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FINCEN'S AML PROPOSAL: AN OVERVIEW FOR INVESTMENT ADVISERS

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Earlier this year, the US Department of the Treasury's (Treasury's) Financial Crimes Enforcement Network (FinCEN) published a notice of proposed rulemaking (the Proposal) that would subject investment advisers to anti-money laundering/countering the financing of terrorism (AML/CFT) programs and related reporting requirements, including suspicious activity reports (SARs).[1]

The proposal would apply to investment advisers registered with the US Securities and Exchange Commission (SEC)—or RIAs—as well as exempt-reporting advisers (ERAs). Although investment advisers are already familiar with AML/CFT requirements of US law and the laws of many foreign jurisdictions, if adopted, the Proposal will, nonetheless, represent a substantial undertaking for investment advisers in terms of building and implementing a compliant operating infrastructure.

If adopted, the Proposal would

- require RIAs and ERAs to develop and implement a written, risk-based AML/CFT program that is reasonably designed both to prevent the adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to achieve and monitor compliance with the applicable provisions of the Bank Secrecy Act (the BSA) and related implementing regulations from the Treasury;[2]
- include RIAs and ERAs within the meaning of "financial institutions" for purposes of the BSA's implementing regulations[3] and impose on such advisers specific FinCEN reporting requirements;
- require RIAs and ERAs to monitor for suspicious activity and to file SARs with FinCEN accordingly; and
- delegate examination authority to the SEC.[4]

The Proposal would also require compliance within 12 months after the adoption of the final rules.

[1] FinCEN, Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 12108 (Feb. 15, 2024).

[2] Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the BSA), 12 U.S.C. § 1829B, 12 U.S.C. §§ 1951-1960, and 31 U.S.C. §§ 5311-5314 and 5316-5336.

[3] The BSA's implementing regulations are located at 31 C.F.R. Chapter X.

[4] At this time, FinCEN is not proposing to include a customer identification program (CIP) requirement, nor is it proposing to include within the AML/CFT program requirements an obligation to collect beneficial ownership information (BOI) for legal entity customers. According to FinCEN, it anticipates addressing CIP via a future joint rulemaking with the SEC and addressing the requirement to collect BOI for legal entity customers in subsequent rulemakings. The proposal was submitted to the Office of Management and Budget's Office of Information and Regulatory Affairs review on April 5, 2024, indicating that we can expect the proposal to be issued within the next 90 days.

BACKGROUND

Currently—and perhaps surprisingly—there are no federal or state AML/CFT regulations directly applicable to investment advisers. FinCEN previously proposed AML requirements for investment advisers in 2003[5] and unregistered investment companies (i.e., private funds) in 2002,[6] however, FinCEN withdrew those proposals in 2008,[7] noting that because investment advisers operate primarily through financial institutions that are subject to the BSA, their activities are at least indirectly subject to BSA requirements. FinCEN proposed another rule in 2015 that, like the Proposal, would have mandated AML programs, SAR filings, and other AML/CFT requirements for RIAs (2015 Proposal),[8] which we previously discussed in our 2015 White Paper.

However, concurrently with its issuance of the Proposal, FinCEN withdrew the 2015 Proposal, noting that substantial growth in adviser assets under management and the expansion of new products and services, the increasingly important role of private funds in the financial system, and the US government's more sophisticated understanding of the illicit finance risks associated with the US investment adviser industry have made the 2015 Proposal outdated.

THE PROPOSAL

Scope

For purposes of the BSA's implementing regulations, the Proposal would define an "investment adviser" as "[a]ny person who is registered or required to register with the SEC under section 20 of the Advisers Act (15 U.S.C. 80b-3(a)), or any person that currently is exempt from SEC registration under section 203(l) or 203(m) of the Investment Advisers Act (15 U.S.C. 80b-3(l), (m))."[9] As was the case with the 2015 Proposal, this definition would include all RIAs. However, unlike the 2015 Proposal, this definition would also include all ERAs. FinCEN noted that the proposed definition of "investment adviser" would include certain non-US investment advisers that are physically located abroad (i.e., do not have a branch,

[5] *See* Anti-Money Laundering Programs for Investment Advisers, 68 Fed. Reg. 23646 (May 5, 2003).

