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FinCEN Proposes Rule to Subject Certain Investment Advisers to Anti-Money Laundering Program, Recordkeeping, and Reporting Requirements under the Bank Secrecy Act

Go-To Guide:

- The U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) issued a Notice of Proposed Rulemaking that would subject certain investment advisers to Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) compliance program, recordkeeping, and reporting requirements under the Bank Secrecy Act (BSA).
- The comment period runs through April 15, 2024. Covered investment advisers would be required to comply with the rule within 12 months from the final rule's effective date.
- FinCEN is proposing to delegate examination authority to the Securities and Exchange Commission (SEC) given the SEC's expertise in the regulation of investment advisers and experience in examining other financial institutions with respect to AML/CFT responsibilities.

After years of rulemaking efforts, FinCEN issued a Notice of Proposed Rulemaking (Proposed Rule) Feb. 15, 2024, that would subject certain investment advisers to AML/CFT compliance requirements under the BSA. The Proposed Rule's comment period runs through **April 15, 2024**. Covered investment advisers would be required to comply within 12 months from the final rule's effective date.

FinCEN has previously proposed to extend AML/CFT program requirements to private funds and investment advisors in 2002, 2003, and 2015, but these efforts were ultimately withdrawn, in part due to arguments that the imposition of AML/CFT program requirements on investment advisers is unnecessary and redundant given that their cash and securities transactions must be processed through financial institutions already subject to AML/CFT program requirements. That said, FinCEN's increased focus on illicit finance risks in the investment advisory sector and significant work done by the Department of the Treasury to justify the Proposed Rule's implementation, reflected in the results of Treasury's risk assessment, suggests momentum to address perceived gaps in the U.S. AML regulatory framework.

Scope

If implemented, the Proposed Rule would apply to the following types of investment advisers:

1. Investment advisers registered (RIAs) with the SEC; and

2. Investment advisers that report to the SEC as exempt reporting advisers (ERAs).

Investment advisers generally must register with the SEC if they have $110 million or more in assets under management (AUM). ERAs are investment advisers that (1) advise only private funds and have less than $150 million in AUM in the United States; or (2) advise only venture capital funds. ERAs are exempt from SEC registration but still must file certain information with the SEC. However, state-registered investment advisers and non-U.S. investment advisers that rely on the foreign private adviser exemption would be excluded from the definition of an investment adviser under the Proposed Rule.

AML/CFT Requirements

If adopted in its current form, the Proposed Rule would require RIAs and ERAs to (1) establish an AML/CFT program to include risk-based procedures for ongoing customer due diligence (CDD); (2) report suspicious activity and file Currency Transaction Reports (CTRs); (3) maintain records of originator and beneficiary information for certain transactions—i.e., Recordkeeping and Travel Rules; (4) implement information-sharing procedures; and (5) adopt special measures and implement special due diligence requirements for correspondent and private banking accounts. These requirements are discussed more fully below.

(1) *AML/CFT Program*: The Proposed Rule would require RIAs and ERAs to develop and implement a written AML/CFT program that is risk-based and reasonably designed to prevent the RIAs and ERAs from being used for money laundering, terrorist financing, and other illicit finance activities (AML/CFT Program). AML/CFT Program minimum requirements include (a) implementing policies, procedures, and internal controls; (b) conducting independent testing of the AML/CFT Program; (c) designating a person or persons responsible for implementing the AML/CFT Program; (d) ensuring ongoing training of appropriate personnel; and (e) implementing risk-based procedures for conducting ongoing customer due diligence that includes (i) understanding the nature and purpose of customer relationships to develop a customer risk profile; and (ii) conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.[1]

[1] The Proposed Rule, however, would defer extending to RIA and ERAs the Customer Identification Program (CIP) rule and beneficial ownership information collection obligations under the CDD rule to later rulemaking.

