February 21, 2024

# FinCEN Proposes Rule Imposing Anti-Money Laundering Requirements on Certain Investment Advisers

On February 13, 2024, the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") published a proposed rule aimed at "keep[ing] criminals and foreign adversaries from exploiting the U.S. financial system and assets through investment advisers" (the "Proposed Rule").[1]

The Proposed Rule would require SEC-registered investment advisers ("RIAs") and exempt reporting advisers ("ERAs") (together, "Covered Investment Advisers") to establish anti-money laundering/countering the financing of terrorism ("AML/CFT") programs and file certain reports with FinCEN, including Suspicious Activity Reports ("SARs") and Currency Transaction Reports ("CTRs"). This represents a significant regulatory development for Covered Investment Advisers, which have generally not been subject to comprehensive AML requirements.[2] The Proposed Rule would not require the Covered Investment Advisers to establish a Customer Identification Program ("CIP") or to collect beneficial ownership information from legal entity clients, but FinCEN has said it anticipates that such requirements would be the subject of future rulemakings.

FinCEN is accepting comments on the Proposed Rule through April 15, 2024. Covered Investment Advisers would be required to comply before 12 months from the effective date of the final rule.

## Background

The U.S. government has long been focused on addressing the money laundering risks posed by investment advisers. In 2003, FinCEN published a Notice of Proposed Rulemaking ("NPRM") aimed at imposing AML requirements for certain investment advisors; the proposal did not result in a final rule. FinCEN again revisited the regulation of investment advisors in 2015, when it issued another NPRM which, again, did not result in a final rule. The Biden Administration's 2021 *Strategy on Countering Corruption* noted that Treasury planned to revisit the 2015 NPRM, signaling continued interest in implementing AML/CFT requirements for investment advisers.[3] In 2022, a senior Treasury official raised concerns that "money launderers may see some

1 FinCEN, "FinCEN Proposes Rule to Combat Illicit Finance and National Security Threats in Investment Adviser Sector" (Feb. 13, 2024), available here.

2 Certain investment advisers may already be subject to AML/CFT requirements, including, for example, by virtue of their status as a registered broker-dealer, a bank, an operating subsidiary of a bank or through contractual obligations for a joint customer of another financial institution subject to AML/CFT requirements. *See* Department of the Treasury, "2024 Investment Adviser Risk Assessment" (Feb. 2024), available here ("Investment Adviser Risk Assessment").

3 The White House, "United States Strategy on Countering Corruption" (Dec. 2021), available here.

investment advisers as a low-risk way to enter the U.S. financial system" and noted that "threat actors likely place funds in private investment companies . . . [to] circumvent traditional AML/CFT compliance programs."[4]

## Key Elements of the Proposed Rule

Under the Proposed Rule, the regulatory definition of "financial institutions" under the Bank Secrecy Act ("BSA") would be modified to include Covered Investment Advisers.

These investment advisers would be required to comply with AML/CFT requirements, including, but not limited to: (i) developing and enacting a risk-based AML/CFT program (discussed further below); (ii) reporting certain transactions to FinCEN, including filing SARs and CTRs;[5] and (iii) complying with the Recordkeeping and Travel rules, in addition to other recordkeeping obligations.[6]

Among other requirements, as part of developing and implementing an AML/CFT program under the Proposed Rule, a covered investment adviser would be required to:

- have its board of directors (or persons that function similar to a board of directors) approve, in writing, the investment adviser's AML/CFT program; [7]
- review "the types of advisory services it provides and the nature of the customers it advises to identify the investment adviser's vulnerabilities to money laundering" and the "investment products offered, distribution channels, intermediaries that it may operate through, and geographic locations of customers and business activities";[8]
- develop and implement "policies, procedures, and internal controls reasonably designed to prevent money laundering, terrorist financing, and other illicit finance activities";[9]
- implement appropriate risk-based procedures for conducting ongoing customer due diligence ("CDD") that includes "(i) understanding the nature and purpose of customer relationships for the purpose of developing 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"; [10]
- designate a qualified person or persons (including a committee) to be responsible for the investment adviser's compliance with the BSA; [11]

---

4 Department of the Treasury, "Remarks by Under Secretary for Terrorism and Financial Intelligence Brian Nelson at SIFMA's Anti-Money Laundering and Financial Crimes Conference" (May 25, 2022), available here.

5 FinCEN, Notice of Proposed Rulemaking: "Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers" (Feb. 15, 2024), available here. The CTRs would be filed in lieu of filing reports using Form 8300.

6 *Id.* Given that mutual funds are already covered as a "financial institution" under the BSA, the Proposed Rule would not apply to the activities of investment advisers in advising mutual funds.

7 *Id*.

8 *Id*.

9 *Id*.

10 *Id*.

11 *Id*. The designated person(s) would need to be vested with the necessary authority and independence, as well as the requisite knowledge of and competency in AML/CFT requirements.