[6] *See* Anti-Money Laundering Programs for Unregistered Investment Companies, 67 Fed. Reg. 60617 (Sept. 26, 2002).

[7] *See* Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering programs for Unregistered Investment Companies, 73 Fed. Reg. 65569 (Nov. 4, 2008); and Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering Programs for Investment Advisers, 73 Fed. Reg. 65568 (Nov. 4, 2008).

[8] FinCEN, Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 80 Fed. Reg. 52680 (Sept. 1, 2015).

[9] Section 203(l) of the Advisers Act and Rule 203(l)-1 thereunder provides an exemption from registration for investment advisers whose only clients are "venture capital funds," regardless of such adviser's assets under management. Section 203(m) of the Advisers Act and Rule 203(m)-1 thereunder provides an exemption from registration for investment advisers whose only clients are "private funds," subject to a limit of $150 million in assets under management from the US. *See* 15 CFR 275.203(l)-1; 15 CFR 275.203(m)-1. Because these two exemptive categories of advisers are not required to register, but are nonetheless subject to certain SEC-reporting obligations, they are collectively referred to as "exempt reporting advisers."

office, or staff in the United States), but are nonetheless registered or required to register with the SEC (for RIAs) or file as ERAs.

The application of the Proposal to non-US RIAs and non-US ERAs with respect to their offshore funds or offshore clients does not clearly align with the SEC's historical approach to the extraterritorial application of the Advisers Act. Although FinCEN, in the Proposal, acknowledged the Reg Lite regulatory regime,[10] it does not recognize the SEC's recent statements with respect to how certain SEC rules apply to non-US ERAs[11] or apply either of these frameworks to the proposed rule.[12]

Instead, FinCEN seeks to apply the rule strictly based on SEC RIA and ERA status, without incorporating the nuances of how the Advisers Act regulatory regime applies outside of the United States. In addition, the Proposal would apply to advisory services that do not involve management of client assets and subadvisory services, as further discussed below. Although the Proposal would not apply to advisers relying on the foreign private adviser exemption,[13] FinCEN already indicated that it may consider future rulemakings to expand the application of the BSA to other investment advisers or similar entities not covered by the Proposal.[14]

The Proposal would require RIAs and ERAs to comply with the BSA regulatory requirements that are generally applicable to financial institutions, including the information sharing provisions of Section 314(a) of the USA PATRIOT Act;[15] currency transaction report (CTR) requirements;[16] certain recordkeeping and travel rules;[17] requirements to implement certain "special measures" if the Secretary of the Treasury finds

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[10] Proposal at 12110.

[11] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Investment

Advisers Act Release No. IA-6383 (August 23,2023); published at 88 Fed. Reg. 63206

(September 14, 2023). In the private fund adviser rulemaking, the SEC stated that the rules do not apply to offshore unregistered advisers or offshore SEC-registered advisers with respect to their offshore private funds (regardless of whether the funds have U.S. investors).

[12] Proposal at 12130.

[13] Id. at 12119 ("As noted, the proposed definition of 'investment adviser' would include certain non-US investment advisers that are physically located abroad (i.e., do not have a branch, officer, or staff in the United States), but are nonetheless registered or required to register with the SEC (for RIAs) or file a Form ADV (for ERAs)").

[14] Id.

[15] The Uniting and Strengthening American by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001—or USA PATRIOT Act—was signed into law by President George W. Bush in response to the September 11, 2001 attacks on the United States.

[16] *See* 31 C.F.R. 1010.310 through 1010.314. The CTR requirement would replace RIAs' and ERAs' obligation to file reports on Form 8300 for the receipt of more than $10,000 in cash and negotiable instruments. *See, e.g.*, 31 CFR 1010.330.

