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FinCEN Proposes Rule to Extend Bank Secrecy Act Obligations to Certain Investment Advisers

The Proposed Rule Would Subject Certain Investment Advisers to a Broad Range of AML/CFT Obligations and Represents a Significant Development for the Sector

Regulators have long considered the lack of anti-money laundering ("AML") and countering the financing of terrorism ("CFT") regulations applicable to investment advisors to be a vulnerability in the U.S. Bank Secrecy Act ("BSA")/AML regime. Despite attempts by the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") to address this,[1] BSA/AML regulations have not been formally applied to this sector. On February 15, 2024, however, FinCEN issued a Notice of Public Rulemaking (the "Proposed Rule") proposing to expand certain AML/CFT requirements under the BSA to include certain investment advisers.

The Proposed Rule provides that, while some investment advisers do maintain AML/CFT programs, namely as advisers to mutual funds or to satisfy relationships with financial institutions such as banks, lenders, and broker-dealers, "there are no Federal or State regulations requiring investment advisers to maintain AML/CFT programs or records under the BSA."[2] As a result, "thousands of investment advisers overseeing the investment of tens of trillions of dollars into the U.S. economy currently operate without legally binding AML/CFT obligations."[3]

The Proposed Rule would "include certain investment advisers in the definition of 'financial institution' under the [BSA], prescribe minimum standards for [AML/CFT] programs to be established by covered

investment advisers, require covered investment advisers to report suspicious activity to FinCEN pursuant to the BSA, and make several other related changes to FinCEN regulations."[4]

Under the Proposed Rule, FinCEN would delegate the authority to examine investment advisers subject to the Proposed Rule for compliance with FinCEN's regulations to the Securities and Exchange Commission ("SEC").

The Proposed Rule requests comments from the public and includes a specific list of questions for which FinCEN is requesting responses. Public comments on the Proposed Rule are due on or before April 15, 2024.

ADDING INVESTMENT ADVISERS TO THE DEFINITION OF "FINANCIAL INSTITUTION"

The Proposed Rule proposes to add two types of investment advisers to the definition of "financial institution" under the regulations implementing the BSA: (1) investment advisers that are registered or required to register with the SEC (such investment advisers ("RIAs")); and (2) investment advisers that report to the SEC as Exempt Reporting Advisers ("ERAs") pursuant to the Investment Advisers Act of 1940, as amended ("Advisers Act"), and the rules thereunder (RIAs and ERAs, collectively, "Covered Investment Advisers").[5] The ERAs, for instance, would include many hedge funds, private equity, and venture capital funds. Notably, advisory activities with respect to mutual funds would be exempt from the AML/CFT program requirements given that mutual funds are already subject to BSA/AML obligations; also, foreign investment advisers and state registered investment advisers would be excluded from the Proposed Rule.

As a result of being added to the definition of "financial institution" under the BSA, Covered Investment Advisers will be required to: (1) establish AML/CFT programs; (2) file Currency Transaction Reports ("CTRs") and Suspicious Activity Reports ("SARs"); (3) maintain records of originator and beneficiary information for certain transactions; (4) share information with FinCEN and other law enforcement agencies (and authorize sharing with certain financial institutions); and (5) implement special due diligence requirements for private banking and correspondent bank accounts involving foreign persons and special measures under the USA PATRIOT Act and the Combatting Russian Money Laundering Act.

At this time, FinCEN is not proposing a customer identification program requirement for Covered Investment Advisers. FinCEN anticipates addressing customer identification program requirements for Covered Investment Advisers in a future joint rulemaking with the SEC.[6] FinCEN also is not proposing an obligation for Covered Investment Advisers to collect beneficial ownership information for legal entity customers (i.e., Customer Due Diligence rule ("CDD")).[7] Under the CDD rule, FinCEN requires certain financial institutions to identify and verify beneficial owners of customers that are legal entities. FinCEN is currently considering revisions to the CDD rule in connection with its implementation of the Corporate Transparency Act; it anticipates addressing this requirement for Covered Investment Advisers in a subsequent rulemaking.

