

A large, stylized hourglass graphic is positioned on the left side of the cover. The top bulb is filled with a dark teal liquid, while the bottom bulb is empty. The hourglass is set against a background of a white sheet of paper that is being folded over the top right corner, creating a diagonal crease. The overall color palette is dominated by teal and white.

The US Private Equity Fund Compliance Guide

How to register and maintain an active and effective compliance program under the Investment Advisers Act of 1940

Executive Summary

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Anti-money laundering

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Introduction

For nearly 40 years, anti-money laundering (AML) compliance has been an important concern to financial services firms of all shapes and sizes. Since the terrorist attacks of September 11, 2001, AML compliance has taken on a new dimension as a significant and necessary tool in the fight against global terrorism. Accordingly, financial services firms are facing ever-increasing pressure from the federal government to ensure that their operations are not being used as a means to launder illicit, and possibly terrorist-related, funds.

For most financial firms – banks, mutual funds and broker-dealers – AML obligations are specifically and clearly laid out in a series of laws and implementing regulations by the US Treasury Department. At a minimum, these financial entities are required to implement a written AML program that includes policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions; the designation of an AML compliance officer; regular and independent tests of the firm's AML program; and a written customer identification program.

Although many financial services firms – including mutual funds – are required by law to implement an AML compliance program, the Department of the Treasury does not currently impose such obligations on non-mutual fund investment companies such as private equity funds. However, where government regulations end, market pressures begin. In today's financial environment, 'investment companies'¹ face increasing pressure from investors and counterparties to implement robust and risk-based AML compliance programs similar to those required by law for other firms. Accordingly, it is prudent for all private equity firms to put in place policies and procedures to ensure that they are not used as a step in a money laundering scheme. This chapter will provide an overview of the best practices for a private equity firms in creating and implementing such an AML program.

What is money laundering?

Money laundering is a scheme or practice of engaging in financial transactions to conceal the identity, source or destination of illegally obtained money. Contrary to popular fiction, participation in and liability for money laundering is not limited to drug dealers, gun runners or terrorists. Financial intermediaries who participate in transactions designed to conceal illegally obtained money may face criminal or civil liability.

With respect to financial intermediaries, active participation in the laundering scheme is not required for liability. Money laundering includes a failure to act when required, willful

¹ Private funds under the Investment Company Act of 1940 (the 'Investment Company Act') have the substantive characteristics of investment companies, but are exempted from the definition of 'investment company' under that Act and almost all requirements to which registered investment companies are subject.

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blindness to the source of a client's money, failing to report suspected attempts at money laundering or failing to maintain adequate books and records of transactions. It is important to recognize that while the scheme is termed 'money' laundering, the actual improper transaction need not actually involve the movement of cash.

At a fundamental level, money laundering typically occurs in three stages. First is the 'placement' stage, where illegally obtained money is introduced into the legitimate financial system – either deposited into an account or converted into a financial instrument. The second step in the washing cycle is the 'layering' stage. Layering involves creating a series of complex financial transactions to obfuscate the audit trail and conceal the source of the illegally obtained funds. In an effort to hide the illegal origins of the money, the criminal may switch accounts multiple times before moving to the third and final phase – 'integration.' In this stage, the laundered funds are reintroduced into the legitimate economic and financial systems in such a way as to make the funds appear legitimate.

Understandably, going after the fruits of past criminality and the funding for future criminality or terrorist activity is of paramount concern to the nation's law enforcement and national security establishment. Accordingly, the federal government enacted two laws that make it a federal offense for any person or entity to conduct or attempt to conduct a financial transaction which in fact involves the proceeds of specified unlawful activity – for example, drug trafficking, mail fraud or wire fraud – with the intent to continue the unlawful activity.² Federal criminal liability extends to more than actual knowledge, but also to 'willful blindness' of the nature of the activity. If found guilty, the punishment can include a fine of \$500,000 or up to twice the value of the property involved in the money-laundering transaction or imprisonment of up to 20 years.

Since its passage in 1970, the Bank Secrecy Act (BSA, or otherwise known as the Currency and Foreign Transactions Reporting Act) has been the primary anti-money laundering statute of relevance to financial institutions. The BSA is a reporting and record keeping statute designed to ensure financial institutions do not remain 'willfully blind' to potential money laundering activity. Under the BSA, financial institutions are to investigate certain high-risk transactions and report them to the government.