[17] 31 C.F.R. 1010.410 and 1010.430. These rules require financial institutions to create and maintain records of transmittals of funds and ensure that certain information pertaining to the transmittal of funds "travel" with the transmittal to the next financial institution in a payment chain.

that reasonable grounds exist to conclude that a foreign jurisdiction, institution, class or transaction, or type of account is a "primary money laundering concern;"[18] special standards for due diligence for private banking and correspondent bank accounts involving foreign persons;[19] and requirements to create and retain records for extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit when transactions exceed $10,000.[20]

AML/CFT PROGRAM REQUIREMENT

General

Proposed rule 31 C.F.R. 1032.210 (the Proposed AML/CFT Rule) would require each RIA and ERA to develop and implement a written, risk-based AML/CFT program that is reasonably designed both to prevent such adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to achieve and monitor compliance with the applicable provisions of the BSA and the Treasury regulations promulgated thereunder.

The Proposed AML/CFT Rule would require that each RIA's and ERA's AML/CFT program be approved in writing by its board of directors or trustees, or, for advisers without a board structure, by its sole proprietor, general partner, trustee, or other persons who have functions similar to a board of directors.

Minimum Requirements

In addition to the aforementioned requirement to implement written policies and procedures, the Proposed AML/CFT Rule would also require RIAs and ERAs to do the following:

- Provide for independent testing for compliance to be conducted by the RIA's/ERA's personnel or by a qualified outside party
- Designate a person or persons responsible for implementing and monitoring the operations and internal controls of the program
- Provide ongoing training for appropriate persons
- Implement appropriate risk-based procedures for conducting ongoing customer due diligence, such as understanding customer relationships for the purpose of developing a customer risk profile, ongoing monitoring for suspicious transactions, and, updating customer information based on risk

These minimum requirements are substantively the same as the AML program requirements that apply to other classes of regulated financial institutions, including banks, broker-dealers, and mutual funds. [21]

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[18] 31 U.S.C. 5318A.

[19] 31 U.S.C. 5318(i). As part of the Proposal, FinCEN proposes 31 C.F.R. 1032.600, which would state that RIAs and ERAs are subject to those "special standards of due diligence; prohibitions; and special measures" referenced in 31 C.F.R. 1010.600 through 1010.670), thereby expressly applying existing standards, prohibitions, and other requirements for financial institutions to RIAs and ERAs.

[20] 31 C.F.R. 1010.410(a)-(c).

[21] "Mutual fund" is defined in FinCEN's regulations as "an 'investment company' [as the term is defined in section 3 of the Investment Company Act (15 U.S.C. 80a-3)] that is an 'open-end company' [as that term is defined in section 5 of the Investment Company Act (15 U.S.C. 80a-5)] that is registered or is required to register with the Commission under section 8 of the Investment Company Act (15 U.S.C. 80a-8)." 31

These requirements are also broader than the 2015 Proposal, in that the 2015 Proposal would not have required the implementation of risk-based procedures for conducting ongoing customer due diligence.

As mentioned in the Proposal, the AML/CFT requirement is not "one-size-fits-all." Rather, it is risk-based and intended to give each RIA and ERA the flexibility to design a tailored program that identifies and mitigates the risks specific to its advisory services and its investors.

In discussing the scope of the Proposed AML/CFT Rule, FinCEN noted that RIAs and ERAs would not be required to apply their AML/CFT programs to open-end mutual funds—including exchange-traded funds (ETFs)—because such funds are treated as "financial institutions" under the BSA. Although FinCEN is not proposing to exempt closed-end funds from the AML/CFT or SAR requirements in the Proposal, FinCEN expects, absent other indicators of high-risk activity, that investment advisers could treat closed-end funds as lower risk for purposes of designing risk-based AML/CFT programs. FinCEN also noted that because subadvisory services are a subcategory of advisory services, the Proposed AML/CFT Rule would apply to RIAs and ERAs that provide subadvisory services.[22]

Dually Registered Investment Advisers and Advisers Affiliated with or Subsidiaries of Entities Required to Establish AML/CFT Programs

As in the 2015 Proposal, FinCEN stated that it is not proposing to require an RIA or ERA that is dually registered as a broker-dealer or is a bank (or bank subsidiary) to establish multiple or separate AML/CFT programs where a comprehensive AML/CFT program already covers all of the entity's relevant business and activities that are subject to BSA requirements. Similarly, FinCEN stated that an RIA or ERA affiliated with, or a subsidiary of, another entity required to establish an AML/CFT program in another capacity would not be required to implement multiple or separate programs if a single program can be extended to all affiliated entities that are subject to the BSA.

