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June 26, 2003

Financial Crimes Enforcement Network
Section 352 Investment Adviser Rule Comments
P.O. Box 39
Vienna, Virginia 22183

Re: Anti-Money Laundering Programs for Investment Advisers
(RIN 1506-AA28)

Ladies and Gentlemen:

We are submitting this letter in response to the Financial Crimes Enforcement Network's ("FinCEN") request for comment on proposed rules ("Proposed Adviser Rules") under the Bank Secrecy Act ("BSA") that would require certain investment advisers to establish anti-money laundering programs ("AML Programs").[1]

We serve as counsel to a number of sponsors of private equity funds. Since 1991 our firm has been involved as counsel for sponsors of or investors in over 575 private equity funds with committed capital in excess of $300 billion. While our experience with these clients informs our comments, this letter reflects the views of our firm and not of any particular group of fund sponsors. Our fund sponsor clients are either registered under the Investment Advisers Act of 1940 ("Advisers Act") or rely upon the exemption from registration as investment advisers under section 203(b)(3) of that Act.

Private equity funds are investment pools that are not subject to regulation under the Investment Company Act of 1940. The typical private equity fund invests in illiquid securities that represent a significant ownership interest in a company. Private equity funds are often used as vehicles for venture capital investments or various types of acquisitions.

Securities issued by private equity funds themselves are very illiquid for legal and other reasons. Most importantly, from an anti-money laundering perspective, the typical private equity fund does not offer investors an opportunity to redeem their securities. For this reason, as discussed below, FinCEN has determined that these types of funds are unlikely to be used by money launderers and that it is unnecessary for these types of funds to establish AML Programs.[2]

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1 Anti-Money Laundering Programs for Investment Advisers, RIN 1506-AA28, 68 FR 23646 (May 5, 2003).

2 *See* Anti-Money Laundering Programs for Unregistered Investment Companies, RIN 1506-AA26, 67 FR 60617 (Sept. 26, 2002).

We have two basic comments on the proposed rules. First, certain investment advisers should not be subject to the rules at all because their only clients are the type of private funds that FinCEN has concluded do not present any appreciable money laundering risks. Second, the requirements of the rule should be tailored to ensure that investment advisers that would otherwise be subject to the rule do not have to engage in unnecessary due diligence with respect to these private funds. We have attached suggested changes to the Proposed Adviser Rules that would address our comments.

A. Private Funds and Their Investment Advisers

As a starting point, we believe that the scope of the Proposed Adviser Rules should be consistent with the scope of the proposed rules requiring the implementation of AML Programs by certain unregistered investment companies (the "Proposed Private Fund Rules"). The Proposed Private Fund Rules would require unregistered investment companies ("Private Funds") to establish AML Programs. Certain types of Private Funds would be exempt from these rules, including funds that do not provide investors a right to redeem any portion of their ownership interest within two years after the date the interest was purchased ("Exempt Private Funds"). FinCEN's rationale for this approach reflects an appropriate balancing between the burdens imposed by AML Programs and the limited risk that Exempt Private Funds would be used to launder money:

> [C]ompanies 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 . . . 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.**[3]

This same sound logic should apply to investment advisers (whether registered or unregistered under the Advisers Act) that limit their activities to sponsoring Exempt Private Funds. These investment advisers limit their activities to the type of Private Funds that FinCEN has concluded do not present any appreciable money laundering risks. These advisers therefore should not be required to establish AML Programs.

B. Exempt Private Funds and Investment Adviser AML Programs

Many investment advisers that sponsor Exempt Private Funds do not limit their advisory activities to those funds; they may also manage Private Funds that will be

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[3] *Id.* (emphasis added).

required to have AML Programs under the Proposed Private Fund Rules, as well as other types of accounts that may or may not be required to have AML Programs in place.

The Proposed Adviser Rules appear to contemplate that an adviser's AML Program would require a fairly detailed analysis of a pooled investment vehicle sponsored by the adviser if the pooled investment vehicle is not subject to the BSA's anti-money laundering program requirements. The proposing release suggests that the adviser's AML Program would be required to address the investors in that pooled investment vehicle under the same criteria as the adviser uses for its non-pooled vehicle clients. Such criteria include the type of entity, its location, the statutory and regulatory regime of that jurisdiction, the adviser's historical experience with that entity or the references of other financial institutions. Moreover, if any of the investors are themselves pooled investment vehicles (*e.g.*, hedge funds or pension funds), then the adviser would need to address the money laundering risks posed by the pooled entity investing in the adviser's fund (and any other intermediary that may be involved) under these same criteria.

We do not believe that these procedures should be applicable to a pooled investment vehicle that presents a low level of money laundering risk. The Proposed Adviser Rules do make an effort to ensure that an adviser's AML Program will not be unnecessarily broad by specifying that the adviser "may exclude from its [AML] program any pooled investment vehicle it advises that is subject to an [AML] program requirement under another provision of this subpart." We believe that this provision should be modified to exclude Exempt Private Funds as well. This change would appropriately limit the scope of required AML Programs to take into account the low-risk nature (from a money-laundering perspective) of Exempt Private Funds. As discussed above, FinCEN has concluded that Exempt Private Funds present a very low level of money laundering risk – so low that they do not have to establish their own AML Programs. There is no reason to reintroduce the burden at the investment adviser level.

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We appreciate the opportunity to comment on the Proposed Adviser Rules and would be pleased to answer any questions you might have regarding our comments. Please contact Woodrow W. Campbell, Jr. at (212) 909-6779 or Kenneth J. Berman at (202) 383-8050.

Respectfully submitted,

DEBEVOISE & PLIMPTON

Appendix

Suggested Changes to Proposed Adviser Rules

§ 103.150 Anti-money laundering programs for investment advisers.

(a) *[~~Definition~~] Definitions*. For purposes of this section[~~, the~~] –

(1) The term *exempt private fund* means a company that is not an "unregistered investment company" under 31 CFR § 103.132(a)(6) because it does not permit an owner to redeem his or her ownership interest within two years of the purchase of that interest.

(2) (i) The term *investment adviser* means a person whose principal office and place of business is located in the United States that:

([~~1~~]A) Is registered or required to be registered with the Securities and Exchange Commission (SEC) under section 203(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(a)) and reports or is required to report in Part 1A of SEC Form ADV (*see* 17 CFR 279.1) that it has assets under management; or

([~~2~~]B) 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 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.

(ii) Notwithstanding subsection (a)(2)(i) of this rule, the term *investment adviser* does not include an investment adviser whose only clients are exempt private funds.

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(b) *Anti-money laundering program required.* Effective [the date that is 90 days after the date of publication of the final rule in the **Federal Register**]:

(1) Each investment adviser shall develop and implement a written anti-money laundering program reasonably designed to prevent the investment adviser from being used for money laundering or the financing of terrorist activities and to achieve and monitor compliance with the applicable provisions of the Bank Secrecy Act (31 U.S.C. 5311 *et seq.*) (BSA) and this part. The investment adviser may exclude from its anti-money laundering program any pooled investment vehicle it advises (i) that is subject to an anti-money laundering program requirement under another provision of this subpart or (ii) that is an exempt private fund.