- conduct ongoing AML training;[12]

- ensure that there is independent testing of the AML/CFT program by the investment adviser's personnel or a qualified outside party, at a cadence based on the "money laundering, terrorist financing, and other illicit finance risks of the adviser and the adviser's overall risk management strategy."[13]

Unlike the AML/CFT requirements imposed on other financial institutions, including banks, certain futures commission merchants, and broker-dealers, the Proposed Rule would not require investment advisers to implement a CIP or to collect beneficial ownership information for legal entity customers. However, FinCEN expects to impose both CIP and beneficial ownership-related requirements in future rulemakings, with the CIP requirement addressed in a joint rulemaking with the SEC.[14]

Under the Proposed Rule, FinCEN plans to delegate its examination authority over investment advisers to the SEC, consistent with how the SEC already acts as FinCEN's delegated authority for exams of broker-dealers in securities and mutual funds. The SEC has utilized its authority to bring AML-related enforcement actions against broker-dealers and mutual funds, including having issued a number of such actions in 2023.[15] The SEC's Division of Examinations' 2023 Enforcement Priorities notes that "[t]he importance of conducting examinations of AML programs of broker-dealers and certain registered investment companies has been elevated due to the current geopolitical environment and the increased imposition of international sanctions, as has the review of firms' monitoring and compliance with OFAC and Treasury-related sanctions. The Division will continue to prioritize examinations of broker-dealers and certain registered investment companies for compliance with their AML obligations[.]"[16]

## Risk Assessment

Notably, the Proposed Rule was accompanied by an AML risk assessment of investment advisers conducted by Treasury.[17] The risk assessment identified "four main categories of illicit finance activity involving the investment adviser sector," including:

- investment advisers that act as an "entry point to the U.S. market for illicit proceeds";[18]

- investment advisers that manage funds for sanctioned entities seeking to "obscure their ownership of U.S. assets";[19]

- investment advisers and the private funds they advise being used by "foreign states," including the People's Republic of China and Russia, to invest in early stage companies that are developing "critical or emerging technologies" with "long-term national security implications";[20] and

12 *Id*.

13 *Id*.

14 *Id*.

15 *See* Paul, Weiss, "Economic Sanctions and Anti-Money Laundering Developments: 2023 Year in Review" at 26 (Jan. 22, 2024), available here.

16 *See* SEC 2023 Examination Priorities, Division of Examinations (Feb. 7, 2023), available here.

17 *See* Investment Adviser Risk Assessment. The risk assessment methodology involved the analysis of, among other information, BSA reports filed between 2013 and 2021 that were associated with RIAs and ERAs. During this same time period, the number of SARs associated with RIAs and ERAs increased by approximately 400 percent. This increase is well beyond the 140 percent overall increase in SARs during the same time period.

18 *Id*.

19 *Id*.

20 *Id*.

- investment advisers that have defrauded their clients. [21]

## Takeaways

This Proposed Rule—which comes on the heels of FinCEN's recent proposed rule to impose AML/CFT obligations in the residential real estate space[22]—suggests that FinCEN has a continued interest in identifying sectors that may pose money laundering risks, but are not currently subject to consistent or comprehensive AML/CFT obligations.

Comments on the Proposed Rule will be accepted until April 15, 2024. Compliance with the Proposed Rule would be required before 12 months from the effective date of the final rule.

In preparing for a final rule, Covered Investment Advisers may wish to consider taking steps, including:

- Review their business and client base to identify any unique vulnerabilities from a money laundering or terrorist financing perspective.

- Evaluate existing AML programs that are in place to identify any gaps between existing programs and the proposed regulatory requirements, and consider policies, procedures, and infrastructure that may need to be developed or revised to fill those gaps.

* * *

21 *Id*.

22 *See* Paul, Weiss "FinCEN Publishes Proposed Rule on Non-Financed Residential Real Estate Transactions" (Feb. 12, 2024), available here.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

**H. Christopher Boehning**
+1-212-373-3061
cboehning@paulweiss.com

**Jessica S. Carey**
+1-212-373-3566
jcarey@paulweiss.com

**John P. Carlin**
+1-202-223-7372
jcarlin@paulweiss.com

**David Fein**
+44-20-7367-1608
dfein@paulweiss.com

**Michael E. Gertzman**
+1-212-373-3281
mgertzman@paulweiss.com

**Roberto J. Gonzalez**
+1-202-223-7316
rgonzalez@paulweiss.com

**Brad S. Karp**
+1-212-373-3316
bkarp@paulweiss.com

**Loretta E. Lynch**
+1-212-373-3000

**Aaron J. Schlaphoff**
+1-212-373-3555
aschlaphoff@paulweiss.com

**Richard S. Elliott**
+1-202-223-7324
relliott@paulweiss.com

**David K. Kessler**
+1-212-373-3614
dkessler@paulweiss.com

**Jacobus J. Schutte**
+1-212-373-3152
jschutte@paulweiss.com

**Jennifer Songer**
+1-202-223-7467
jsonger@paulweiss.com

*Associates Jennifer Gilbert and Samuel Kleiner contributed to this Client Memorandum.*