FPA
THE FINANCIAL PLANNING ASSOCIATION

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FinCEN
Section 352 Investment Adviser Rule Comments
P.O. Box 39
Vienna, VA 22183

Re: Section 352 Investment Adviser Rule Comments

Dear Sir or Madam:

The Financial Planning Association ("FPA") provides the following comments concerning the referenced proposed rule on anti-money laundering. FPA is the largest organization in the United States representing the financial planning profession, with 29,800 individual members. A significant number of financial planners registered with the Securities and Exchange Commission ("SEC" or the "Commission") maintain discretion over client assets, and would be subject to the proposed rule.

In the wake of 9/11, FPA understands and appreciates the need for the Treasury Department to close loopholes for money laundering by terrorist organizations. Registered investment advisers, like larger financial institutions, may have a role to play in that prevention effort. FPA believes, however, that the rule as proposed would have a significant, adverse impact on investment advisers, especially small firms, and that the compliance burden would significantly outweigh the resulting *de minimis* benefits. Moreover, the proposed rule would transform the role of investment advisers with assets under management from that of portfolio *monitors* into portfolio *investigators*, which would put them in a

role that far exceeds their traditional portfolio management oversight. The proposed rule, accordingly, should be changed to reflect that reality.
Due to the highly personalized nature of a financial planner's business, planners become well acquainted with their clients. For that very reason, it is unlikely that a terrorist organization would use a financial planning firm to launder funds. (Money launderers want to be anonymous, which is not the case with financial planning clients.) But while investment advisers know much about their clients' personal financial goals, that knowledge is limited to the extent to which the clients may provide detailed information on spending patterns.

When providing portfolio management services, financial planners review their clients' investment portfolios periodically, and are obviously aware of how their clients' account balances change over time. Investment advisers also may have discretion over client cash accounts, such as money market mutual funds, although as non-custodians, <u>advisers typically do not have access to specific cash flow data that permit the investment adviser to see how funds are disbursed</u>. By monitoring client account balances on an ongoing basis, the adviser becomes aware when an account has more or less cash than usual, which under normal circumstances might suggest the need – typically on a quarterly basis -- to re-balance the account in helping the client stay on target to meet long-term investment goals. But advisers typically do not have access to, nor would they necessarily inquire about why, where, and to whom distributions were made.

Based on the financial planner's relationship with his or her clients, however, there may be an appropriate role for them to play in combating money laundering. Financial planners desire to be good corporate citizens. However, the requirements for any anti-money laundering program need to recognize that there are minimal risks of money laundering involved in the investment advisory business and that there are practical limits on the ability of an investment adviser to identify a money laundering activity without resorting to an investigative role.

To the extent an anti-money laundering program is warranted for investment advisers, FPA generally supports the proposed rule, but with several critical modifications.

FPA supports the concept of an SEC-registered investment adviser with discretionary accounts conducting a risk-based analysis in attempting to identify any "red flags" that indicate potential money laundering activities. The investment adviser could also train its employees in how to monitor and identify unusual circumstances. These types of activities would be consistent with the monitoring role of an investment adviser.

As stated in the preamble, however, the proposed rule would require the investment adviser to establish and implement certain policies and procedures that erroneously assumes the investment adviser generally has access to specific disbursement data. Even if the investment adviser had such information, it would require the adviser to act as an investigator if he or she were to ascertain the reason for a significant withdrawal or deposit– a role that is more appropriate for law enforcement personnel. Specifically, the proposed rule would have the investment adviser investigate suspicious activity with respect to disbursements for which only the custodian – not the asset manager -- would have detailed information. It is not clear under the proposed rule whether the investment adviser would have a duty to report such activity to law enforcement, as with a suspicious activity report, or what the adviser's liability would be if it fails to report that activity or fails to investigate the nature of unusual financial activity. FPA seeks clarification concerning what type of reporting requirements would be required under the proposed rule.

The two presumptions about data access addressed in the preamble to the proposed rule are of particular concern. These would require the investment adviser to:

- Identify unusual transactions associated with the placement of funds into an account, such as when funds are drawn on accounts of parties having no apparent relationship to the client, or when numerous checks or transfers are used; and

- Identify unusual transactions associated with the withdrawal of assets from an account, such as transfers to unrelated accounts or accounts located in certain foreign countries.