As a result of these provisions, which are thoughtfully designed to avoid requiring redundancies, larger financial institutions that are already subject to AML/CFT requirements in some capacity should be able to leverage those existing operational structures, which could reduce the time and cost associated with getting into compliance. Stand-alone RIAs and ERAs, however, will largely have to build from scratch or partner with a third-party service provider, which may put them at a relative disadvantage.

Contractual Delegation

FinCEN stated that it would permit an RIA or ERA to delegate contractually the implementation and operation of aspects of its AML/CFT program to another financial institution, agent, fund administrator, third-party service provider, or other entity. FinCEN noted that advisers that have already implemented AML/CFT policies and procedures often have delegated the administration of AML/CFT policies and procedures to a fund administrator (typically alongside other non-AML/CFT activities).

However, FinCEN made clear that the RIA or ERA would remain fully responsible and legally liable for its AML/CFT program and must be able to demonstrate the program's compliance with AML/CFT

C.F.R. 1010.100 (gg). In addition to traditional mutual funds, this definition would also include US-listed ETFs that invest in equities, fixed income instruments and other investment securities, and certain unit investment trusts.

[22] Although an adviser may act as a "primary adviser" or "subadviser," FinCEN noted that the Investment Advisers Act of 1940 does not distinguish between advisers and subadvisers. Rather, all are "investment advisers." *See* Proposal at 12124 *citing* 76 Fed. Reg. 39646, 39680 (Jul. 6, 2011) at n. 504 and accompanying text.

requirements. The RIA or ERA would also be responsible for ensuring that FinCEN and the SEC can obtain information and records relating to the AML/CFT program.

SUSPICIOUS ACTIVITY REPORTS

Similar to the 2015 Proposal, the Proposal would require RIAs and ERAs to file SARs of any suspicious transaction relevant to a possible violation of law or regulation. Under proposed rule 31 C.F.R. 1032.320 (Proposed SAR Rule), a transaction would be required to be reported to FinCEN if it is conducted or attempted by, at, or through an RIA or ERA; it involves or aggregates funds or other assets of at least $5,000; *and* the RIA/ERA knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part)

- involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade any federal law or regulation or avoid any transaction reporting requirement under federal law or regulation;
- is designed to evade any requirements of the BSA or regulations promulgated thereunder;
- has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the RIA/ERA knows of no reasonable explanation for the transaction after examining the available facts; or
- involves use of the RIA/ERA to facilitate criminal activity.

The Proposed SAR Rule would also require that an RIA or ERA evaluate customer activity and relationships for money laundering, terrorist financing, and other illicit finance risks and design a suspicious transaction monitoring program that is appropriate for the particular RIA or ERA in light of such risks. FinCEN discussed a few examples of suspicious activity, including:

- Transactions designed to hide the source or destination of funds and fraudulent activity
- An investor in a private fund, particularly venture capital funds, requesting access to detailed non-public technical information about a portfolio company that is inconsistent with a professed focus on economic return
- Investing in a private fund by using multiple wire transfers from different accounts maintained at different financial institutions or requesting that a transaction be processed in a manner to avoid funds being transmitted through certain jurisdictions
- Wire activity that does not correlate with a customer's stated investment objectives
- Transferring funds or other assets involving the accounts of third parties with no plausible relationship to the customer, transfers of funds or assets involving suspicious counterparties—such as those subject to adverse media, exhibiting shell company characteristics, or located in jurisdictions with which the customer has no apparent nexus
- The customer behaving in a manner that suggests that the customer is acting as a "proxy" to manage the assets of a third party
- An unusual withdrawal request by a customer with ties to activity or individuals subject to US sanctions following or shortly prior to news of a potential sanctions listing
- Potential fraud and manipulation of customer funds directed by the RIA or ERA itself, such as insider trading, market manipulation, or an unusual wire transfer request by an

RIA or ERA from a private fund's account held for the fund's benefit at a qualified custodian

FinCEN made clear that there is no way to provide a definitive list of suspicious transactions given that the techniques of money laundering, terrorist financing, and other illicit finance activity are continually evolving. FinCEN explained that a determination to file a SAR should ultimately be based on all the facts and circumstances relating to the transaction and the customer in question.

