

definition is extremely broad, listing numerous types of businesses, and section 5312(a)(2)(Y) authorizes the Secretary to include additional types of businesses within the BSA definition if he determines that they engage in any activity similar to, related to, or a substitute for any of the listed businesses. Because of the types of activities certain investment advisers engage in and the services they provide, FinCEN is proposing to exercise its authority to define these investment advisers as financial institutions solely for purposes of section 5318(h) and to require them to establish anti-money laundering programs.

An investment adviser is defined in the Investment Advisers Act of 1940 (Advisers Act) (15 U.S.C. 80b *et seq.*) as “any person who, for compensation, engages in the business of advising others * * * as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or * * * issues * * * analyses or reports concerning securities,” subject to certain exceptions.⁵ Many investment advisers provide investment advice to clients who have granted the adviser the power to manage the assets in their accounts, frequently on a discretionary basis. As a result, these investment advisers engage in activities that are “similar to, related to, or a substitute for” financial services that are provided by other BSA financial institutions.

Advisers managing clients’ assets work so closely with other BSA financial institutions—such as by directing broker-dealers to purchase or sell client securities or by directing banks to transfer client funds—that the advisers’ activities are related to those of the other financial institutions. Advisers’ services can be a substitute for products offered by investment companies or insurance companies, for example, when clients seek to have advisers manage their assets through other forms of pooled investment vehicles or through separate accounts. Some investment advisers offer asset management services that are similar to, and that may even compete directly with, asset management services provided by certain banks through their trust departments. FinCEN also notes that the close interrelationship between investment advisers and other financial institutions (such as securities broker-dealers, mutual funds, commodity trading advisors, and commodity pool

commodity trading advisors that are registered or required to register under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*).

⁵ Advisers Act, Section 202(a)(11) (15 U.S.C. 80b-2(a)(11)).

operators) is further demonstrated by the fact that they are often jointly registered with, affiliated with, or sponsored by each other.

III. Money Laundering and Investment Advisers

Money laundering occurs when money from illegal activity is moved through the financial system to make it appear that the funds came from legitimate sources. Money laundering usually involves three stages, known as placement, layering, and integration. In the placement stage, cash or cash equivalents are placed into the financial system. Investment advisers rarely have occasion to receive currency from or disburse it to clients. Nevertheless, in some instances, FinCEN has received reports of suspicious activities indicating that clients may attempt to use investment advisers in the placement stage. These reports include attempts by clients to structure transactions with an investment adviser to avoid reports of currency transactions,⁶ as well as attempts to fund accounts with fraudulent checks.

“Layering” describes the distancing of illegal proceeds from their criminal source through the creation of complex layers of financial transactions. A money launderer could use its client account with an investment adviser as one of many accounts in a layering scheme, frequently transferring funds to the adviser for management and then withdrawing the funds or transferring them to accounts at other institutions. Layering could also involve establishing an advisory account in the name of a fictitious corporation or an entity designed to conceal the true owner. For example, FinCEN in one instance received reports of suspicious activity involving an investment advisory client who established an account under an alias for the family of a Colombian narcotics trafficker. Investment advisory firms could also be used for integrating illicit income into legitimate assets. “Integration” occurs when illegal funds previously placed into the financial system are made to appear to have been derived from a legitimate source. For example, proceeds from investments made on a client’s behalf by an investment adviser would appear legitimate to any financial institution receiving such proceeds.

The crime of money laundering also encompasses the movement of funds to support terrorism or terrorist organizations.⁷ These funds may be

⁶ “Structuring” is described *infra* at note 25 and accompanying text.

⁷ 18 U.S.C. 1956, 2339A, and 2339B.

from illegitimate or legitimate sources. Even where the funds derive from legitimate sources, money launderers might attempt to use investment advisers to aid movement of the funds through the money laundering patterns described above, in order to disguise the identity of the originator of the funds.

Investment advisers in the United States today control over \$21 trillion in assets.⁸ Although advisers rarely hold financial assets themselves and even more rarely accept cash, they are often in a critical position of knowledge as to the movement of large amounts of financial assets through financial markets.⁹ If some of these assets include the proceeds of illegal activities, or are intended to further such activities, an anti-money laundering program should help discover them. In some cases, an investment adviser may be the only person with a complete understanding of the source of invested assets, the nature of the clients, or the objectives for which the assets are invested. Other market participants may, for example, hold and trade assets in an account controlled by the adviser, but these parties often rely solely on an investment adviser’s instructions and lack knowledge of the adviser’s clients. In other cases, an adviser may be the only participant aware of the overall investment program of a client who may use multiple broker-dealers to trade securities in transactions that individually may not raise money laundering concerns.¹⁰ As a result, FinCEN believes that investment advisers have an important role to play in preventing the use of their services for money laundering and the financing of terrorism.¹¹

⁸ Information filed by investment advisers registered with the SEC shows that these advisers had assets under management of over \$21 trillion as of February 2003.

⁹ Rule amendments proposed by the SEC would generally prohibit an adviser from holding clients’ funds or securities directly; instead, the adviser would have to maintain these assets in accounts with a broker-dealer, bank, or other qualified custodian. *Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Release No. 2044 (July 17, 2002) (67 FR 48579 (July 25, 2002)).

¹⁰ 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 knowledge that proceeds were derived from illegal activity if he or she ignored “red flags” that indicated illegality.

¹¹ Moreover, FinCEN is concerned that the failure of advisers to implement effective anti-money laundering programs may result in money launderers seeking their services to access financial

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