Stradley Ronon

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Client Alert | Investment Management

Seeing SARs: FinCEN Proposes Bruising AML Rules for Investment Advisers

The Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury (Treasury), proposed new anti-money laundering and countering the financing of terrorism (AML/CFT) regulations on February 13 that would create and expand certain obligations of registered investment advisers (RIAs) and exempt reporting advisers (ERAs)[1] under the Bank Secrecy Act (BSA). If the proposed rule is adopted, RIAs and ERAs would be required to develop and implement an AML/CFT program, file suspicious activity reports (SARs) and currency transaction reports (CTRs), and meet certain recordkeeping and other requirements.

Key Takeaways

- FinCEN's proposed rule would apply to ERAs as well as RIAs (but not to state-registered advisers). This could have a significant impact on non-U.S. advisers.
- The proposed rule does not address how the requirements would apply to sub-advisory activities.
- Advisers to mutual funds and open-end exchange-traded funds (ETFs) would be exempt from the AML/CFT and SARs requirements.
- The proposed rule would not require a customer identification program or collection of beneficial ownership information … yet.
- The proposed rule would delegate examination authority related to oversight of compliance with the rule to the U.S. Securities and Exchange Commission (SEC) (similar to funds and broker-dealers).

The proposed rule would expand the definition of a "financial institution" under the BSA to include RIAs and ERAs.[2] This is not the first FinCEN rule proposal addressing investment

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[1] ERAs include both venture capital fund advisers, as defined in Rule 203(l)-1, and private fund advisers, as defined in Rule 203(m)-1, under the Investment Advisers Act of 1940.

[2] Although Congress did not include RIAs and ERAs in the definition of a "financial institution" in the BSA, the statute provides that the Secretary of the Treasury may promulgate regulations to include "any business or agency which engages in any activity … [determined] to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage" (31 U.S.C. Section 5312(a)(2)(Y)).

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advisers.[3] Along with the February 13 proposed rule, Treasury concurrently released a detailed risk analysis, justifying the proposed rule based on, among other reasons, changes in the investment adviser industry since FinCEN's last rule proposal in 2015. Thus, it appears that this time FinCEN is determined to finalize a rule.

In the risk analysis, Treasury identified private funds as particularly vulnerable to misuse as vehicles for illicit financial activities.[4] The February 13 proposed rule, however, does not clarify whether the private fund or its underlying investors are the customers, and it suggests that RIAs and ERAs that advise private funds would be expected to identify and report to law enforcement and regulators any private fund and underlying investors that may be associated with illicit finance activity.

Importantly, the proposed rule would not require RIAs to comply with AML/CFT recordkeeping or SARs filing requirements related to open-end funds that the RIAs advise since such funds separately are required to comply with AML/CFT obligations under the BSA. RIAs that are dually registered with the SEC as investment advisers and broker-dealers would not be required to establish multiple or distinct programs, provided that a comprehensive AML/CFT program covers the institution's advisory and broker-dealer activities. Additionally, it would be permissible for a single joint SARs to be filed in instances where an RIA or ERA is already covered by an affiliated bank or broker-dealer, provided that the joint SARs contained all relevant facts and that each institution maintained a copy of the SARs and any supporting documentation. The Treasury analysis found that "approximately 20 percent of RIAs, representing approximately 75 percent of the total AUM of RIAs, were affiliated with either a bank or broker-dealer."

Finally, while this rulemaking would not require advisers to implement a customer identification program (CIP) or impose requirements related to collecting beneficial ownership information, FinCEN seeks to address CIPs in a future joint rulemaking with the SEC and anticipates addressing beneficial ownership information requirements through subsequent rulemakings.

Key Proposed Requirements
▪ Implement AML/CFT programs.
▪ File SARs and CTRs.
▪ Maintain records related to transmittal of funds.

[3] FinCEN first proposed rules for advisers in 2003, which were withdrawn in 2008: Anti-Money Laundering Programs for Investment Advisers (68 FR 23646) and Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering Programs for Investment Advisers (73 FR 65568), respectively. FinCEN again proposed rules for investment advisers in 2015: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers (80 FR 52680). The proposed rule withdraws the 2015 proposal.

[4] "This assessment finds 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)" (2024 Investment Adviser Risk Assessment).

Implement AML/CFT Programs

By expanding the definition of a “financial institution” to include RIAs and ERAs, FinCEN would require advisers to establish AML/CFT programs that are reasonably designed to combat money laundering and terrorist financing through the institution under the BSA. Advisers would be required to develop programs that include internal policies, procedures and controls; the designation of a compliance officer; an ongoing employee training program; and an independent audit function to test the programs. FinCEN coordinated with SEC staff to develop additional factors for prescribing minimum standards for AML/CFT programs for RIAs and ERAs. Advisers also would be required to conduct ongoing due diligence to monitor suspicious activity.

File SARs and CTRs

FinCEN’s proposed rule also would require advisers to file SARs related to suspicious transactions. The proposed requirements would align with current requirements imposed on financial institutions.[5] Criteria for reporting include suspicious transactions conducted or attempted by, at, or through an adviser involving or aggregating at least $5,000 in funds or assets. The rule also would require advisers to report transactions or patterns of transactions the adviser suspects (or has reason to suspect): (1) involve funds from illegal activity or are used to conceal funds derived from illegal activity; (2) are designed to evade requirements of the BSA; (3) have no business purpose; or (4) involve using the adviser to facilitate criminal activity.

Further, the proposed rule would require advisers to file CTRs when they participate in certain types of transactions in currency of more than $10,000 on one business day.

Maintaining Records Related to Transmittal of Funds

The proposed rule would apply to FinCEN’s recordkeeping and travel rules, which require financial institutions to create and retain records for transmittals of funds and ensure that pertinent information “travels” with the transmittal. These rules apply to transmittals equal to or in excess of $3,000 and, among other things, require the transmitter’s financial institution to obtain and retain the name, address and other information related to the transmitter and transaction.

Information Sharing and Other Special Measures

Advisers covered by the proposed rule also would be subject to information-sharing procedures developed under the USA PATRIOT Act. An adviser generally would be required, upon request from FinCEN, to expeditiously search its records for specified information to determine whether the investment adviser 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 to report any such identified information to FinCEN. Advisers would be required to apply such information-sharing procedures to any mutual funds and open-end ETFs that they advise.

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[5] Advisers required to comply with the proposed rule would remain subject to any related SEC reporting requirements.

Conclusion

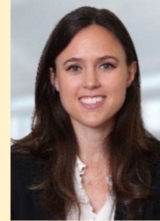
FinCEN seeks comments on a wide range of issues, including the impact on non-U.S. advisers, sub-advisory arrangements, delegation to service providers and whether ERAs should be considered covered advisers. The comment period closes on April 15.

For more information, contact:

Sara P. Crovitz
Vice Chair, Investment Management
202.507.6414
scrovitz@stradley.com

Mark A. Sheehan
Partner
215.564.8027
msheehan@stradley.com

Jessica D. Burt
Partner
202.419.8409
jburt@stradley.com



Katie Gallop
Associate
202.507.5161
kgallop@stradley.com