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FinCEN Issues Rule Imposing AML Requirements on Certain Investment Advisers

On August 28, 2024, the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") issued a rule (the "Final Rule") imposing new anti-money laundering/countering the financing of terrorism ("AML/CFT") standards on certain investment advisers ("Covered Investment Advisers").[1] The Final Rule finalizes a draft that FinCEN proposed in its February 2024 Notice of Proposed Rulemaking ("NPRM"), with certain changes as discussed below.[2]

Although the Final Rule does not take effect until January 1, 2026, Covered Investment Advisers may wish to consider taking steps to prepare for these expansive new legal obligations.

Key Elements of the Final Rule

Which Investment Advisers Are Covered?

The Final Rule adds investment advisers to the definition of "financial institution" for purposes of FinCEN's regulations that implement the Bank Secrecy Act.[3] The Final Rule defines investment advisers as "SEC-registered investment advisers (RIAs) and exempt reporting advisers (ERAs)." However, the Final Rule includes certain exemptions to these categories that were not reflected in the NPRM. FinCEN explained the Final Rule "exclude[s] RIAs that register with the SEC solely because they are (i) mid-sized advisers, (ii) multi-state advisers, or (iii) pension consultants, as well as (iv) RIAs that do not report any assets under management (AUM) on Form ADV."

Additionally, with respect to Covered Investment Advisers that have their principal offices and places of business outside the United States (defined as "foreign-located investment advisers"), the Final Rule applies only to their advisory activities that "(i) take place within the United States, including through involvement of U.S. personnel of the investment adviser, such as the involvement of an agency, branch, or office within the United States, or (ii) provide advisory services to a U.S. person or a foreign-located private fund with an investor that is a U.S. person."

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1 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" (Sept. 4, 2024), available here (the "Final Rule"). Unless otherwise stated, the quotations in this memorandum are from the Final Rule.

2 Paul, Weiss, "FinCEN Proposes Rule Imposing Anti-Money Laundering Requirements on Certain Investment Advisers" (February 21, 2024), available here.

3 31 CFR § 1010.100(t)

What Are the Requirements Imposed on Covered Investment Advisers?

The Final Rule will require Covered Investment Advisers to fulfill AML/CFT obligations similar to what other financial institutions have been required to undertake under FinCEN's BSA regulations. These include:

- *Establish AML/CFT programs meeting certain minimum standards*: All Covered Investment Advisers must "develop and implement a written AML/CFT program that is risk-based and reasonably designed" to prevent the Covered Investment Advisers from being used to facilitate AML/CFT activity. The program must meet minimum standards, which include: (1) establishing internal policies, procedures and controls "reasonably designed" to prevent AML/CFT activities,[4] (2) conducting independent testing; (3) designating a qualified person or persons responsible for the implementation and monitoring of the AML/CFT program's policies, procedures and controls; (4) administering AML/CFT training to the applicable personnel; and (5) implementing "appropriate risk-based procedures" for customer due diligence ("CDD"), which involves procedures to conduct ongoing monitoring to detect and report suspicious activity.[5] The program must be approved in writing by the Covered Investment Adviser's board of directors or trustees, or, in lieu of a board, other persons who have parallel roles and responsibilities.

  - *Customer Identification Program*: While not covered in the Final Rule, FinCEN and the SEC will separately establish Customer Identification Program ("CIP") requirements, for which there is a pending NPRM.[6] Under the CIP NPRM, Covered Investment Advisers are not required to collect beneficial ownership information for legal entity customers. While the Final Rule states that the "categorical collection of beneficial ownership information for legal entity customers of investment advisers" is not currently required, FinCEN "may consider a subsequent rulemaking imposing such an obligation on investment advisers."

- *SAR and CTR reporting*: Covered Investment Advisers are required to report any suspicious transactions through Suspicious Activity Reports ("SARs"). The Final Rule states that the SAR reporting obligation extends to activity that is "conducted or attempted by, at, or through an investment adviser" which "parallels the language of the BSA regulations for money service businesses, broker-dealers, and mutual funds."[7] Covered Investment Advisers are also required to file Currency Transaction Reports ("CTRs") for the "receipt of more than $10,000 in currency and certain negotiable instruments" instead of filing such reports using the FinCEN/Internal Revenue Service Form 8300.

