusion of all unregistered investment advisers would bring within the scope of the BSA's anti-money laundering requirements so many unnecessary parties so as to tax the resources of the federal regulatory agencies charged with oversight of financial institutions, diminishing the effectiveness of that oversight.

Many such persons have heretofore avoided having to engage expensive legal counsel specializing in Advisers Act issues. Reliance on the *de minimis* safe harbor provided by section 203(b)(3) precludes these persons from exhausting precious resources on discrete legal questions under the Advisers Act. Particularly if required to affirmatively state the exact number of clients and the total amount of assets under management, as determined under the Advisers Act, and to establish and maintain any sort of meaningful anti-money laundering program, a small business would be required to engage specialized legal counsel at extensive costs. This additional expense is unwarranted.

Thank you very much for the opportunity to comment on this important matter. If you have any questions concerning these comments, or if we can be of assistance in connection with this matter, please do not hesitate to contact me at the number indicated above.

Very truly yours,

Sean Caplice