In addition, the Proposed SAR Rule would also permit an RIA or ERA to file SARs that it believes are relevant to the possible violation of any law or regulation, but whose reporting would not be required by the Proposed SAR Rule, such as suspicious transactions below the $5,000 threshold.

As with the proposed AML/CFT program, FinCEN noted that RIAs and ERAs would also not be required to apply the SAR reporting requirements to open-end mutual funds given that open-end mutual funds are already defined as "financial institutions" under the BSA and because of the regulatory and practical relationship between open-end mutual funds and their investment advisers.

Joint Filings

In situations where multiple RIAs, ERAs, or financial institutions with SAR filing obligations are involved, as with SAR rules applicable to other financial institutions, the Proposed SAR Rule would permit joint filings.

Filing and Notification Procedures

The Proposed SAR Rule would require that a SAR be filed no later than 30 calendar days after the date of initial detection by the RIA or ERA of facts that may constitute a basis for filing a SAR. In addition to filing the SAR, for situations requiring immediate attention, such as suspected terrorist financing or ongoing money laundering schemes, RIAs and ERAs would be required to notify immediately by telephone the appropriate law enforcement authority.

RIAs and ERAs would also need to collect and maintain supporting documentation relating to each SAR separately and make such documentation available to FinCEN, any federal, state, or local law enforcement agency, or any federal regulatory authority, such as the SEC, that examines the RIA or ERA for compliance with the BSA under the Proposed SAR Rule, upon request of that agency or authority.

Retention of Records

RIAs and ERAs would be required to maintain copies of filed SARs and the underlying related documentation for a period of five years from the date of the filing.

Confidentiality

Like the 2015 Proposal, the Proposed SAR Rule would prohibit disclosure of a SAR (or information that would reveal the existence of a SAR) except under very limited circumstances. In instances where an RIA, ERA, and any of their current or former personnel are subpoenaed or otherwise requested to disclose a SAR or reveal information that would disclose the existence of a SAR, the RIA or ERA would have to decline to produce the SAR (or such information) and notify FinCEN.

The Proposed SAR Rule contains certain rules of construction that permit limited disclosure of SARs (or information that would reveal the existence of a SAR) and underlying facts and documents. A third rule of

construction would permit the "sharing of a SAR within an investment adviser's corporate organizational structure for purposes consistent with the BSA *as determined by regulation or in guidance*."[23]

Although this provision would initially appear to permit an RIA or ERA to share a SAR within its organizational structures, that permission is conditioned on there being guidance or regulation that permit such sharing. In the 2015 Proposal, FinCEN specifically declined to permit RIAs to engage in such sharing and instead requested comment on the issue.[24]

Here, although FinCEN did not expressly provide such guidance in the Proposal, FinCEN explained that it will consider permitting investment advisers to share SARs with certain US affiliates, provided the affiliate is subject to a regulation providing for the confidentiality of SARs issued by FinCEN or by the affiliate's federal functional regulator, and consistent with SAR sharing guidance finalized in 2010 and applicable to other BSA-defined financial institutions.[25]

Limitation on Liability

The Proposed SAR Rule would limit an RIA or ERA and their personnel's liability in connection with filing SARs.

SEC Examination Authority

Finally, as in the 2015 Proposal, FinCEN again proposes to delegate its examination authority to the SEC. The SEC currently has delegated authority to examine broker-dealers and certain investment companies with the respective obligations under the BSA and its implementing regulations.[26] Although FinCEN delegated the examination authority to the SEC, FinCEN would still be able to inspect an adviser's AML/CFT program.

IMPACT ON PRIVATE FUND ADVISERS

The Proposal would apply to most advisers to US private funds, the vast majority of which are either RIAs or ERAs. According to FinCEN, private funds play an increasingly important role in the financial system and continue to grow in size, complexity, and number.[27] Private funds can be a particularly attractive entry point for illicit proceeds, according to FinCEN, because they present a possibility of high returns as

[23] *See* Proposed Rule 31 C.F.R. 1032.320(d)(1)(ii)(B) (emphasis added).