AML/CFT PROGRAMS

Under the BSA, financial institutions are required to establish AML/CFT programs to mitigate the risk of money laundering and terrorism financing. As a result of including Covered Investment Advisers under the definition of "financial institution," Covered Investment Advisers would be subject to this requirement. Importantly, the Proposed Rule notes that the AML/CFT program requirement "is not a one-size fits-all requirement but rather is risk based and is 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."[8] Covered Investment Advisers would be required to implement AML/CFT programs within twelve months of the effective date of the Proposed Rule.

The Proposed Rule proposes to require AML/CFT programs to cover all advisory activities except activities undertaken with respect to mutual funds because mutual funds already have their own obligations under the BSA.[9] In addition, the AML/CFT programs would not be required to cover non-advisory services, such as making managerial/operational decisions about portfolio companies of a private equity fund.[10]

While the Proposed Rule would allow Covered Investment Advisers to delegate the implementation and operation of aspects of its AML/CFT program to third parties, the Covered Investment Adviser "would remain fully responsible and legally liable for, and need to demonstrate, the program's compliance with AML/CFT requirements and FinCEN's implementing regulations."[11]

Under the Proposed Rule, Covered Investment Advisers' AML/CFT programs would be required to include the following elements:

- Policies, procedures, and internal controls;
- Independent testing for compliance conducted by company personnel or a qualified outside party;
- A designated person or persons responsible for implementing and monitoring the operations and internal control program;
- Ongoing training for appropriate persons; and
- Ongoing CDD.

Significantly, a Covered Investment Adviser's AML/CFT program will be required evaluate, on a risk-weighted basis, the nature and purpose of customer relationships so that it can identify and report suspicious transactions.[12] This rule will apply across the board, including to investors who may be introduced to the adviser by other intermediary entities who may or may not have their own AML/CFT obligations.

Given that an investment advisor's operations (including a range of compliance-related activities) may be conducted by agents or third-party service providers, such as broker-dealers in securities (including prime brokers), custodians, transfer agents, and fund administrators, the Proposed Rule allows a Covered Investment Adviser to contractually delegate the implementation and operation of its AML/CFT program. However, the Covered Investment Adviser would remain responsible under the Proposed Rule for compliance with AML/CFT requirements and FinCEN's implementing regulations. The Covered Investment Adviser also would be required to ensure that FinCEN and the SEC are able to obtain information and records relating to the AML/CFT program.

OBLIGATIONS TO FILE CTRS AND SARS

The Proposed Rule would require Covered Investment Advisers to file SARs for any suspicious transaction relevant to a possible violation of law or regulation. Specifically, Covered Investment Advisers would be obligated to file SARs if a transaction is conducted or attempted by, at, or through an investment adviser, it involves or aggregates funds or other assets of at least $5,000, and the investment adviser knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part) involves illegal activity, is designed to evade regulations under the BSA, or has no business or lawful purpose.[13] This will be a significant obligation and, if the Proposed Rule is implemented, will require careful attention.

In addition, under current law, investment advisers are required to file reports for the receipt of more than $10,000 in currency and certain negotiable instruments using joint FinCEN/Internal Revenue Service Form 8300. Under the

Proposed Rule, Covered Investment Advisers would be required to file CTRs with FinCEN instead of FinCEN/Internal Revenue Service Form 8300.[14]

RECORDKEEPING REQUIREMENTS

Under the Proposed Rule, Covered Investment Advisers would be subject to FinCEN's Recordkeeping and Travel Rules, which require financial institutions "create and retain records for transmittals of funds and ensure that certain information pertaining to the transmittal of funds that equal or exceed $3,000 'travels' with the transmittal to the next financial institution in the payment chain."[15] However, the Proposed Rule notes that some transmittals "involving investment advisers would fall within an existing exception to the Recordkeeping and Travel Rules designed to exclude transmittals of funds from these Rules' requirements when certain categories of financial institutions are the transmitter and recipient."[16] In addition, the Proposed Rule would "subject investment advisers to requirements to create and retain records for extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit."[17]