A third requirement, to assess the reasonableness of certain additions or withdrawals from an account given the clients' investment objectives and the firm's knowledge about the person, would require the investment adviser to determine whether the deposits or withdrawals were consistent with the client's investment objectives. Absent simply reporting unusual activity to the FINcen hotline as a suspicious activity, the adviser would have to "pry" into the clients' affairs beyond the scope of the client engagement to determine whether a withdrawal was made for legitimate reasons. Especially with new clients, many withdrawals may be made to people with whom the investment adviser is unfamiliar, so any disbursement would be a potential money laundering activity. The investment adviser also would have to track the number of transactions into and out of an account, and determine a threshold that would alert the adviser when there are an unusually high number of transactions. The investment adviser also would have to assess the reasonableness of deposits and withdrawals in connection with the clients' investment objectives and the firm's knowledge about the individual.

These requirements raise several questions that suggest why it would be extremely difficult for an investment adviser to comply effectively with the intent of the proposed rule:

- How does the investment adviser establish a protocol that will alert it to situations where there is a questionable relationship between the client and a source of funds, or to situations involving too many transactions? What criteria would be used to indicate when there is a need for further investigation?

- To what extent must the investment adviser investigate unusual transactions? What type of analysis is required to satisfy the investment adviser that the client is not engaged in money laundering?

- How does an investment adviser assess the "reasonableness" of deposits or withdrawals in relation to relevant factors? What factors would be relevant, and what factors can be overlooked? To what extent would an analysis of those factors be required? Would the investment adviser be required to contact a client to determine what his or her motives were in relation to a particular transaction?

Each of these questions points to the main problem with the policies and procedures the proposed rule would require an investment adviser to establish: While the purpose is to address the role of the investment adviser in identifying questionable transactions, the gap between the desired ends (identifying suspicious activity) and the means to achieve those ends is amorphous. It would be extremely difficult for an investment adviser to create an identification program that is both relevant to the problem of identifying money laundering and workable within the time and financial constraints on investment advisers. We question whether the listed requirements, if implemented, could guard against money laundering unless the adviser had regular access to data on individual disbursements and knew something about the individuals.

Further, the rule creates a unique burden on smaller advisory firms who may be required to hire an independent auditor, if in-house personnel were unavailable to independently test the program. We disagree with the Rule's brief analysis of the Regulatory Flexibility Act that concludes expenditures associated with establishing and implementing an anti-money laundering program would be commensurate with the size of the firm and a *de minimis* cost for small firms. The costs would be disproportionately higher for a small firm, particularly for the nearly 400 sole proprietors having to outsource the testing program.[1] No specific costs, or range of costs based on size of firm by personnel or assets under management, are provided in the Rule's brief discussion of costs. We anticipate that these costs could run into the thousands of dollars for each audit of a small firm.

Concerning the need for clarification in a final Rule, we also ask for confirmation that an investment adviser acting as an investment management consultant would not be covered by the rule because the consultant would not be directly managing assets, but overseeing performance objectives. We seek clarification because SEC rules permit investment advisers to count as assets under management those accounts where they have discretionary authority to hire and fire managers and reallocate assets among them.[2]

With respect to whether the proposed rule would impose duplicative regulation on investment advisers that are also registered broker-dealers, FPA urges FinCEN to confirm that compliance with the broker-dealer's anti-money laundering rule constitutes compliance with the rule applicable to investment advisers. The proposed rule is not clear on that point. For example, the proposed rule says that a dually registered broker-dealer/investment adviser is only required to have one anti-money laundering program, but that it would still have to satisfy each of the anti-money laundering requirements applicable to investment advisers. Advisers that are dually registered as broker-dealers should not have to comply with ambiguous and separate sets of requirements.

In conclusion, it seems that in large part the USA Patriot Act was enacted to raise the level of awareness among various types of financial institutions concerning the need to be vigilant about the susceptibility of the U.S. financial system to money laundering. That suggests a monitoring function. It is certainly worthwhile, accordingly, to have an investment adviser that manages client assets raise the level of awareness concerning money laundering by requiring it to review any potential vulnerabilities to money laundering. It would also seem prudent for the investment adviser to establish a training program so that employees are aware of some of the "red flags" identifying suspicious activities. But it is not appropriate for investment advisers to become investigators, and the rule as proposed would require them to potentially transform their role of trusted adviser to private detective in surveillance of their own clients.

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[1] *See* "Evolution Revolution: A Profile of the U.S. Investment Advisory Profession," IARD survey data published by Investment Counsel Association of American and National Regulatory Services, September 2002.

[2] *See* Form ADV: Instructions for Part 1A at 7.

Please do not hesitate to contact the undersigned at 202.626.8770 if you have any questions or comments.

Sincerely,

Duane R. Thompson

Duane R. Thompson
FPA Group Director -- Advocacy