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Market Solutions

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Anti-Money Laundering Compliance for Investment Advisers— What You Can Do Right Now

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Navigant

In This Issue

I. Introduction

Investment advisers in the United States today control approximately $43.8 trillion in assets.[1] Advisers often have critical knowledge of the movement of large amounts of financial assets through U.S. and global financial markets. In some cases, the investment adviser may be the only person with access to the identity of the customer, the source of the invested assets and the customer's investment objectives.[2] As a result, investment advisers can have an important role to play in preventing the use of their services for money laundering and terrorist financing.[3]

Most investment advisers are not currently subject to affirmative anti-money laundering requirements, but they may still have AML obligations stemming from counterparty expectations, broker-dealer or custodial bank requirements or customer requirements. The Financial Crimes Enforcement Network ("FinCEN") first raised the possibility of an AML compliance rule for investment advisers in 2003, when it issued a Notice of Proposed Rulemaking that would have required certain investment advisers to establish AML compliance programs.[4] FinCEN is the Department of the Treasury bureau responsible for the administration of the Bank Secrecy Act ("BSA"), the U.S. anti-money laundering compliance requirements. FinCEN withdrew the proposed rule in 2008. On November 15, 2011, James H. Freis Jr., the Director of the FinCEN, announced in a speech that FinCEN was working on a proposed rule requiring investment advisers to establish anti-money laundering compliance programs and file suspicious activity reports.[5] While Director Freis did not announce the specific provisions of the rule, there are steps that advisers can take to prepare.

II. How Will the Rule Look?

Director Freis did not provide much detail on the rule that FinCEN is writing except to say there would be an AML compliance requirement and the requirement to file suspicious activity reports.[6] FinCEN strives to apply the same rules to all entities covered by the BSA. Based on the rule that was withdrawn, the rule for investment advisers would look a lot like all of the other AML program requirements under the BSA. The AML compliance program requirement is likely to rest on the same "Four Pillars" of compliance that apply to all financial institutions under the BSA:

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Legislative/Regulatory Actions

This column was written by lawyers from Morrison & Foerster LLP to update selected key legislative and regulatory developments affecting financial services and capital markets activities. Because of the generality of this column, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

In this issue we address various selected developments in connection with the **Dodd-Frank Act** (including developments relating to Title VII, Regulation D, Enhanced Prudential Standards, and the Volcker Rule), **Derivatives**, **Consumer Protection** and **BSA/AML**.

DODD-FRANK ACT

Title VII Update

The CFTC has released final rules addressing many areas, including final rules relating to registration, reporting and recordkeeping, protection of cleared swap customer collateral and external business conduct standards and internal business conduct standards. As discussed below, these all require that swap dealers (SDs), major swap participants (MSPs) and other market participants devote substantial resources to formulating systems and policies and procedures designed to ensure compliance with the rules by July 2012. Even with this deadline looming, the CFTC has not addressed many of the most pressing matters, such as finalizing the swap definitions and providing guidance on extraterritoriality.

Registration: The CFTC adopted final rules that establish a process to register SDs and MSPs. The National Futures Association has been tasked with performing the registration functions. The registration process permits provisional registration. Such provisional registration may be commenced at any time, but a provisionally registered entity will need to supplement its registration from time to time as additional rules come into effect. The deadline for mandatory registration will be finalized once the definitions are finalized. For most market participants, formulating a registration strategy may be a challenge in the absence of final definitions. SDs who have begun to consider the registration process are only now beginning to confront the overwhelming operational, disclosure and conduct requirements that must be addressed as part of this process.

Business conduct standards: The CFTC also finalized both external and internal business conduct standards. The external business standards impose new, burdensome procedures for SDs and MSPs. Among other things, SDs will be required to conduct diligence on counterparties in order to verify that each counterparty is an eligible contract participant or a special entity that must be treated differently. New disclosures will be required that provide material information about a transaction, including the risks, terms, incentives and conflicts of interest that may arise in connection with the transaction. In addition, a dealer must provide daily mid-market marks for uncleared swaps. SDs will have to establish procedures to discharge their suitability obligations and to ensure that communications with counterparties are "fair and balanced." In dealing with special entities, such as municipalities, government agencies, and pension plans, SDs will be subject to higher standards and will have to act in the "best interest" of the special entity if the dealer is acting as an advisor to the special entity or if the dealer fails to rely on a limited safe harbor for certain ERISA plans and other special entities. The internal business conduct standards require

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Vicki Belden	**TD Bank**
Wendy Bradley	**OCC**
Melissa Callison	**Charles Schwab & Co., Inc.**
Dan Caneva	**UnionBanc Investment Services**
Amy Chan	**Bank of the West**
Janet Chapman	**Union Bank**
Hillel Cohn	**Morrison & Foerster LLP**
Christine Cole	**Union Bank**
Jeanne Elmadany	**FINRA**
Brian Fraser	**Richards Kibbe & Orbe LLP**

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A. Policies, Procedures and Internal Controls[7]

To set the appropriate "tone at the top" the BSA requires each financial institution to adopt written policies, procedures and internal controls that senior management must approve. Even without a formal customer identification requirement, the advisers will probably need to obtain all relevant customer-related information necessary for an effective anti-money laundering compliance program. In the adopting release for the recently finalized AML program rule for mortgage originators and lenders, who do not have a customer identification requirement, FinCEN reiterated its expectation that those entities would conduct significant customer due diligence to support a robust risk-based compliance program.[8]

"The independent test is an institution's 'last line of defense' against abuse by criminals and money launderers in that a good test will detect weakness in the program before the criminals or the regulators do."

B. AML Compliance Officer

FinCEN will likely require the adviser to designate an AML compliance officer responsible for ensuring that the program is implemented effectively, for monitoring compliance with the program and for arranging for appropriate training of personnel.

C. Ongoing Training

All financial institutions with AML program requirements must provide "on-going" training of appropriate persons about their responsibilities.

D. Independent Test

All AML compliance program rules require the financial institutions to conduct an independent test to monitor and maintain an adequate compliance program.[9] The independent test is an institution's "last line of defense" against abuse by criminals and money launderers in that a good test will detect weakness in the program before the criminals or the regulators do. The testing must also be risk-based, and a knowledgeable third party or any officer or employee of the institution independent from the designated AML compliance officer, may conduct the test.

