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FinCEN Proposes Anti-Money Laundering Rules for Registered Advisers

By Jay G. Baris

The Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) on August 25, 2015 proposed rules to require SEC- registered investment advisers to adopt and maintain anti-money laundering (AML) programs and to file suspicious activity reports (SARs). The rules would not apply to state-registered investment advisers.

FinCEN's rules would define investment advisers as "financial institutions" for purposes of the Bank Secrecy Act (BSA). Thus, investment advisers would face similar requirements as those that apply to banks, broker-dealers and mutual funds. These requirements would include adopting compliance policies, filing Currency Transaction Reports (CTRs) and keeping records relating to transmittal of funds. FinCEN's proposals would not require advisers to adopt a customer identification ("know your customer" or KYC) program, which FinCEN likely will address in the future. FinCEN would delegate compliance examination responsibility to the SEC.

BACKGROUND

The BSA establishes the legal framework for FinCEN's regulatory oversight created by the Currency and Financial Transactions Reporting Act of 1970, as amended by the USA/PATRIOT Act in 2002 and other laws. Among other things, the BSA requires "financial institutions" to report certain financial transactions in an effort to thwart illegal efforts of money launderers and financers of terrorism who seek to process criminal proceeds through the financial system to disguise their illegal origin or ownership or control of assets, or to promote illegal activities. Congress designed FinCEN to implement the BSA. While the BSA applies broadly to financial institutions, early regulations applied only to traditional banks. After 2001, the BSA regulations applied to broker-dealers, money transferors and registered investment companies, among others.

In 2002 and 2003, FinCEN proposed rules to require unregistered investment companies and registered investment advisers to establish AML programs. FinCEN withdrew these proposals in 2008. In 2010, the Dodd-Frank Act amended the Investment Advisers Act of 1940 to require many unregistered investment advisers to register with the SEC, so the two-pronged approach originally proposed in 2002 and 2003 was no longer appropriate to address money laundering risks. FinCEN's new proposal effectively covers the same requirements as the two original proposals.

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Below is a summary of the key features of the proposed rules.

CURRENCY TRANSACTION REPORTS

Investment advisers currently are required to file reports on Form 8300 when they receive more than $10,000 in cash or negotiable instruments. FinCEN would replace this requirement with one that would require investment advisers to file CTRs for transactions involving a transfer of more than $10,000 in currency by or through the investment adviser in a single day. As a practical matter, investment advisers generally would no longer be required to file reports involving negotiable instruments, which they are less likely to receive from customers in any event.

RECORDKEEPING AND TRAVEL RULES

The rules would require investment advisers to create and retain records of transmittals of funds, and ensure that information relating to the transmittal of funds "travel" with the transmittal to the next financial institution in a payment chain.

AML COMPLIANCE PROGRAMS

Advisers would be required to adopt and maintain AML compliance programs that include internal policies, procedures and controls reasonably designed to ensure compliance with the new FinCEN rules if adopted. The rules would require an adviser's board, general partner or sole proprietor to approve the AML compliance program and to designate an AML officer. The rules would also require investment advisers to establish employee training programs and obtain independent audits of the program.

An AML program would be required to cover all of the adviser's advisory activity, including activity that does not entail the management of client assets and management of publicly or privately offered real estate funds.

Advisers would need to analyze money laundering and terrorist financing risks posed by particular clients that maintain an account with them by using a risk-based evaluation of relevant factors. The programs would have to take into account clients with separate accounts and private funds. While the rule would also apply to mutual fund clients and closed-end fund clients, FinCEN acknowledges that such registered funds have their own AML requirements and generally involve less risk.

While investment advisers may delegate compliance to certain service providers that are better equipped to monitor AML programs, the adviser would retain responsibility for the effectiveness of the AML program.

SARS

The rules would require investment advisers to report suspicious transactions, similar to the requirements that now apply to banks, casinos, money service businesses, broker-dealers, mutual funds, insurance companies, futures commission merchants and introducing brokers in commodities. Generally, the rules would require advisers to report suspicious transactions that involve an aggregate of at least $5,000. The requirement to file an SAR applies regardless of whether the transaction involves currency.

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INFORMATION SHARING

The rules would create a safe harbor to allow sharing of information between the government and financial institutions to allow FinCEN to require financial institutions to search their records to determine whether they have maintained an account or conducted a transaction with a person who is suspected of engaging in terrorist activity or money laundering.

OUR TAKE

Investment advisers often rely on other financial institutions (e.g., broker-dealers, custodian banks) to service advisory clients. Although these other financial institutions currently are subject to AML requirements, they may not be as familiar with all aspects of the clients' businesses. FinCEN believes that savvy, would-be money launderers may attempt to exploit gaps in regulatory oversight. The proposed rules would tighten that net.

We note, however, that the proposed rules continue to exclude investment advisers that are exempt from SEC registration, including small private fund advisers, state-registered advisers and advisers to venture capital funds. We believe that, in the future, FinCEN may subject these advisers to AML obligations, too.

PUBLIC COMMENTS

The deadline for public comments is 60 days after the proposal is published in the *Federal Register*.

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