(2) *SARs and CTRs*: The Proposed Rule would require RIAs and ERAs to file CTRs rather than filing reports using FinCEN Form 8300 and would add several provisions specifying how RIAs and ERAs should fulfill their proposed CTR obligations. Further, the Proposed Rule would require RIAs and ERAs to file suspicious activity reports (SARs) for any suspicious transaction that involves or aggregates at least $5,000 in funds or assets, in line with reporting obligations applicable to other financial institutions subject to the BSA.

(3) *Recordkeeping and Travel Rule*: Because the Proposed Rule would classify RIAs and ERAs as financial institutions under the BSA, RIAs and ERAs would be required to comply with the Recordkeeping and Travel Rules when they engage in transactions that meet the definition of a transmittal order.

(4) *Information-Sharing Procedures (Section 314(a) and 314(b) of the USA Patriot Act)*: The Proposed Rule would expressly subject RIAs and ERAs to FinCEN's rules implementing the special information-sharing procedures to detect money laundering or terrorist activity of Sections 314(a) of the USA PATRIOT Act. These provisions generally would require RIAs and ERAs, upon request from FinCEN, to expeditiously search their records for specified information to determine whether the RIA and ERA maintains or has maintained any account for, or has engaged in any transaction with, an individual, entity, or organization named in FinCEN's request and report such identified information to FinCEN. RIAs and ERAs would also be able to participate in voluntary information sharing with other financial institutions under Section 314(b) of the USA PATRIOT Act.

(5) *Special Measures and Special Due Diligence Standards*: FinCEN proposes to subject RIAs and ERAs to Sections 311 and 312 of the USA PATRIOT Act. Generally, Section 311 requires U.S. financial institutions to implement certain "special measures" if the Treasury Secretary finds that reasonable grounds exist to conclude that a foreign jurisdiction, institution, class of transaction, or type of account is a "primary money laundering concern." Similarly, Section 312 of the USA PATRIOT Act establishes special due diligence requirements for private banking and correspondent bank accounts involving foreign persons. Importantly, FinCEN is not proposing to permit investment advisers to exempt any mutual funds they advise from these requirements.

Key Aspects of the AML/CFT Requirements

The Proposed Rule contains several key requirements regarding the AML/CFT Program. First, the Proposed Rule would require that AML/CFT Programs cover all advisory activities, except activities undertaken with respect to mutual funds, which have their own obligations under the BSA.

Second, the Proposed Rule would require that the AML/CFT Program be approved in writing by the board of directors or trustees (or, alternatively, by the sole proprietor, general partner, trustee, or other persons that have functions like a board of directors).

Third, the Proposed Rule makes clear that investment advisers dually registered with the SEC as broker-dealers or that are a subsidiary of another entity required to establish an AML/CFT Program in another capacity can satisfy both regulatory regimes in one comprehensive program.

Fourth, FinCEN proposes delegating examination authority for this rule to the SEC given the SEC's expertise in the regulation of investment advisers and experience examining other financial institutions with respect to AML/CFT responsibilities.

Lastly, the Proposed Rule would permit RIAs and ERAs to contractually delegate the implementation and operation of aspects of their AML/CFT Programs. However, if they choose to do so, RIAs and ERAs would be required to continue to demonstrate their AML/CFT Programs' compliance with the Proposed Rule's requirements.

Key Takeaways

While the Proposed Rule remains subject to public comment until April 15 and further rulemaking may extend some of its requirements, RIAs and ERAs should begin to consider whether they might be subject to the Proposed Rule if it is adopted in its current, or close to current, form, and what steps they may need to take to comply with FinCEN's expectations.

Authors

This GT Alert was prepared by:

- Richard M. Cutshall | +1 303.572.6527 | cutshallr@gtlaw.com
- Marina Olman-Pal | +1 305.579.0779 | Marina.Olman@gtlaw.com
- Kyle R. Freeny | +1 202.331.3118 | freenyk@gtlaw.com
- Melissa Peach | +1 212.801.6898 | Melissa.Peach@gtlaw.com
- Janiell "Alexa" Gonzalez | +1 305.579.0509 | Janiell.Gonzalez@gtlaw.com