Independent AML Review – Lessons Learned

July 21, 2020

Do you know when your mutual fund or ETF’s last independent anti-money laundering (AML) review was conducted? Did you walk away with findings from your last that were insightful and actionable? Has your Fund’s AML Compliance Officer (AMLCO) established and discussed with the Fund Board the appropriate frequency for conducting independent AML reviews? Each year at Foreside, we conduct numerous independent AML reviews of open-end investment companies (Funds), *e.g.*, mutual funds and ETFs. As your firm prepares for or seeks to improve upon past independent reviews, here are some key considerations:

Timing and Preparation

While regulations require a “periodic” independent review of a Fund’s AML program, the AMLCO, Chief Compliance Officer (CCO), Fund Board (Board) and others should ensure that the Fund follows the independent review frequency established in the Fund’s AML program. Ultimately, the AMLCO is responsible for the Fund’s AML program, and by extension, for setting a review frequency and adhering to it. A “periodic” review frequency is permissible. However, AMLCO’s should consider whether a pliable “periodic” frequency in their AML program is rigid enough to make certain that the independent AML review is completed in a timely and consistent manner.

As your Fund’s review deadline approaches, it is important to budget time sufficient for retaining a firm to perform the independent review, conducting the review and adding the report to the Board materials. Thus, the Fund should work with the independent reviewer from the outset to open up clear lines of communication and delineate expectations.

Although certain aspects of the review can be expedited depending on the Fund's structure, the independent review relies on information from a number of different parties including the Fund and certain service providers. Typically, Funds contractually delegate a number of key AML responsibilities to service providers. However, in practice, it is unlikely that this delegation includes an independent AML review. Funds may need to advise service providers of the purpose, importance, timeline and document production expectations surrounding the independent review, as some service teams may not be accustomed to sharing compliance data with third parties. Allotting ample time to complete the independent review provides the independent reviewer with the proper time to thoroughly review the Fund's AML program, which can result in key findings, observations and other insights.

Written Assessment and Other Takeaways

An independent review should ultimately consist of a written assessment of the Fund's AML program. Any reported findings, including exceptions, should be shared with the Fund's Board and appropriately addressed by the AMLCO. The written assessment should demonstrate to the Board: (i) the independent reviewer understood the Fund's AML program and risks; and (ii) an appropriate level of review has been performed to ensure adherence to requirements set forth by regulations and the Fund's AML program.

Additionally, similar to management letter comments in SOC reports, there may be findings that are minor or otherwise not included in the written assessment. Details and areas of improvement that may be outside the specific scope of the independent review offer a terrific opportunity for an independent reviewer to provide added value to their client and enhance the subject Fund's AML program.

Case Studies

The Brief	Mutual Fund sponsor's AML program covered both the Mutual Funds and registered investment adviser (RIA). This created overlapping language within their AML program that unnecessarily subjected the RIA to PATRIOT Act requirements, which are applicable for the Mutual Funds. Other instances in the AML program were unclear as to which requirements, responsibilities or other aspects applied to which entity.
The Approach	While there was technically nothing wrong with the way the program was written, Foreside offered insights on how the AML program could be more clearly differentiated to strengthen both the RIA and Mutual Funds' AML program.

The Result	Client received several suggestions on how to clearly delineate the distinct requirements and responsibilities between the Mutual Funds and RIA. While the original program did not contain major AML deficiencies, its structure could have created headaches during a regulatory examination. This exemplifies Foreside's sharp focus on providing our clients with practical and actionable compliance advice.

Foreside, through our relationships with a diverse client base of Fund complexes and service provider partners, can offer a best-practice perspective on how other clients have approached similar challenges or streamlined certain processes. In particular, recently launched funds may choose to postpone an independent AML review until the Fund's AML program has established some operational history. However, setting an independent AML review during or after the first year (and periodically thereafter) and leveraging Foreside's broad industry viewpoint can provide tremendous utility to the AMLCO and Fund Board in establishing an efficient, right-sized AML program for the Fund early on.

The Brief	ETF sponsor had recently launched Mutual Funds. Foreside conducted an independent review of the ETFs' AML program based on their previously established review frequency. The ETF sponsor also requested that Foreside perform an initial review of the Mutual Funds' AML program, despite their operational infancy.
The Approach	While the AML regulatory requirements are the same for both ETFs and Mutual Funds, methods for achieving compliance can greatly vary due to each product's unique structural characteristics. Foreside thoroughly reviewed the AML programs to identify a number of ways that the ETF and Mutual Fund AML Programs needed to be enhanced and corrected, in order to appropriately acknowledge the operational differences between the products.
The Result	Foreside's independent AML review generated practical suggestions on how to more efficiently deploy resources and engage service providers to meet regulatory obligations. This also included harmonizing and streamlining compliance processes that were redundant. The Client received key input on how to both enhance the ETFs' AML program and establish an effective AML program for the Mutual Funds.