Specifically, the BSA requires financial institutions to:

- file currency transaction reports (CTRs) for same-day cash transactions over \$10,000;
- file a Report of International Transportation of Currency or Monetary Instruments for the transportation of currency or monetary instruments of over \$10,000 into or out of the US;
- maintain a monetary instrument log (for a five-year period) of cash purchases of monetary instruments totaling \$3,000 to \$10,000;

² Codified at Sections 1956 and 1957 of the Title 18 of the US Code.

**Laws that
regulate and/or
prevent money
laundering
Federal
criminal laws**

**The Bank
Secrecy Act**

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- report interests in foreign financial accounts on the Report of Foreign Bank and Financial Accounts (FBAR); and
- file a suspicious activity report (SAR) for any suspicious transaction relevant to a possible violation of law or regulation.

Although many investment advisers and transfer agents are subject to the BSA because of their status as banks or part of a bank holding company, funds of any kind (including investment companies registered under the Investment Company Act) were not originally subject to the BSA's reporting or recordkeeping requirements. That exclusion changed in 2001.

The USA Patriot Act

On October 26, 2001, President Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act or Patriot Act). The Patriot Act was a sweeping piece of legislation enacted in the wake of the September 11, 2001 terrorist attacks. Specifically, Title III of the Patriot Act – the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 – has proven to be the most significant US anti-money laundering legislation since passage of the BSA in 1970.

Closing a gap in the BSA, the Patriot Act specifically expanded the definition of 'financial institution' to include 'investment companies' (including both registered funds under the Investment Company Act and funds that are exempted from the definition of 'investment company' and therefore not regulated under that Act). The Patriot Act also amended the BSA to impose new anti-money laundering compliance obligations on all financial institutions. Specifically, the Patriot Act requires that financial institutions implement AML programs that include the following elements:

- the development of internal policies, procedures and controls designed to detect and prevent money laundering;
- the designation of a compliance officer to oversee the AML program;
- an ongoing employee training program on how to detect and prevent money laundering; and
- an independent audit function to test the AML program.

Although the Patriot Act requires AML programs for all financial institutions, the Act also gave the Secretary of the Treasury (or its designate, the Financial Crimes Enforcement Network [FinCEN]) wide latitude to issue rules or regulations implementing provisions of the Act. Specifically, the Secretary is permitted to clarify portions of or definitions in the Patriot Act, and is also permitted to exempt categories of financial institutions from the statutory requirement to implement an AML program.

Shortly after the Act's passage, the Treasury turned its attention to some of the more loosely defined terms in the Act, such as 'investment company.' However, not all investment companies are created equal. Indeed, the Treasury's rulemaking efforts with respect to investment companies have made distinctions between mutual funds, closed-end

The Office of Foreign Asset Control

funds and other investment funds (for example, private equity funds, hedge funds and venture capital funds). For example, on April 29, 2002, FinCEN published a rule specifically requiring mutual funds – that is, open-end investment companies – to establish and implement AML programs.³ However, other types of funds – including private equity funds – were exempted from any AML provision of the Patriot Act. In 2008, FinCEN explicitly stated it would not proceed with AML requirements on unregistered investment companies or investment advisers without further rulemaking.⁴ As FinCEN noted, any concern associated with money laundering through an unregistered investment company is abated by the fact that most transactions must be conducted through entities that are already subject to BSA-Patriot Act requirements regarding AML compliance; accordingly, there is minimal risk of money laundering through these unregulated investment companies.

Although FinCEN has indicated that it will not currently impose any AML requirements on private equity funds and their investment advisers, such entities are still obligated to comply with other AML-sanctioned regimes, that is, those of the Office of Foreign Asset Control (OFAC).

OFAC is an office within the Treasury Department that administers and enforces economic and trade sanctions against targeted foreign countries, groups of individuals (that is, terrorists and narcotics traffickers) and others in furtherance of US foreign policy and national security goals. OFAC's authority derives from the President's Wartime and National Emergency Powers and other specific legislation that allows the office to impose controls on certain financial transactions and freeze certain assets under US jurisdiction. All US persons – located anywhere in the world – must comply with OFAC regulations. The term 'US persons' is immensely broad and includes US citizens, resident aliens, all persons and entities within the US, all US incorporated entities and their foreign branches, and in certain limited circumstances, foreign subsidiaries of US entities and foreign persons.

As part of its sanctions program, OFAC publishes and regularly updates lists of sanctioned countries and persons. OFAC's list of specially designated nationals and blocked persons (SDNs) identifies individuals and entities whose property is subject to blocking

³ *Anti-Money Laundering Programs for Mutual Funds*, 67 Fed. Reg. 21,117 (April 29, 2002) at http://www.fincen.gov/statutes_regs/frn/pdf/352mufunds.pdf.