III. What You Can Do To Prepare

A. Conduct a Risk Assessment

The necessary foundation of any risk-based AML compliance program is a detailed knowledge of the money laundering, terrorist financing, and financial crime risk inherent in your business. Once you identify the particular risks of your business, you can design an appropriate AML program to mitigate that risk. In addition, you can better identify and mitigate gaps in your internal controls.[10] You should identify the specific risk categories applicable to your business: customer risk, products and services risk, transaction risk and geographic risk. Then when you design an AML compliance program, you can focus limited compliance resources on the parts of the business that present the most risk.

B. Due Diligence

There is, as yet, no specific requirement to conduct general customer due diligence ("CDD") in the BSA.[11] FinCEN has stated that the cornerstone of a strong compliance program is the adoption and implementation of internal controls, which include comprehensive CDD policies, procedures, and processes for all customers, particularly those that present a high risk for money laundering or terrorist financing.[12] Conducting appropriate CDD also assists an institution in identifying, detecting, and evaluating unusual or suspicious activity.

Now would be a good time to evaluate the customer information you already collect to make sure that you are obtaining sufficient information to understand the risk of your investors. If not, you should think about what additional information you would need to collect if FinCEN finalizes the Rule. You may also want to consider evaluating your customer base as a whole. You can review your existing customers and determine whether some of them present a heightened risk of money laundering and terrorist financing based on what you already know. If so, consider whether you will want to obtain

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additional due diligence information for those higher risk customers in the event that the rule is finalized.

In some instances, you will want to obtain information on the beneficial owners of the entity accounts or investors. FinCEN has stated that customers that have been identified by an institution's CDD procedures as posing a heightened risk should be subjected to enhanced due diligence ("EDD") that is reasonably designed to enable compliance with the requirements of the BSA. This may include steps to identify and verify beneficial owners to reasonably understand the sources and uses of funds in the account and the relationship between the customer and the beneficial owner.[13] FinCEN has identified certain trusts, corporate entities, shell entities, and personal investment companies ("PICs") as examples of customers that may pose heightened risk.[14]

> *"The necessary foundation of any risk-based AML compliance program is a detailed knowledge of the money laundering, terrorist financing, and financial crime risk inherent in your business."*

In addition, FinCEN rules establish particular due diligence requirements concerning beneficial owners in the areas of private banking and foreign correspondent accounts.[15] Even if those particular rules do not apply to investment advisers, they are an indication of the types of accounts that the regulators and law enforcement believe present a higher risk of money laundering and terrorist financing. So if you have private banking type customers or customers who are foreign financial institutions, the rules and guidance covering the due diligence analysis for banks and broker-dealers that have those kinds of accounts may be helpful.

C. Training

Training your staff is an important step to ensure that your company is ready to implement AML compliance rules. The staff will need training on your program and their roles and responsibilities in its implementation. Your staff should have a good understanding of how "typical" customers behave. You may need to focus their awareness and make sure that they know what to do if they see something suspicious. Training the staff on the red flags they may see in the course of their duties, as well as your escalation procedures for identifying and reporting potentially suspicious activities, will be critical to the success of your program. Employees that will have specific AML responsibilities will require special training.

D. Independent Test

One important step you could take now is to think about who will conduct your independent test. If your company is large enough to have an internal audit department, that may be a good choice. You may have to provide training to the internal auditors to ensure they have a working knowledge of the BSA so that the test is adequate. If you do not have an internal audit department, or choose not to use them for your test, you will need to determine whether to engage an outside auditor or another independent party in your company to conduct the test. There is no right answer, but it is imperative that the tester has both a working knowledge of the BSA and the risk of your business. ■

1. See ***http://www.nrs-inc.com/company/pdfs***
2. 68 *Federal Register*, No. 86 (May 5, 2003) at 23647.
3. Id.
4. Id.
5. Remarks of James H. Fries, Jr., American Bankers Association / American Bar Association Money Laundering Enforcement Conference. See ***http://www.fincen.gov/news_room/speech/pdf/20111115.pdf.***
6. Id.
7. 31CFR 1029.210 (a).
8. 77 *Federal Register,* No. 30 (February 14, 2012).
9. 31 CFR 1029.210(b) (4).
10. *FFEIC Bank Secrecy Act/Anti-Money Laundering Examination Manual* (2010) at 22. While the FFEIC manual does not apply to advisers, it contains helpful guidance about how to identify and mitigate AML risk that can be applied to other financial services businesses.
11. On March 5, 2012, FinCEN issued an Advanced Notice of Proposed Rulemaking to announce that the agency is considering developing a Customer Due Diligence rule to cover banks, brokers or dealers in securities, mutual, funds, futures commission merchants, and introducing brokers in commodities with the possibility of extending the rule to other financial institutions in the future. 77 *Federal Register,* No. 43 (March 5, 2012). FinCEN is also considering, as part of this effort to increase financial transparency, a categorical requirement for financial institutions to identify beneficial ownership of their accountholders, subject to risk-based verification. Id.

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12. Joint Guidance on Obtaining and Retaining Beneficial Ownership Information, FIN-2010-G001 (March 5, 2010).
13. Id.
14. Id.
15. Id.

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Alma Angotti is a Director in Navigant's Global Investigations & Compliance practice. Alma has held senior enforcement positions at the SEC, Treasury's Financial Crimes Enforcement Network (FinCEN) and FINRA. A widely recognized anti-money laundering expert, Alma advises the financial services industry as well as other regulators and government officials around the world on AML and counter terrorist finance matters.

Who's News

James Connors was recently promoted to Senior Audit Manager helping cover the Wholesale Banking division within Wells Fargo.

Edwin Follosco has changed roles at Union Bank and is now a Senior Compliance Officer with the bank's Global Capital Markets Compliance Group..

Stephanie Korenman, formerly Executive Director & Senior Counsel at Morgan Stanley Smith Barney, has joined the New York law firm of Stern Tannenbaum & Bell as a Partner and co-head of the firm's newly-formed Financial Markets Practice Group

Linda Lerner, formerly Counsel at Debevoise & Plimpton LLP, has joined Crowell & Moring LLP as a Partner in their New York office.