[24] *See* the 2015 Proposal at 52692.

[25] *See* Sharing Suspicious Activity Reports by Securities Broker-Dealers, Mutual Funds, Futures Commission Merchants, and Introducing Brokers in Commodities with Certain U.S. Affiliates, FIN-2010-G005 (Nov. 23, 2010); Sharing Suspicious Activity Reports by Depository Institutions with Certain U.S. Affiliates, FIN-2010-G006 (Nov. 23, 2010).

[26] 31 C.F.R. 1010.810(b)(6).

[27] FinCEN noted that there are approximately 5,500 RIAs who advise more than $20 trillion in private fund AUM, and over the past five years the number of private equity funds advised by RIAs increased 60 percent to more than 24,000. Proposal at 12117.

opposed to more costly forms of money laundering, such as trade-based money laundering or informal value transfer systems.[28]

FinCEN explained that private funds can be used to obscure the names of individual investors or beneficial owners so that the investment fund is identified as the owner of a particular asset. In addition, FinCEN explained that an illicit finance vulnerability in the context of private fund advisers is that they routinely rely on third-party administrators located outside of the United States, where AML/CFT supervision of fund administrators is often still nascent and where the offshore fund administrators have varied, non-uniform practices with respect to due diligence.[29]

However, the Proposal would not apply to all private fund adviser services. Specifically, the Proposal would not apply to any "non-advisory services."[30] As an example of non-advisory services in the context of private equity funds, FinCEN explained that fund personnel may play certain roles with respect to the portfolio companies in which the fund invests. FinCEN stated that activities undertaken in connection with those roles, such as making managerial/operational decisions about portfolio companies, would not constitute "advisory services" for purposes of the Proposal.

Conceivably, advisers that provide valuation services or other market research services may be able to carve out such aspects of their business from their AML/CFT policies and procedures. For the most part, however, we expect that services provided by advisers to private funds would be subject to the Proposal.

IMPACT ON OTHER ADVISERS

As noted above, the Proposal broadly captures all RIAs and ERAs, including those acting as subadvisors, such as RIAs for managed account programs. RIAs for managed account programs may serve as subadvisers that have little or no engagement with clients, have little or no access to nonpublic personal information about clients, provide only model portfolios to primary advisers that manage client accounts and maintain client relationships, or provide non-discretionary investment advice including financial planning.

In all of these circumstances, the RIAs for managed account programs have relatively limited—and sometimes zero—contact with clients and therefore limited engagement in the "advisory activities" that the Proposal seeks to address, such as the management of customer assets, the provision of financial advice, and the execution of transactions for customers.[31] Thus, RIAs with such arrangements have limited ability to detect whether clients are engaging in money laundering or other suspicious activity. Yet, the Proposal would impose the same AML/CFT program and SAR reporting obligations on RIAs for managed accounts as it would on RIAs that do routinely interact with clients and engage in client-facing advisory activities.

[28] Id. at 12114.

[29] Id.

[30] Id. at 12123.

[31] Id.

Because the Proposal contemplates the ability of an RIA or ERA to be able to tailor its AML/CFT policy based on the risk represented by its business model, such RIAs or ERAs should be permitted to adopt and implement lower-touch policies and procedures.[32]

IMPLICATIONS

FinCEN indicated that the Proposal is intended to further the United States' efforts to comply with several international AML/CFT standards established by the Financial Action Task Force (FATF). Most recently, in 2016, the United States was subject to a mutual evaluation by FATF where the United States was rated as "partially compliant" on Recommendations 1, 12, and 20 for the failure to apply AML/CFT requirements to investment advisers, among other reasons.[33] If adopted, FinCEN indicated that the Proposal would help bring the United States closer to satisfying FATF standards.