⁴ FinCEN had previously suggested proposed rules regarding non-mutual fund investment companies and investment advisers. Specifically, on September 26, 2002, FinCEN issued a notice of proposed rulemaking to require 'unregistered investment companies' to establish and implement AML programs. FinCEN, however, included a specific exclusion for those funds that subjected their investors to a two-year lock up on the grounds that there was less risk of money laundering in funds where money is not readily accessible. Similarly, in mid-2003, FinCEN proposed requiring investment advisers to establish and implement AML programs.

Because most of the institutions subject to the proposed rule have never been subject to federal financial regulations, implementation of AML requirements raised serious practical and policy considerations. Accordingly, FinCEN affirmatively stated that proposed rule would not be binding until finalized.

FinCEN never finalized either proposal and on October 29, 2008 – given the passage of time – formally withdrew both proposed rules.

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and with whom US persons cannot do business. OFAC also maintains sanctions programs that include a broad list of restricted countries.⁵

Liability for violating OFAC regulations can be quite severe. Criminal penalties can include fines ranging from \$50,000 to \$10,000,000 and imprisonment ranging from 10 to 30 years for willful violations. Civil penalties range from \$250,000 or twice the amount of each underlying transaction, up to \$1,075,000 for each violation. The OFAC sanctions constitute a strict liability regime, where liability is imposed regardless of any culpability, including intent or negligence.

OFAC guidance for securities industry

On November 5, 2008, OFAC issued compliance guidance for the securities industry. Specifically, OFAC published the *Opening Securities and Futures Accounts from an OFAC Perspective*, and revised its *Risk Factors for OFAC Compliance in the Securities Industry*. Although the OFAC sanctions constitute a strict liability regime, the OFAC guidance is clear that securities firms should develop risk-based OFAC compliance programs. In evaluating a contemplated enforcement action or determining penalties for violations, OFAC will consider the existence, extent and adequacy of a firm's transaction processing system, as well as its overall OFAC risk-based compliance program.

Guidance for private equity funds regarding AML policies and procedures

Although FinCEN and the Treasury Department exempt private equity funds and their advisers from AML compliance, it is best practice for private equity funds to put in place an AML program that complies with the BSA/Patriot Act and OFAC regimes because: (i) funds are still subject to criminal and OFAC liability; (ii) the Treasury Department has indicated a desire to revisit whether investment advisers or non-mutual fund investment companies fall under the definition of financial institution in BSA; and (iii) parties that are subject to AML requirements often require counterparties to transactions to also have AML programs. The AML program should be tailored to the specific business of the private equity fund, and take into account such factors as the nature and location of investors and investment lock-up time frames.

Written AML program

The fund manager should adopt a written AML program, which should be approved by the private equity fund's senior management. The basic framework of the written AML program should include:

- the development of internal policies, procedures and controls designed to detect and prevent money laundering;
- the designation of a compliance officer to oversee the AML program;
- an ongoing employee training program on how to detect and prevent money laundering; and
- an audit to test the AML program.

⁵ Restricted countries include Cuba, Iran, North Korea and Syria. Both lists in their entirety may be found on OFAC's website at <http://www.treas.gov/offices/enforcement/ofac/>.

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AML compliance officer

The private equity fund's designated AML compliance officer should have sufficient authority and resources to implement the written AML program. The AML compliance officer should:

- actively monitor the fund manager's compliance with AML laws and the written AML program;
- coordinate AML training for appropriate personnel;
- consult with appropriate persons, including the fund's senior management, in deciding whether to accept or reject an investor based on money laundering risks;
- evaluate, in consultation with others, whether to delegate portions of AML compliance to third parties;
- review internal reports of suspicious activity and determine whether to report such suspicions to law enforcement; and
- consider an outside review of the AML program.

Although the compliance officer may serve other roles within the private equity fund, he/she should not hold any position where actual money laundering could occur, that is, processing subscriptions or redemptions.

Investor identification program

As part of the AML program, the fund manager should establish and maintain a program that is reasonably designed to identify investors in the fund. The due diligence of an investor identification program (also known as a customer identification program or CIP in the retail investment market) includes: (i) identifying the identity of a direct investor acting on his or her own behalf; (ii) if an investor is acting on behalf of others, identifying the underlying investors; or (iii) determining that it is acceptable to rely on the due diligence efforts of a third party, such as an investment intermediary. It would be prudent to identify investors – direct or underlying – and whether additional due diligence is required prior to accepting an investment or within a reasonable time after an account is opened.