Michael Lugowski, formerly a Director with Alaric Compliance Services, LLC, has joined BlueFire Capital, LLC (Chicago, IL) as their Chief Compliance Officer.

Stevenson Munro, formerly Anti-Money Laundering and OFAC Compliance Officer at Societe General Americas, has joined GE Capital as Compliance Leader for Anti-Corruption and Economic Sanctions.

Richard N. Pagnotta, Sr., formerly Chief Compliance Officer at China Merchants Bank Co. Ltd., New York Branch, has joined Itaú Unibanco S.A., New York Branch, as SVP & Chief Compliance Officer.

Ravi Ramnarain, CPA, has been promoted to Senior Audit Officer at Mercantil Commercebank.

Mary Somerville, formerly Managing Director at FTI Consulting, retired last December. She is now an independent contractor/self-employed regulatory consultant.

Gary Swiman, formerly President of the Asset Management Division at ICS Risk Advisors, has joined C&A Consulting LLC as a principal to head up their expanding compliance and regulatory practice focused on the hedge fund and private equity communities.

Kevin Zambrowicz, formerly a Partner at Bingham McCutchen LLP, has joined the Securities and Exchange Commission as Associate General Counsel/Legal Policy.

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that SDs and MSPs maintain certain enumerated records, including transactional records for every swap transaction and position, daily trading records for all executed swaps and business records relating to governance, financials, marketing and complaints. These standards also require the designation of a chief compliance officer who will have significant responsibilities, including conducting an annual compliance report that includes a CCO certification. SDs and MSPs also are required to establish detailed risk management programs that must be designed to ensure compliance with position limits, address risk limits, exposures and risk monitoring, and establish policies regarding the use of clearing. SDs and MSPs also will be required to establish procedures to mitigate conflicts of interest, which will require, among other things, the establishment of information and physical walls between research and non-research personnel. All of this will require SDs and MSPs to formulate compliance policies, update their procedures and their documentation, conduct detailed training and implement significant IT changes.

Reporting: The CFTC also adopted final rules relating to real-time reporting and swap data reporting, which establish a staggered compliance schedule that depends on the type of product and the status of the responsible reporting party. The compliance date for the reporting requirements will depend on the dates of publication of final definitions. As a general matter, the reporting rules require that executed swaps be reported to swap data repositories (SDRs), which are, in turn, responsible for disseminating certain information. For swaps executed through a swap execution facility (SEF) or on a designated contract market (DCM), the SEF or DCM is responsible for reporting to the SDR. For non-cleared swaps, the rules establish a hierarchy for reporting. Once fully phased in over the three-year period, reporting windows will vary from 15 minutes to two hours for primary economic terms of swaps for swaps with SD/MSP counterparties. Market participants also will be required to report certain information over the life of a swap, not just at execution, and to maintain detailed records of swap transactions.

Regulation D

The SEC recently adopted the first of the two Regulation D rulemakings mandated by the Dodd-Frank Act. The Dodd-Frank Act modified the net worth standard included in the definition of "accredited investor" under the Securities Act and directed the SEC to adopt amendments disqualifying the offer or sale of securities in Rule 506 offerings by certain felons and similarly situated bad actors.

In May 2011, the SEC proposed amendments to rules to disqualify certain securities offerings from reliance on the private placement safe harbor provided by Rule 506 of Regulation D. In December 2011, the SEC adopted amendments to the net worth standard, with those changes becoming effective on February 27, 2012. Meanwhile, the agency now expects to adopt amendments in the first half of 2012 providing for disqualifications with respect to felons and bad actors.

As contemplated by Section 413(a) of the Dodd-Frank Act, the SEC has amended the net worth standard included in the "accredited investor" definition to now exclude the value of an individual's primary residence from the calculation used

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Carrie Hughes	Union Bank
Tamara Hunter	Handelsbanken
Scott Ilario	Compliance Outsourcing Solutions
Nicolas Khouri	Ally Financial
Howard Kirkham	Federal Reserve Bank of Chicago
Kevin Lesinski	Seyfarth Shaw LLP
Joseph Lynyak, III	Pillsbury Winthrop Shaw Pittman LLP

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to determine if the individual (either alone, or jointly with the individual's spouse) qualifies as an "accredited investor" on the basis of having a net worth in excess of $1 million, as measured at the time of exempt sale of the security to the individual. Before the enactment of the Dodd-Frank Act, an individual could include the value of his or her primary residence when calculating net worth.

Under the amended rules, debt secured by an individual's primary residence, up to the estimated fair market value of the residence, will not be treated as a liability when determining if the individual's net worth exceeds the $1 million threshold. On the other hand, debt secured by the primary residence that is in excess of the estimated fair value of the property, and debt secured by the primary residence and incurred in the 60 days prior to the sale of securities, must be included as a liability in the net worth calculation.

In order to ease the transition to the new rules, the SEC has permitted the pre-Dodd-Frank net worth standard to apply to certain pre-existing purchase rights. The SEC will review the definition of "accredited investor" every four years, beginning in 2014.

With the net worth standard rules now adopted, the SEC is expected to turn its attention to the proposed disqualifications with respect to felons and similarly situated bad actors in Rule 506 offerings. The bad actor disqualification requirements under the proposed rules are substantially similar to those applicable to offerings under Regulation A, including the list of "covered persons" to whom the disqualification provisions would apply and disqualifying events.

The proposed rule also incorporates a reasonable care exception that would apply if an issuer could establish that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of a covered person. The SEC has received a number of comment letters on this release, raising many complex issues in the implementation of the proposed bad actor and felon disqualifications for the most widely used private offering safe harbor.

Moreover, as legislative activity has recently focused on restrictions with respect to communications in connection with private offerings, and in particular the ban in Rule 506 offering on general solicitation and general advertising, the SEC is moving forward with efforts to examine the general solicitation ban and more generally the regulation of offers in private offerings. We expect that, in the near future, the SEC may issue a concept release soliciting comment on these issues, and more changes to Regulation D may result from any of these SEC and legislative private offering reform initiatives.

Our news bulletin entitled "One Down, One to Go: The SEC Completes the First Required Dodd-Frank Act Regulation D Rulemaking" is available at *http://www.mofo.com/files/Uploads/Images/120118-Dodd-Frank-Regulation-D.pdf* and our news bulletin entitled "Dodd-Frank Update: SEC Proposes Bad Actor Disqualifications for Private Placements under Regulation D" is available at *http://www.mofo.com/files/Uploads/Images/110603-Regulation-D.pdf*.

