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FinCEN Proposes Expanding AML Rules to Investment Advisers

Alert

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On February 13, 2024, the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of Treasury (Treasury) issued a "Notice of proposed rulemaking" (proposed rule) that would require Securities Exchange Commission (SEC)-Registered Investment Advisers (RIAs) and Exempt Reporting Advisers (ERAs) to implement the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) requirements pursuant to the Bank Secrecy Act (BSA).

The proposed rule comes after the Treasury published the 2024 Investment Adviser Risk Assessment, which identified that an uneven application of AML/CFT requirements in the investment advisory space creates a national security threat.

Generally, RIAs and ERAs have been exempt from most AML rules. However, the proposed rule would include them in the definition of "financial institution" under the BSA, subjecting them to requirements currently applicable to other financial institutions (such as banks, broker-dealers, etc.). The proposed rule would apply such AML rules to RIAs and ERAs, but they would not apply to investment advisers registered only at the state level.

The proposed rule would require RIAs and ERAs to develop and implement AML compliance programs; file suspicious activity reports; and meet certain recordkeeping obligations. These requirements will be discussed in further detail below.

In contrast, the proposed rule does not expand the customer identification program (CIP) requirements that currently apply to those other financial institutions, nor does it add an obligation to collect beneficial ownership information for legal entity customers at this time. Those rules would continue to apply as they

do today, but would not be expanded to apply to investment advisers; however, FinCEN anticipates addressing CIP via future joint rulemaking with the SEC and addressing the requirement to collect beneficial ownership information in subsequent rulemakings.

FinCEN is soliciting public comments for the proposed rule for a 60-day period following the publishing of the proposed rule (comments accepted until April 15, 2024). This is the third time FinCEN proposed a similar expansion of these AML rules to investment advisers; the first two proposals met fierce industry resistance and were not adopted. Industry opposition is expected again.

ANTI-MONEY LAUNDERING PROGRAM

If the proposed rule is adopted in its current form, within 12 months after the effective date, RIAs and ERAs would be required to develop and implement an AML compliance program. Minimum requirements of an AML compliance program would include the following:

- Development and implementation of reasonably designed policies, procedures, and controls to comply with BSA requirements and identify potential money laundering or illicit finance risks.
- Designation of at least one AML compliance officer.
- Implementation of an ongoing AML training for certain employees/personnel.
- Testing independent of the AML program.
- Incorporation of risk-based procedures for conducting ongoing customer due diligence to (1) understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and (2) identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

FinCEN notes that the AML compliance program requirement would not be a one-size-fits-all requirement, but would be risk-based and intended to give investment advisers the flexibility to design their programs to identify and mitigate the specific risks of the advisory services they provide and the customers they advise, subject to the minimum requirements above. The AML compliance program must be approved in writing by the board of directors or trustees, and if there is no such board, by the sole proprietor, general partner, trustee, or other person(s) with functions similar to a board of directors, and be made available to FinCEN upon request.

SUSPICIOUS ACTIVITY REPORTING

Under the proposed rule, RIAs and ERAs would be subject to required reporting of suspicious activity, including the filing of Suspicious Activity Reports (SARs), including where:

- The transaction is conducted or attempted by, at, or through the RIA or ERA;
- The transaction involves or aggregates funds or other assets of at least $5,000; and
- The RIA or ERA knows, suspects, or has reason to suspect that the transaction (or a related pattern of transactions):
  - 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 to avoid any transaction reporting requirement under federal law or regulation;
  - Evades, by design, any requirements of the BSA;
  - Has no business or apparent lawful purpose or is not the sort in which the customer would normally be expected to engage, and the RIA or ERA knows of no reasonable explanation for the transaction after examining the available facts; or
  - Involves use of the investment adviser to facilitate criminal activity.

Additionally, the proposed rule encourages the voluntary reporting of other suspicious transactions, even if such activity does not meet these criteria.

RECORDKEEPING

FinCEN has broad authority to impose recordkeeping requirements on financial institutions under the Recordkeeping and Travel Rules of the BSA. The proposed rule would require RIAs and ERAs to comply with certain aspects of those rules, such as creation and retention of records for transmittals of funds and ensuring that certain information relating to the transmittal of funds "travels" with the transmittal to the next financial institution in the payment chain.

SPECIAL INFORMATION-SHARING PROCEDURES

The proposed rule would subject RIAs and ERAs to FinCEN's rules implementing the special information-sharing procedures to detect money laundering or terrorist financing activity of sections 314(a) and 314(b) of the USA PATRIOT Act. The proposed rule would require an RIA or ERA, upon request from FinCEN, to expeditiously search its records to determine whether the RIA or ERA maintains any account for, or has engaged in any transaction with, a party named in FinCEN's request.

In addition, RIAs and ERAs would be allowed to participate in voluntary information-sharing arrangements with other financial institutions regarding parties suspected of possible terrorist financing or money laundering activities with another financial institution.

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CONCLUSION

Although previous efforts by FinCEN to impose similar AML requirements on RIAs and ERAs have been unsuccessful, it would be prudent for RIAs and ERAs to assess their current AML programs to identify any enhancements that may be needed in light of the proposed rule.

RIAs and ERAs should review what will be expected when identifying and reporting suspicious activities (note: money laundering is not the only trigger of a reporting obligation, among other things, FinCEN points to investment fraud and foreign investor access to sensitive and controlled technology through investment relationships as potential triggers for SARs).

RIAs and ERAs may want to analyze the proposed rule to determine potential opportunities to comment on different aspects of the proposed rule. For example, FinCEN has sought comments on the following specific sections of the rule, among others:

- Proposed definition of "Investment Adviser."
- AML/CFT program requirement.
- Proposed minimum requirements of the AML/CFT program.
- Risk-based procedures for ongoing customer due diligence.

As mentioned above, the comment period runs through April 15, 2024.

For more information on the expanding AML rules, please contact Janae Aune, Donta Dismuke, Eric Mikkelson, Heidi Wicker, or one of the attorneys listed below or the Stinson LLP contact with whom you regularly work.

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