It is also a prudent practice for subscription documents to require investors to covenant that all identification information provided is genuine and accurate, and that the investor agrees to provide any other information or documentation necessary for compliance with the private equity fund's AML program. With respect to direct investors, subscription documents should also include an agreement that the investor is acting solely on his or her own behalf.

In order to confirm a natural person investor's identity, the fund manager should take reasonable steps to ascertain the investor's name, address and, if applicable, social security number or taxpayer identification number. Supporting documentation to confirm an investor's identity includes passports, government-issued photo identification, utility bills containing the investor's name and address, reports from credit bureaus or other generally available public information confirming identity.

With respect to a legal entity investor, the fund manager should take reasonable steps to obtain the entity's name, address, taxpayer identification number and the entity's authority

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to make the investment. Supporting documentation includes articles of incorporation, government-issued business license, partnership agreement, trust instrument or other such generally available public information.

However, when either a natural person or legal entity investor's funds are wired from a financial institution located in a Financial Action Task Force (FATF) member-nation,⁶ no additional information may be generally necessary unless there is a specific money laundering concern, or the investor is otherwise considered a prohibited or high-risk investor (discussed in more detail below).

In addition to a pre-check prior to accepting investment funds, the fund manager should perform reasonably timed follow-up checks after the initial investment to ensure that investors continue to not be prohibited or high-risk investors. Based on the nature of the fund's business (for example, extended lock-up period for redemptions), such follow-up checks can be done as infrequently as annually or longer, but in all events should be reasonably tailored to the fund's specifics. At a minimum, the private equity fund should perform a follow-up check prior to redemption or any other distribution to investors. In particular, the private equity fund should perform a follow-up check if a redemption is requested to be made to a different address or investor name than that given at the time of the subscription.

Enhanced due diligence for high risk investors

Certain potential investors present a higher risk with regard to money laundering concerns. High-risk factors include, but are not limited to:

- investors or investment companies located in non-FATF jurisdictions or jurisdictions designed by FATF as 'non-cooperative';⁷
- an investor whose investment is routed from or through an account held in a foreign shell bank,⁸ an 'offshore bank,'⁹ a bank organized or chartered in a jurisdiction designed by FATF as non-cooperative, or a bank subject to special measures under Section 311 of the USA Patriot Act;¹⁰
- an investor who is a bank subject to enhanced due diligence requirements of Section 312 of the Patriot Act;¹¹

⁶ FATF, also known by its French name Groupe d'action financière (GAFI), is an inter-governmental organization created in 1989 whose purpose is the development and promotion of national and international policies designed to combat money laundering and terrorist financing.

⁷ A list of FATF members and observers may be found at <http://www.fatf-gafi.org>.

⁸ A bank chartered in foreign jurisdiction, but with no physical presence anywhere in the world.

⁹ A bank that, although licensed to perform banking activities, is prohibited from engaging in any banking activities with the citizens of, or in the local currency, of the licensing jurisdiction.

¹⁰ Section 311 of the Patriot Act (adding Section 5318A of the BSA) authorizes the Secretary of the Treasury to designate a foreign jurisdiction, institution, class of transactions or type of action as being of 'primary money laundering concern,' and to impose one or more of five special conditions.

¹¹ Section 312 of the Patriot Act requires US financial institutions to apply enhanced due diligence when a correspondent account is requested or maintained by, or on behalf of, a foreign bank operating: (i) under an offshore banking license; (ii) under a banking license that has been designed non-cooperative by FATF; or (iii) designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns.

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- an investor who is a senior foreign political figure (SFPF), a politically exposed person (PEP)¹² or an immediate family member or close associate of the same; and
- any other investor who causes the fund manager or compliance officer to believe that the source of the funds are not legitimate.

When confronted with an investor who manifests one or more indicia of high risk, the fund manager, in consultation with the compliance officer, should undertake enhanced due diligence procedures to confirm the legitimacy of the subscription funds. To confirm the legitimacy of the investor and his or her funds, one can review reports published by the US or other multinational agency (for example, FATF) with regard to the AML or counterterrorism legislation in the investor's home country. The fund manager can also do a standard internet or media search (or search of any other publicly available database) to assess the investor's business reputation. The fund manager should also, to the extent reasonably possible, assess the source of the investor's wealth and, where a SFPF or PEP is involved, take reasonable steps to determine that the source funds are not derived from any public corruption. With respect to an investor who is a non-natural-person legal entity, the fund manager should review any recent changes in ownership or senior management and determine the relationship between the entity and its home government.