In addition, concurrently with the Proposal, Treasury published its 2024 Investment Adviser Risk Assessment (Risk Assessment), which identified several illicit finance threats involving investment advisers.[34] The Risk Assessment identified several reasons that investment advisers may be vulnerable to such threats, including that "the investment adviser sector is generally not required to implement comprehensive AML/CFT obligations, which creates arbitrage opportunities for bad actors by allowing them to access the US financial system through investment advisers with weaker or non-existent client due diligence."[35]

According to FinCEN Director Andrea Gacki, "[t]he current patchwork of AML/CFT requirements creates regulatory gaps that criminals and foreign adversaries exploit to launder money, hide illicit wealth, and compromise American innovation. [The Proposal] would level the regulatory playing field, protect U.S. economic and national security, and safeguard American businesses."[36]

NEXT STEPS

Although FinCEN's prior efforts to adopt rules imposing AML obligations on investment advisers were never finalized, RIAs and ERAs that do not already have AML programs in place may want to consider

[32] For example, by analogy, ETFs have very little transparency as to the nature of the investors that purchase their shares in exchange-based secondary transactions and, accordingly, typically will have AML policies and procedures that focus on getting representations as to the existence and extensiveness of the AML policies and procedures in place at contractual counterparties and financial intermediaries. Conceivably, a similar construct could work for RIAs or ERAs whose business are limited to model delivery or sub-advisory services where they have no nexus with investors and are not involved in the investor onboarding process.

[33] *See* FATF, Mutual Evaluation of the United States (2016).

[34] Treasury, 2024 Investment Adviser Risk Assessment.

[35] Id. at 1-2. The risk assessment found that "the highest illicit finance risk in the investment adviser sector is among ERAs (who advise private funds exempt from SEC registration), followed by RIAs who advise private funds, and then RIAs who are not dually registered as, or affiliated with, a broker-dealer (or is, or affiliated with, a bank)." Id. at 5.

[36] *See* Press Release, FinCEN, FinCEN Proposes Rule to Combat Illicit Finance and National Security Threats in Investment Adviser Sector (Feb. 13, 2024).

formulating internal teams and preliminary plans for building AML/CFT infrastructure in anticipation of the adoption of a final rule. With substantial portions of the US financial services market already subject to AML/CFT requirements (e.g., broker-dealers, banks, mutual funds, and ETFs), the arguments against subjecting RIAs and ERAs to comparable requirements are unlikely to persuade FinCEN during the public comment process, particularly given the proliferation of technology and complexity in the market that has heightened the risk of illicit money laundering and terrorism-related activities globally. As we discussed in our prior White Paper, RIAs and ERAs without programs may find useful an AML program template provided by the Financial Industry Regulatory Authority (FINRA) for use by its smaller broker-dealer members.[37]

Although the FINRA Small Firm Template may be a helpful starting point, RIAs and ERAs should be mindful that AML programs will need to be tailored to account for the risks associated with a firm's specific business and its clients. Further, all RIAs and ERAs may find it helpful to review guidance from the federal banking regulators[38] regarding compliance with the BSA, literature from FATF regarding money laundering and terrorist financing in the securities industry,[39] as well as commentary from FinCEN in the Proposal regarding the expected scope of an RIA's or ERA's AML/CFT program as well as the risk profile of certain advisory clients.[40]

In addition, these resources identify "red flags" that could be useful with respect to compliance with the Proposed SAR Rule. Finally, in anticipation of the Proposal being adopted, it is likely that the market for AML professionals could get increasingly competitive, particularly after final rules are adopted and increasingly so as a future compliance date approaches. Accordingly, RIAs and ERAs may want to proactively consider onboarding professionals with AML/CFT experience. Relatedly, outsourced solutions for RIAs and ERAs could also develop in the market, which smaller firms may want—or need—to consider for cost-effective compliance solutions.

Morgan Lewis has a global team of lawyers who regularly assist investment advisers with their regulatory compliance needs, including those related to AML. Our team stands ready to assist with the review of your firm's policies.

[37] FINRA Small Firm Template.

[38] *See* BSA/AML Examination Manual.

[39] *See* FATF, Money Laundering and Terrorist Financing in the Securities Sector (Oct. 2009).

[40] Proposal, 89 *Fed. Reg.* at 12123.

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