Enhanced Prudential Standards

On March 2, 2012, the Federal Reserve announced that it would extend the deadline for comments on its proposed set of enhanced prudential standards (the "Proposed Rule") from March 31 to April 30, 2012 (the Federal Reserve publication is available at *http://www.gpo.gov/fdsys/pkg/FR-2012-03-07/pdf/2012-5522.pdf*). In announcing the extension, the Federal Reserve cited the range and complexity of the issues addressed in the proposal.

Whether the Federal Reserve intended this result or not, the extension will enable the U.S. banking organizations subject to the proposal to file comments informed by the Federal Reserve's and other agencies' thinking on related issues:

- The Federal Reserve will publish in the next few weeks the results of the latest round of stress tests for [19] largest bank holding companies. The level of detail in the releases has been the subject of extended discussion between the tested institutions and the Federal Reserve. The EPS proposal would require the publication of institution-specific data and results, some of which might otherwise be treated as proprietary and confidential. The Federal Reserve's decision on the publication of the completed stress tests will signal its approach under the Proposed Rule.
- The Proposed Rule is limited to U.S. banking entities (with consolidated assets of more than $50 billion) and any other designated financial

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institutions, but it deliberately does not address foreign banking organizations. The Federal Reserve has said that it will propose standards for FBOs in the near future, and this proposal could affect how U.S. institutions look at the Proposed Rule.

- The Federal Reserve also has said that it will propose new capital rules pursuant to the Collins Amendment. While the Proposed Rule largely adopts or defers to Basel II and III, the Collins proposals could affect thinking about how capital rules are addressed in the Proposed Rule.

The timeframe for a final rule on enhanced prudential standards is largely open-ended. With one exception, the Dodd-Frank Act does not set deadlines for the finalization of these standards. The Act does require that the risk committee requirements for systemically important financial institutions be in place by July 21, 2012, to take effect on October 21, 2012.

As required by Dodd-Frank, the FDIC and the OCC also have proposed rules for bank-level stress tests, comparable to the requirements in the Proposed Rule. The extension of the comment period of the Proposed Rule by the Federal Reserve had a ripple effect and on March 21, 2012, the FDIC as well as the OCC extended their respective comment periods to April 30, 2012 (see *http://www.gpo.gov/fdsys/pkg/FR-2012-03-21/pdf/2012-6799.pdf*).

Volcker Rule

The extended comment period for the proposed rule implementing the Volcker Rule ended on February 13, 2012. The regulators received more than 17,000 comments letters from private citizens, industry groups, financial institutions and even from foreign regulatory authorities, many of them heavily criticizing the proposed rule. For the time being, we can only speculate whether the regulators will publish a final rule in the near future or if the current proposal will be substantially revised and republished for another round of public comments. The statutory effective date of the Volcker Rule is quickly approaching (July 21, 2012), though during a House Financial Services Committee meeting on February 29, 2012, Federal Reserve Chairman Ben Bernanke said that he doesn't think a final rule will be ready by July and that the regulators "have a lot of difficulties to go through [the comments]." Dan Gallagher, a Commissioner at the SEC, noted in a speech at the Institute of International Bankers conference on March 5, 2012, that the regulators must be willing to re-examine their proposal and "if necessary" go back to the drawing board, and FDIC Chairman Martin Gruenberg said most recently to the press that there are "some complex issues and a lot of comments to work through" and that a final rule may not be ready by July 21, 2012.

Please note that since the last FMA *Market Solutions* we have published additional material regarding the proposed rule which you can find at *http://www.mofo.com/files/Uploads/Images/120126-The-Volcker-Rule-Compliance-Considerations.pdf*.

DERIVATIVES

On February 9, 2012, the CFTC amended Rule 4.5 under the Commodity Exchange Act to sharply limit the ability of registered investment companies that use derivatives from relying on an exclusion from the definition of a commodity pool operator ("CPO"). Advisers to funds that fail to qualify for the exclusion would also have to register as CPOs.

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Orlando Mais	Mercantil Commercebank
Don Ryu	Oracle Financial Services Software
James Shorris	LPL Financial, LLC
Janet Tarkoff	JMP Securities LLC
Robert "BJ" Thomas	Bank of the West
Denise Walker	Navigant
Allison Watkins	Wells Fargo Audit Services

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The new rule reinstates the "5 percent threshold test," which the CFTC eliminated in 2003. Generally, the 5 percent threshold test requires registered investment companies that hold certain commodity futures, commodity options contracts, or swaps whose aggregate initial margin and premiums exceed 5 percent of the liquidation value of the fund's portfolio to register as CPOs. The new rules count derivatives trades used for the purposes of managing portfolio risk toward the 5 percent limit, but exclude transactions used for "bona fide hedging." In the case of an option that is in-the-money at the time of purchase, funds may exclude the in-the-money amount in computing the 5 percent threshold.

The CFTC adopted an "alternative net notional test." This test provides that an investment company's aggregate net notional value of the fund's commodity interest positions may not exceed 100 percent of the liquidation value of the fund's portfolio (taking into account unrealized profits). The rule itself states that investment companies must satisfy both the 5 percent threshold and the alternative net notional test. The adopting release, however, implies that funds seeking to rely on the exemption can satisfy either the 5 percent threshold test or the alternative net notional test.

The rule defines how funds must calculate "notional value" for each futures position and swap position. Funds may net futures contracts with the same underlying commodity across designated contract markets and foreign boards of trade, and swaps cleared on the same designated clearing organization where appropriate. As a condition for relying on the exclusion from the definition of a CPO, a fund must not hold itself out as a vehicle for trading in the commodity futures, commodity options, or swaps markets. Funds relying on Rule 4.5 by filing a notice of exclusion must annually affirm the notice of exemption from registration, withdraw such exemption if their activities no longer require registration, or withdraw such exemption and apply for registration within 30 days of the calendar year end.

The adopting release contains additional rule amendments, including the CFTC's rescission of the exemption in Rule 4.13(a)(4) for operators of pools that are offered only to individuals and entities that satisfy the qualified eligible person standard in Rule 4.7 or the accredited investor standard under the SEC's Regulation D.