If despite the additional due diligence, there continues to be a risk that the subscription funds originated from illicit sources, the investor should be rejected. The decision to accept or reject an investment by a high-risk investor should involve more senior management than that typically required to open an investor account. The entire decision-making process with respect to high-risk investors should be documented and retained. Moreover, upon rejection of the high-risk investment, the compliance officer and fund manager should assess whether the circumstances warrant the filing of a SAR with FinCEN.

Prohibition on certain investors

Certain investors present an unacceptable risk of money laundering and should be subject to a blanket prohibition on the acceptance of any investment. At a minimum, any person or entity specifically identified as a prohibited person or entity on any list maintained by OFAC must be deemed a prohibited investor. Similarly, any individual or entity that is from a country that is broadly prohibited by OFAC or subject to special measures by the Secretary of the Treasury under Section 311 of the Patriot Act must also be deemed a prohibited investor. These lists are continuously updated, and a fund's compliance officer should ensure that all cross-checks (initial and follow-up) are done against the most up-to-date lists.¹³

¹² Although there is no global definition of a PEP, the FATF has issued guidance defining PEPs as 'individuals who are or have been entrusted with prominent public functions in a foreign country, for example heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials... The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.'

¹³ All OFAC lists are accessible at <http://www.treas.gov/ofac> and all special measures under Section 311 can be found on FinCEN's website at www.fincen.gov/statutes_regs/patriot/section311.html. Similarly, the Financial Industry Regulatory Authority (FINRA), a self-regulatory organization for broker-dealers, maintains a search engine of OFAC's sanctioned names at <http://apps.finra.org/rulesregulation/ofac/1/default.aspx>.

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Suspicious activity reporting

A private equity fund's AML program should require any employee who suspects money laundering to immediately inform his or her immediate supervisor and the AML compliance officer of the attempted transaction. The AML compliance officer, in consultation with the fund senior management and counsel, should then evaluate whether to inform law enforcement of the suspicious transaction through the filing of a SAR with FinCEN.

It is important to note – and the AML program should clearly state to employees – that reports of suspicious activity are confidential and must not be disclosed to any person involved in the suspect transaction. The BSA prohibits anyone involved with the filing of a SAR to inform the subject of the SAR of that filing, except when requested to do so by an appropriate government entity (including FinCEN). In the event the fund receives a subpoena or other legal request (for example, a civil discovery request) to produce information related to a SAR, the fund should decline to provide any such information (including whether a SAR was even prepared or filed) and contact FinCEN for further guidance.

OFAC compliance program

Private equity funds should also establish and maintain an effective risk-based OFAC compliance program. Although a strict liability regime, in the event of an OFAC violation, the adequacy of the fund's transaction processing system, as well as the overall OFAC compliance program, are taken into account in assessing potential penalties. In general, a strong OFAC compliance program will mirror the investor identification program or CIP that is part of the BSA/Patriot Act AML program. Specifically, as also required by a robust AML Program, OFAC expects all financial entities to screen potential new clients, investors and transactions through the SDN List or other OFAC sanctions program prior to engaging in the contemplated transaction.

However, despite similarities between BSA/Patriot Act requirements and OFAC, there are notable differences between the two. Specifically, under BSA/Patriot Act, a customer is defined as '[a] person that opens a new account,' and therefore AML due diligence need not extend to beneficial owners of omnibus accounts established by an intermediary. OFAC regulations, however, apply to all property of a sanctions target within the possession or control of a US person, including shares held in an omnibus account on behalf of a sanctioned party. Accordingly, in some cases, it would be prudent for the fund manager to identify beneficial owners of omnibus accounts established by an intermediary.

The key to setting up an acceptable OFAC compliance program is appropriate risk assessment of the fund's customer base and geographic location in which it conducts business. A fund should assess whether its business model is subject to high OFAC risk indicators such as large number of international transactions, including wire transfers; investments from foreign accounts or investors; placement by foreign brokers not subject to OFAC regulations; international private banking, including offshore banks; investment by offshore trusts; and transactions with overseas offices and subsidiaries.¹⁴

¹⁴ OFAC has published a non-exhaustive list of risk factors in *Risk Factors for OFAC Compliance in the Securities Industry*, located at http://www.treas.gov/offices/enforcement/ofac/policy/securities_risk_11052008.pdf.