SPECIAL INFORMATION-SHARING PROCEDURES

The Proposed Rule would require Covered Investment Advisers to comply with certain information-sharing procedures for the detection of money laundering or terrorist activity. Specifically, the Proposed Rule would "expressly subject investment advisers to FinCEN's rules implementing the special information sharing procedures to detect money laundering or terrorist activity of sections 314(a) and 314(b) of the USA PATRIOT Act."[18] As a result, "law enforcement would be able to request from Covered Investment Advisers, where there is reasonable suspicion and credible evidence, potential lead information that might otherwise never be uncovered."[19] In addition, Covered Investment Advisers would be able to "participate in voluntary [ ] information sharing arrangements, through which they would be able to gather additional information from other financial institutions, which would enable broader understanding of customer risk and filing of/or file more comprehensive SARs, for example."[20]

SPECIAL DUE DILIGENCE REQUIREMENTS

The Proposed Rule would subject Covered Investment Advisers to special due diligence requirements for private banking and correspondent bank accounts involving foreign persons under regulations implementing Section 312 of the USA PATRIOT Act. As a result, Covered Investment Advisers will be required to "maintain due diligence programs for correspondent accounts for foreign financial institutions and for private banking accounts that include policies, procedures, and controls that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving any such correspondent or private banking accounts."[21]

In addition, the Proposed Rule would require Covered Investment Advisers to implement certain "special measures" under Section 311 of the USA PATRIOT ACT for jurisdictions where the Secretary of the Treasury "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'"[22] and similar special measures under the Combatting Russian Money Laundering Act, which allows for special measures in the context of Russian illicit finance.

REQUEST FOR COMMENTS

As noted above, FinCEN is requesting public comments on the Proposed Rule by April 15, 2024. In particular, FinCEN is seeking comments in response to sixty specific questions covering the following topics:

- The Proposed Rule's proposed definition of "investment adviser" (e.g., is there duplication with existing requirements under the Investment Advisers Act of 1940, whether other categories of entities, like advisers to mutual funds, be exempted);
- The Proposed Rule's proposal to require Covered Investment Advisers to file CTR and comply with the Recordkeeping and Travel Rules (i.e., are banks already sufficiently gathering this information);
- The Proposed Rule's exclusion of foreign investment advisers and state registered investment advisers;
- The Proposed Rule's requirement that Covered Investment Advisors submit SARs;
- The Proposed Rule's special information sharing procedures (including the circumstances under which investment advisers would enter into voluntary 314(b) information sharing arrangements); and
- The Proposed Rule's special diligence requirements.

King & Spalding is well positioned to provide clients with insights and guidance about the Proposed Rule.

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[1] *See* FinCEN, Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 80 FR 52680 (Sept. 1, 2015). Notably, FinCEN's 2015 proposed investment adviser rule was never finalized, and has been formally withdrawn by FinCEN concurrently with the Rule.
[2] *See* FinCEN, Financial Crimes Enforcement Network: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers, 89 FR 12108, 12108 (Feb. 15, 2024) (hereinafter, the "Rule").
[3] *See id.*
[4] *See id.*
[5] *See id.*
[6] *See id.*
[7] *See* FinCEN, Customer Due Diligence Requirements for Financial Institutions, 81 FR 29398 (May 11, 2016).
[8] *See* the Rule at 12122.
[9] *See id.* at 12123.
[10] *See id.*
[11] *See id.* at 12125.
[12] *See id.* at 12128.
[13] *See id.* at 12131.
[14] *See id.* at 12109.
[15] *See id.* at 12120.
[16] *See id.* at 12121.
[17] *See id.*
[18] *See id.* at 12134.
[19] *See id.*
[20] *See id.*
[21] *See id.* at 12135.
[22] *See id.*