In a companion release, the CFTC proposed rules that provide for regulatory harmonization for registered investment companies and their advisers that must register with the CFTC. Comments on the proposal are due by April 24, 2012.

Funds must comply with Rule 4.5 for registration purposes not later than the later of December 31, 2012, or 60 days after the effective date of the final CFTC rulemaking to come that will further define the term "swap." Funds and advisers required to register due to the amendments to Rule 4.5 must comply with the CFTC's recordkeeping, reporting, and disclosure requirements pursuant to part 4 of the CFTC's regulations within 60 days following the effectiveness of a final rule implementing the CFTC's proposed harmonization effort. CPOs claiming exemption under Rule 4.13(a)(4) must comply with the rescission of the rule by December 31, 2012.

For additional details, please see the Morrison & Foerster news bulletin at *http://www.mofo.com/files/Uploads/Images/120216-Commodity-Pool-Operator-Exemption.pdf*. The full text of the final rules is available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister020912b.pdf*, and the full text of the proposed harmonization rules is available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister020912.pdf*.

CONSUMER PROTECTION

Consumer Protection Update

In the last quarter, following the recess appointment of Richard Cordray as Director, the CFPB has continued to push ahead with new consumer protection initiatives:

- CFPB Proposed Rule on Privilege. The CFPB has proposed an amendment to its Rules of Practice which would purport to allow disclosure of privileged documents to CFPB examiners, and from the CFPB to "any state or federal agency," without waiving attorney-client privilege. Comments are due by April 16.
- Larger Participant Rule. The CFPB has proposed a rule allowing it to examine debt collectors and credit bureaus that are "larger participants" in the

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consumer financial products markets. Comments are due by April 17.

- Checking Accounts and Overdraft Protection. The CFPB began to collect consumer complaints about checking and deposit accounts. It also subpoenaed data from the nine largest banks about their overdraft protection practices, and issued a notice requesting public comment on the overdraft practices of banks. During the same period, the CFPB held a "Town Hall Meeting" on checking account disclosures, and proposed a "penalty fee box" disclosure for monthly checking account statements, which would alert consumers to the fees that they have paid in the prior month for services such as overdraft protection.
- The CFPB continues to enhance its Consumer Complaint Database. It now collects complaints about credit cards, mortgages and checking accounts, and by the end of the year will collect complaints about all bank and non-bank consumer financial products. Recently, the CFPB staff posted icons indicating that consumers could submit complaints about instalment loans and other "personal loans." These icons were posted prematurely, however, and the CFPB is not yet ready to accept complaints for any lenders beyond the 110 banks currently being examined.
- FTC-CFPB Memorandum of Understanding ("MOU"). The FTC and CFPB entered into a MOU, required by the Dodd-Frank Act, describing how they will exercise their overlapping jurisdiction over non-bank financial services markets. The MOU establishes procedural requirements, rather than jurisdictional limitations – that is, rather than dividing up jurisdiction over specific products, the MOU requires the agencies to consult with one another before initiating rulemaking proceedings, investigations, or enforcement actions.
- Section 1420 of the Dodd-Frank Act requires mortgage lenders and servicers to send mortgage borrowers a periodic statement for each billing cycle, and the CFPB is required to develop a model form for this statement. The CFPB has published a prototype mortgage statement. *See http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-seeks-input-on-draft-monthly-mortgage-statement/*.
- Further CFPB developments:
  - The CFPB filed with Congress at the end of January its first semi-annual report, required by the Dodd-Frank Act, about the CFPB's activities. The Report reiterates that the CFPB's primary focus is mortgages, mortgage servicing, credit cards and student loans, but it also mentions payday lending, deposit accounts and prepaid cards. The Report includes a list of the CFPB's regulatory priorities. See *http://www.consumerfinance.gov/wp-content/uploads/2012/01/Congressional_Report_Jan2012.pdf*.
    - Highlights of the Report include information that the CFPB "has begun assessing the policies and practices of certain mortgage servicing companies, including their default servicing practices like loan modification and foreclosure." (See page 23.)
    - The Report also notes that the CFPB has hired 757 employees. Fewer than a third of these (230) transferred from federal banking regulators and other agencies.
    - The Report also includes a description of the CFPB's complaint handling process (pages 16-20), and recaps various reports, rules, policies and financial highlights.
  - The CFPB released its budget for FY 2012 and FY 2013. The plan calls for 942 full-time equivalent employees ("FTEs") in FY 2012 (ending September 30, 2012), and 1,359 FTEs in FY 2013. Total expenditures would be about $356 million in FY 2012 and $448 million in FY 2013. (By comparison, the Federal Trade Commission requested a $300 million budget for FY 2013.)

BSA/AML

Customer Due Diligence

On Monday, March 5, 2012, FinCEN issued an advanced notice of proposed rulemaking ("ANPR") to solicit public comments on a wide range of questions pertaining to the possible application of a specific customer due diligence ("CDD") rule for financial

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Legislative/Regulatory Actions

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institutions that would strengthen and clarify the current general CDD requirements. As FinCEN pointed out in the press release accompanying the ANPR, FinCEN is "concerned that there is a lack of uniformity and consistency in the way financial institutions address these implicit CDD obligations and collect beneficial ownership information within and across industries." FinCEN believes that issuing an express CDD rule that requires financial institutions to perform CDD, including an obligation to categorically obtain beneficial ownership information, is necessary to protect the U.S. financial system from money laundering and terrorist financing. In addition, FinCEN emphasizes that the collection of CDD information is fundamentally important in facilitating tax reporting, investigations and compliance, including in connection with assisting foreign government investigations.