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Performance of third-party AML programs

The OFAC compliance program should also include policies and procedures that are reasonably designed to identify prohibited transactions and accounts, and cause the reporting of such information to OFAC. When a fund identifies assets and accounts coming from a sanctions target, it must ‘block’ – that is, freeze – those funds or property located in the US, or that are held by or in the possession of a US person. Blocked funds or accounts must be placed in a segregated account that accrues interest at a commercially reasonable rate until such time as the investor is removed from the SDN list, the sanctions program is lifted or the investor obtains a license from OFAC to release the funds. If an attempted transaction is identified as being prohibited by OFAC but the funds have not been received, the transaction should be rejected.

Moreover, the private equity fund must report transactions involving a sanctions target to OFAC within ten days of a transaction being blocked or rejected. In addition to the immediate reports, the fund is required to submit an annual report of all property and funds blocked as of June 30 (including accumulated interest) to OFAC by September 30.

The other requirements for an adequate and effective OFAC compliance program will follow the requirements for a successful AML program described above. Specifically, an effective OFAC compliance program will include periodic independent testing of the OFAC compliance program, designation of an OFAC compliance officer and ongoing OFAC training program for employees.

Understandably, undertaking an extensive AML program may require resources beyond those of many private equity funds. When compliance resources are limited, the fund may choose to outsource its AML compliance to a third party. For example, a fund manager may choose to delegate AML compliance responsibilities to the fund administrator, the investment adviser, broker-dealers, placement agents or other introducing parties, or a third party specializing in implementing AML compliance programs. Similarly, when funds are wired from a US-regulated financial institution or a foreign financial institution in a FATF jurisdiction, the fund manager may (in the absence of any specific money laundering concerns) rely on that institution’s investor identification procedures. In fact, it is quite common for a fund administrator or placement agency to perform the bulk of a fund’s AML obligations.

However, prior to accepting vetting by a third party, the fund manager should take reasonable steps to ensure that the third party’s AML program adequately addresses the policies and procedures set forth in the fund’s written AML program. To do so, the fund manager should seek assurances from the third party that necessary procedures have been performed. In certain circumstances, the fund manager may also request to obtain a copy of the third party’s written AML program or obtain a certification (which may be publicly available on the institution’s website) that the third party is in compliance with its AML requirements. And while not a common practice, if the fund manager believes the risk of money laundering is especially high or has certain concerns regarding the third party’s AML compliance, he or she may also establish a procedure that allows for regular audits of the third party’s AML program.

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In determining whether it is reasonable to rely on a third party's AML program, the fund manager may wish to look beyond the written AML program, taking into account the third party's location, any relevant AML laws in that jurisdiction and generally the third party's business reputation. This extra step is particularly important when dealing with unregulated entities or entities in non-FATF jurisdictions.

In this area, specific lessons can be learned from the retail broker-dealer market. In the retail market, federal regulators and self-regulatory organizations have consistently held that introducing and clearing firms are both obligated to implement robust AML procedures and are both obligated to file SARs. In the retail broker-dealer context, examiners have found a lack of communication between introducing and clearing firms to be a primary source of finger pointing during an investigation. The message from the retail market is as applicable to the private equity market: private equity funds and third parties (such as placement firms) must work together to effect secured transactions and meet the mutual goals of their AML programs.

In the end, any decision to delegate AML compliance to a third party must be reasonable and be done in consultation with the private equity fund's compliance officer. Although a fund manager may choose to delegate portions of its AML program, the ultimate responsibility for a fund's AML compliance falls on the fund and the private equity fund may be held liable for the failures of a third party – even failures of the fund administrator – to properly perform AML procedures. Of course the more prudent a fund is in vetting its third party's AML program, the less severe any criminal or OFAC enforcement liability will be for the third party's AML deficiencies. □

Compliance checks:

- Advisers should adopt written AML/OFAC programs, designate an AML compliance officer, have ongoing training and audit the AML/OFAC program.
- AML compliance programs should be based on a risk assessment of manager's client and investor base, including geographic location of investors.
- Pre-check potential investors as well as conduct follow-up checks periodically after investment.
- All US persons located anywhere in world must comply with OFAC regulations.
- Even if adviser delegates AML or OFAC checks to a third party, it still is ultimately responsible.
- Funds should be redeemed to same investor and account as subscription unless further due diligence checks were made.

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