- *Maintain certain records*: Under the Final Rule, Covered Investment Advisers will be required to comply with the Recordkeeping and Travel Rules, which require financial institutions to create and retain records for "extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit in amounts exceeding $3,000" and for "transmittals of funds and ensure that certain information pertaining to the transmittal of funds 'travels' with the transmittal to the next financial institution in the payment chain." Under the Final Rule, a Covered Investment Adviser's "primary requirements" as to these rules will involve when the Covered Investment Advisers act as the

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4 When establishing internal policies, procedures, and controls, Covered Investment Advisers will be required to review "the types of advisory services that it provides and the nature of the customers that it advises" to identify the vulnerabilities to being used for money laundering, terrorist financing, and other illicit activities, and will also be required to review "investment products offered, investment recommendations, distribution channels, intermediaries that it operates through, and geographic locations of customers and advisory activities."

5 The CDD procedures must include, but are not limited to: "(i)[u]nderstanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and (ii) [c]onducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information."

6 Paul, Weiss, "SEC and FinCEN Propose Rule Requiring Certain Investment Advisers to Establish Customer Identification Programs" (May 29, 2024), available here.

7 In response to comments requesting clarity regarding what constitutes activity that is "conducted or attempted by, at, or through" the Covered Investment Adviser, the Final Rule provides several examples of such conduct, including, among other types of transactions, activity "designed to hide the source or destination of funds and fraudulent activity" or "unusual wire activity that does not correlate with a customer's stated investment objectives."

"transmittor or recipient in transactions." Covered Investment Advisers will—as with banks, broker-dealers, and future commission merchants—be excepted from the Travel Rule for transfers where the Covered Investment Adviser is the transmitter and recipient.[8]

The Final Rule does not apply to certain activities of Covered Investment Advisers. It permits an investment adviser to exclude from its AML/CFT program any mutual fund advised by the investment adviser.[9] It also permits an investment adviser to exclude from its AML/CFT program "(i) bank- and trust company-sponsored collective investment funds and (ii) any other investment adviser subject to the final rule that is advised by the investment adviser."

Can Covered Investment Advisers Delegate These Responsibilities?

The Final Rule permits a Covered Investment Adviser to delegate responsibility for carrying out certain components of its AML/CFT program to a third party as the individual Covered Investment Adviser deems "appropriate to delegate," but the Covered Investment Adviser will nonetheless be "fully responsible and legally liable for, and be required to demonstrate to [its] examiners" that the AML/CFT program is in full compliance with the applicable rules and regulations.

When Is the Final Rule Effective?

The Final Rule revises the previously stated date for compliance and will now be effective on January 1, 2026.

Consistent with FinCEN's existing delegation of authority to the SEC to conduct examinations of broker-dealers of securities and mutual funds for compliance with the BSA and FinCEN's regulations, FinCEN will delegate authority to the SEC to conduct examinations of the Covered Investment Advisers for compliance with the Final Rule.

Takeaways

While many Covered Investment Advisers may have already established AML programs, this has been done on a voluntary and prudential basis. Once the Final Rule goes into effect, we anticipate that the SEC will prioritize examining for compliance with these new requirements. 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[.]"[10]

In advance of the Final Rule taking effect, Covered Investment Advisers may wish to consider taking steps to prepare for its application, including:

- reviewing their products, services and customer base to assess their risks from an AMT/CFT perspective; and
- evaluating their existing AML/CFT programs to identify any gaps with respect to the Final Rule, including whether policies, procedures and technical infrastructure may need to be bolstered to fill any identified gaps.

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8 Additionally, in response to requests for clarity, FinCEN provided in the Final Rule examples of when and in what circumstances Covered Investment Advisers will be expected to collect information in service of the Recordkeeping and Travel Rules. For example, for Covered Investment Advisers "advising private funds . . . their authority and discretion over the fund and customer assets in the fund may make them more likely to have to comply with the Recordkeeping and Travel Rules."

9 The Final Rule "includes modified text . . . to permit an investment adviser to categorically exclude any mutual fund from an investment adviser's AML/CFT program requirements without obligating the adviser to verify that such mutual fund has implemented an AML/CFT program."

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

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content.

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