The ANPR contains questions from FinCEN regarding its consideration to codify, clarify, consolidate, and strengthen existing CDD regulatory requirements and supervisory expectations, and to establish a categorical requirement for financial institutions to identify beneficial ownership of their account holders, subject to risk-based verification and pursuant to an alternative definition of beneficial ownership as described in the ANPR. Please note that although the scope of the ANPR includes all financial institutions that are required to have an AML program, FinCEN, at this time, is considering developing a CDD rule to initially cover only banks, broker-dealers, mutual funds, futures commission merchants and introducing brokers in commodities, and the ANPR is focused mainly on such institutions. Comments on the ANPR are due on May 4, 2012. The text of the ANPR is available at ***http://www.gpo.gov/fdsys/pkg/FR-2012-03-05/pdf/2012-5187.pdf*** and the respective FinCEN press release at ***http://fincen.gov/news_room/nr/pdf/20120229.pdf***. ■

**Jay G. Baris, David H. Kaufman, David M. Lynn, Anna Pinedo, Andrew M. Smith, Dwight C. Smith, Indira Lall and Isabelle Sajous contributed to this column.*

Watch For

CFTC Press Release 6220-12 (March 27, 2012) – The CFTC's Division of Market Oversight issued an Advisory addressing bona fide hedge transactions and positions.

CFTC Press Release 6219-12 (March 27, 2012) – The CFTC's Division of Market Oversight issued an Advisory highlighting the Commission's special call authorities relating to claimed exemptions from speculative position limits.

MSRB Notice 2012-16 (March 26, 2012) – The MSRB filed with the SEC a proposed rule change consisting of a restatement of its 2002 interpretive notice concerning the application of MSRB Rule G-17 (on conduct of municipal securities and municipal advisory activities) to sophisticated municipal market professionals.

OCC News Release 2012-54 (March 26, 2012) – The Federal Reserve Board, FDIC & OCC sought comment on proposed revisions to the interagency leveraged finance guidance issued in 2001. Comments must be submitted no later than June 8, 2012.

CFTC Press Release 6216-12 (March 23, 2012) – The CFTC sought comment on a request from New York Portfolio Clearing, LLC, a registered derivatives clearing organization, for an order permitting cross margining for market professionals. Comments are due on or before April 23, 2012.

CFTC Press Release 6215-12 (March 22, 2012) – The CFTC's Division of Market Oversight issued a letter to market participants regarding compliance with the large trader reporting system for physical commodity swaps and swaptions. The Division will provide temporary and conditional no-action relief for less than fully compliant reporting, transitioning to fully compliant reporting by July 2, 2012.

MSRB Notice 2012-15 (March 21, 2012) – The SEC approved amendments to MSRB Rule G-14 (reports of sales or purchases), including Rule G-14 RTRS procedures, and amendments to the Real-Time Transaction Reporting System.

March 21, 2012 – The MSRB received SEC approval to begin displaying inter-dealer yield data on the EMMA website.

March 20, 2012 – The SEC approved the MSRB's proposal to amend Rule G-14, including the Rule G-14 RTRS Procedures, and to amend the Real-Time Transaction Reporting System information system and subscription service.

CFTC Press Release 6212-12 (March 20, 2012) – The CFTC sought public comment on a request from ICE Clear Europe for an order permitting portfolio margining of cleared swaps and foreign futures contracts. Comments should be submitted on or before April 19, 2012.

FDIC Press Release 30-2012 (March 20, 2012) – The FDIC Board approved two notices of proposed rulemaking. The first would implement section 210(c)(16) of the Dodd-Frank Act, which permits the FDIC as receiver for a failed SIFI to enforce and prevent termination of the contracts of the institution's subsidiaries or affiliates. The second would make limited clarifications and additional changes to the deposit insurance assessment system for insured depository institutions with more than $10 billion of assets.

SEC Press Release 2012-48 (March 19, 2012) – The SEC issued a Risk Alert on strengthening practices for the underwriting of municipal securities, and an Investor Bulletin on municipal bonds.

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Watch For *(Continued from page 12)*

CFTC Press Release 6211-12 (March 16, 2012) – The CFTC released analysis, conducted by staff of the SEC's Division of Risk, Strategy, and Financial Innovation, of market data related to single-name and index credit default swaps.

SEC Press Release 2012-43 (March 14, 2012) – The SEC announced charges from an investigation of secondary market trading of private company shares.

FINRA Regulatory Notice 12-15 (March 14, 2012) – The SEC approved a rule to establish an accounting support fee to fund the Governmental Accounting Standards Board; effective date was February 23, 2012.

MSRB Notice 2012-14 (March 13, 2012) – The MSRB requested comment on proposed changes to MSRB Rule G-34 concerning the designation of "not reoffered" in connection with new issues of municipal securities. Comments are due no later than April 10, 2012.

CFTC Press Release 6200-12 (March 9, 2012) – The CFTC requested submissions from industry participants who wish to be considered for designation by the Commission as the source for identifiers to be used for identification of swap counterparties in swap recordkeeping and swap data reporting under the jurisdiction of the Commission beginning on July 16, 2012.

FINRA Regulatory Notice 12-14 (March 7, 2012) – FINRA requested comment on proposed amendments to NASD Rule 2340 to address values of unlisted direct participation programs and real estate investment trusts. The comment period expires April 11, 2012.

MSRB Notice 2012-13 (March 6, 2012) – The MSRB requested comment on proposed rule amendments (G-11, G-8 and G-32) and an interpretive notice on retail order periods (G17 and G-30). Comments should be submitted no later than April 13, 2012.

MSRB Notice 2012-12 (March 5, 2012) – The MSRB filed a rule proposal with the SEC to strengthen regulation of broker's brokers.

FINRA Regulatory Notice 12-13 (March 2, 2012) – The SEC approved the Consolidated FINRA Best Execution Rule, effective May 31, 2012.

MSRB Notice 2012-10 (March 1, 2012) – The MSRB requested comment on a concept proposal for electronic dissemination of 529 college savings plan disclosure documents. Comments should be submitted no later than April 2, 2012.

February 29, 2012 – The MSRB made trade alerts available electronically and enhanced EMMA market statistics.

FINRA Regulatory Notice 12-11 (February 28, 2012) – The SEC approved new FINRA rule 4524 requiring the filing of Supplemental FOCUS Information and a supplementary schedule to the Statement of Income (loss) page of the FOCUS report. The rule was implemented on February 28, 2012 and the due date of the initial SSOI, covering the quarter ending September 30, 2012, is October 26, 2012.

SEC Press Release 2012-33 (February 27, 2012) – The SEC released a risk alert to help firms prevent and detect unauthorized trading in brokerage and advisory accounts.

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Watch For *(Continued from page 13)*

MSRB Notice 2012-08 (February 27, 2012) – The MSRB filed a proposal with the SEC to amend the SHORT system subscription service.

MSRB Notice 2012-06 (February 23, 2012) – The MSRB published a long-range plan to guide the evolution of its market transparency products (including the EMMA website), maximize their benefits for the protection of investors and state and local governments, and provide for the efficient allocation of MSRB resources.

FINRA Regulatory Notice 12-10 (February 21, 2012) – FINRA requested comment on ways to facilitate and increase investor use of BrokerCheck information. The comment period expires April 6, 2012.

FINRA Regulatory Notice 12-09 (February 17, 2012) – FINRA requested comment on a proposal to identify and manage conflicts involving the preparation and distribution of debt research reports. The comment period expires April 2, 2012.

FINRA Regulatory Notice 12-08 (February 10, 2012) – The SEC requested broker-dealers to make SARs and SAR information available to FINRA; effective January 26, 2012.

CFTC Press Release 6178-12 (February 9, 2012) – The CFTC voted to establish a new subcommittee of the Technology Advisory Committee (TAC) to focus on high frequency trading. Nominations for members of the new subcommittee are being sought.

CFTC Press Release 6176-12 (February 9, 2012) – The CFTC issued a final rule amending registration and compliance obligations for commodity pool operators and commodity trading advisors. They also issued a proposed rule to harmonize compliance obligations for registered investment companies required to register as commodity pool operators.

FINRA Information Notice (February 9, 2012) – The SEC approved a supplement to the Options Disclosure Document which contains general disclosures on the characteristics and risks of trading standardized options.

FINRA Regulatory Notice 12-07 (February 8, 2012) – FINRA requested comment on proposed amendments relating to reporting of OTC trades executed in a mixed capacity. The comment period expired March 26, 2012.

MSRB Notice 2012-04 (February 7, 2012) – The MSRB requested comment on a draft interpretive notice concerning the application of MSRB Rule G-17 to bondholder consents by underwriters of municipal securities. Comments were due by March 6, 2012.

CFTC Press Release 6173-12 (February 2, 2012) – The CFTC and SEC released a joint report to Congress on international swap regulation.

January 31, 2012 – FINRA published its 2012 annual regulatory and examination priorities to highlight new and continuing areas of significance to its regulatory programs, including topics of heightened importance to FINRA's Member Regulation, Market Regulation and Enforcement Departments, and the Office of Fraud Detection and Market Intelligence. This information represents their current assessment of certain key issues facing the securities industry.

FINRA Regulatory Notice 12-04 (January 18, 2012) – The SEC approved amendments to FINRA Rule 0160 (Definitions) and the repeal of Incorporated NYSE Rule 2A (Jurisdiction), effective February 21, 2012.

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Watch For *(Continued from page 14)*

SEC Press Release 2012-12 (January 18, 2012) – The SEC sought public comment on financial literacy and investor disclosure issues it is studying as part of a review mandated by the Dodd-Frank Act.

FINRA Regulatory Notice 12-03 (January 17, 2012) – FINRA provided guidance on heightened supervision of complex products.

FINRA Regulatory Notice 12-02 (January 13, 2012) – FINRA provided guidance on the application of communications rules (NASD Rules 2210 and 2211) to disclosures required by the Department of Labor.

Available Publications

March 7, 2012 – The MSRB released a new edition of its *Fact Book*, an annual sourcebook that analyzes trading data, continuing disclosure submissions and other statistics for the $3.7 trillion municipal bond market. Electronic copies can be found on the Publications page of the MSRB's website – ***www.msrb.org.***

January 19, 2012 – The newly updated GASB 2011-2012 Annual Bound Editions (*Codification, Original Pronouncements, and Comprehensive Implementation Guide*), are available for purchase at ***www.gasb.org/store.*** These publications equip preparers, auditors, and financial statement analysts with resources needed to stay abreast of the evolving governmental accounting environment.

January 18, 2012 – MSRB published the electronic version of its printed *2012 Rule Book*, which describes the rules for municipal securities dealers and municipal advisors effective as of January 1, 2012. Printed copies are available for sale from the MSRB.

January 10, 2012 – The FDIC's *Compliance Examination Manual* has been updated to incorporate new statutes, regulations, examination procedures and guidance.

Please add dp-fma@starpower.net to your e-mail address book as well as your firm's "white" list. This will keep FMA newsletters and program notices from being accidentally filtered.

Program Update

2012 Securities Compliance Seminar

Registrations are still being accepted for FMA's 21st Securities Compliance Seminar taking place April 25 – 27, 2012 at the Sir Francis Drake Hotel in San Francisco, California. This annual program is a three-day educational and networking experience for securities compliance professionals, internal auditors, risk managers, attorneys and regulators. And, *CPE and CLE accreditation will be available.*

The Program Planning Committee has been hard at work developing varied agenda topics and confirming noted industry leaders and regulators as speakers. Members include: **Mitchell Avnet** *(Lincoln Financial Group)*; **Anthony Cipiti, Jr.** *(Squire Sanders (US) LLP)*; **Jim Embersit** *(Ernst & Young LLP)*; **Alexander Sixbey** *(Lincoln Financial Group)*; **Bala Subramaniam** *(Fidelity India)*; and **Vaughn Swartz** *(TD Securities)*.

The current agenda (which can be viewed in its entirety at ***www.fmaweb.org***) includes these general sessions, concurrent workshops and confirmed speakers:

Key 2012 Legislative and Regulatory Initiatives

- Hardy Callcott ■ Bingham McCutchen LLP
- Louis Dempsey ■ Renaissance Regulatory Services, Inc.
- Don Lopezi ■ FINRA
- John Wright ■ Wells Fargo & Company

Governance Risk & Compliance vs. ERM

- Debra Freitag ■ RegEd
- Sean Gray ■ PNC Financial Services Group
- Chuck Hester ■ Oracle Financial Services Software
- Scott McCleskey ■ Thomson Reuters

Anti-Money Laundering

- Alma Angotti ■ Navigant
- Sarah Green ■ FINRA
- Nicholas Khouri ■ Ally Financial

Regulatory Forum

- Marc Fagel ■ SEC
- Judith Foster ■ OCC
- Malcolm Northam ■ FINRA
- Kathleen Miles ■ MSRB
- Jan Lynn Owen ■ California Dept of Corporations
- Brandon Reddington ■ OFAC

Municipal Market Developments and Prospects

- Bruce Gabriel ■ Squire Sanders (US) LLP
- David Levy ■ U.S. Bancorp
- Kathleen Miles ■ MSRB

Internal Auditor Roles and Responsibilities

- Janet Chapman ■ Union Bank
- Mitchell Mantua ■ Ernst & Young LLP

Cross Border Issues

- Hillel Cohn ■ Morrison & Foerster LLP
- Don Lopezi ■ FINRA
- Anna Pinedo ■ Morrison & Foerster LLP
- Janet Tarkoff ■ JMP Securities LLC

Retail Compliance Workshop

- Christine Kaufman ■ Impact Consultants, Inc.

Institutional Compliance Workshop

- Matthew Hardin ■ Hardin Compliance Consulting LLC
- James Rabenstine ■ Nationwide

Social Media—Balancing the Risk and Reward within Financial Services

- Melissa Callison ■ Charles Schwab & Co., Inc.
- Jaqueline Hummel ■ Hardin Compliance Consulting LLC
- Carolyn Pawelek ■ Socialware
- Stephen Selby ■ LIMRA Regulatory Strategy Center

Whistleblower Rules: A Game Changer

- Kevin Lesinski ■ Seyfarth Shaw LLP
- Oliver Quinn ■ Taft and Partners
- Kristin Snyder ■ SEC

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2012 Securities Compliance Seminar

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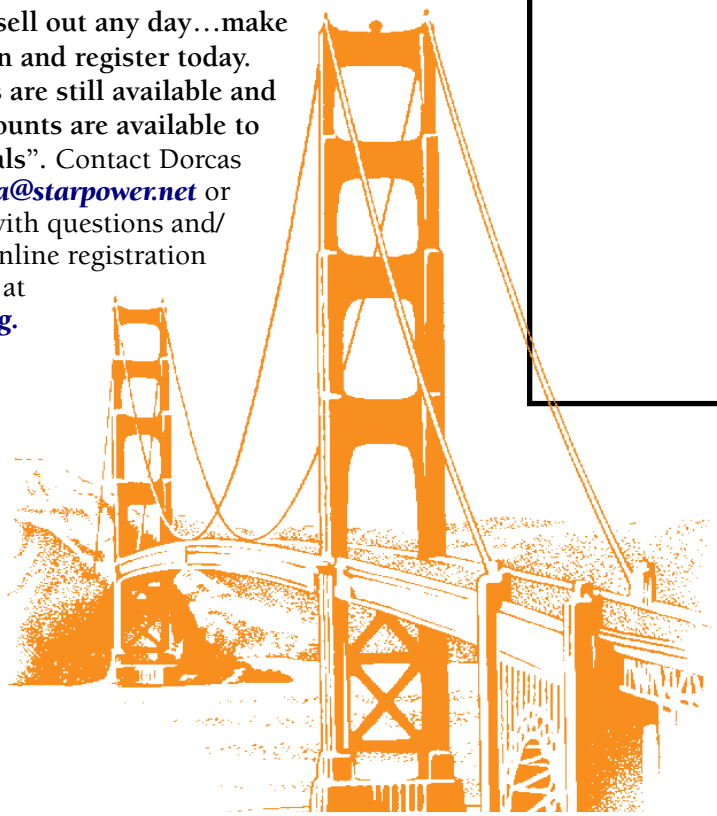
Conflicts of Interest / Insider Trading

- Steve Brown ■ PricewaterhouseCoopers LLP
- Scott Ilario ■ Compliance Outsourcing Solutions
- Michael Sullivan ■ Wells Fargo & Company
- Andrew Tino ■ PNC Capital Markets and Harris Williams

In addition, peer group discussions (lead by facilitators) will take place on Wednesday and Thursday afternoons. Tentative topics include: *AML/BSA/OFAC; Ask the Regulators; Broker-Dealer Compliance Hot Topics; Compliance & Technology; Cross Border Concerns; Conflicts of Interest/Insider Trading; Current Investment Adviser Issues; Customer Complaints; Fixed Income Pricing & Valuation; Governance Risk & Compliance vs. ERM; Internal Audit Hot Topics; Legislative & Regulatory Update/Regulatory Reform; Managing Remote Offices & Employees; Municipal Market Developments; New Fiduciary Standard; Privacy & Protection of Information; Private Funds; Social Media; Surviving a Regulatory Exam & Increased Regulatory Oversight; and Whistleblower Rules.* If you would like to facilitate one of these discussions, please contact FMA (see below).

The hotel may sell out any day…make your reservation and register today. Team discounts are still available and additional discounts are available to California "locals". Contact Dorcas Pearce at ***dp-fma@starpower.net*** or 202/544-6327 with questions and/or to register. Online registration is also available at ***www.fmaweb.org.***



FMA gratefully acknowledges these sponsors of FMA's 2012 Securities Compliance Seminar:

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2012 Legal & Legislative Conference

Fall dates and DC hotels are currently being considered for FMA's 21st **Legal & Legislative Issues Conference**. This annual program is a high-level forum for banking and securities attorneys as well as senior compliance officers and regulators. The day and a half program provides participants with an opportunity to share information on current legal and regulatory developments as well as network with peers.

FMA will assemble a Program Planning Committee in the coming weeks to develop an agenda focusing on current areas of regulatory and Congressional scrutiny/activity. **If you would like to volunteer for the committee (or serve as a speaker), contact Dorcas Pearce at *dp-fma@starpower.net* or 202/544-6327.**

FMA requests your input! An e-survey will be sent out in April to a sampling of past conference attendees and colleagues asking for topical as well as speaker suggestions for the agenda. The Planning Committee will rely greatly on these responses when formulating the program...so please respond quickly and share your thoughts and ideas…even if you do not receive the survey. Help us make this the best conference ever.

CLE and CPE accreditation…as well as team discounts…will be available, so be sure to budget for (and plan to attend) the 2012 Legal & Legislative Issues Conference. Contact Dorcas Pearce at ***dp-fma@starpower.net*** or 202/544-6327 with questions and/or to volunteer.

ATTENTION SPONSORS!
FMA is actively pursuing sponsorship opportunities regarding this conference. Please contact FMA if your firm would like to support this event.