MAYER | BROWN

09 SEPTEMBER 2024

THIRD TIME WAS THE CHARM: FINCEN FINALIZES AML COMPLIANCE REQUIREMENTS FOR CERTAIN INVESTMENT ADVISERS

AUTHORS: MATTHEW BISANZ, ADAM D. KANTER, BRAD A. RESNIKOFF, KELLY F. TRUESDALE

On August 28, 2024, the Financial Crimes Enforcement Network (FinCEN) finalized a rule establishing anti-money laundering (AML) compliance obligations for certain investment advisers (the "Final Rule"). [1] FinCEN largely adopted the substance of the proposed rule[2] (the "Proposal")—discussed in our previous Legal Update —as proposed; however, there are several key differences between the Final Rule and the Proposal. In this Legal Update, we discuss these differences and potential impacts to investment advisers in advance of the Final Rule's January 1, 2026, compliance deadline.

BACKGROUND

Although the statutory definition of "financial institution" under the Bank Secrecy Act (BSA) is broad, [3] FinCEN has generally applied the BSA's AML compliance obligations only to specific types of financial institutions for which FinCEN has established rules governing the related AML compliance obligations.[4] Under the Proposal, and as implemented by the Final Rule, FinCEN would exercise its authority to designate certain "investment advisers" as "financial institutions" for purposes of the BSA, thus imposing AML compliance obligations, and would establish the related rules governing those obligations.

Under the Proposal, "investment advisers" were generally defined to include:

- Investment advisers, based on the definition of "investment adviser" in the Investment Advisers Act of 1940, that were registered or required to be registered with the Securities and Exchange Commission ("SEC" and the advisers, "RIAs"); and
- Investment advisers that report to the SEC as exempt reporting advisers ("ERAs" and, together with RIAs, "SEC Advisers").

The Proposal did not include exempt foreign private advisers, excluded family offices, or state-registered investment advisers that are prohibited from registering with the SEC.

The Proposal would subject SEC Advisers to comprehensive AML compliance obligations, including obligations to maintain a comprehensive "five pillar" AML compliance program, suspicious activity and other reporting, recordkeeping, and due diligence requirements. For additional background on these requirements, refer to our previous Legal Update.

CHANGES FROM THE PROPOSED RULE

The Final Rule differs from the Proposal in several notable respects, most of which relate to the scope of

investment advisers subject to the Final Rule and to situations where multiple entities may be subject to AML compliance obligations for the same activities. We discuss several of these key differences below.

DEFINITION OF "INVESTMENT ADVISER"

While the Final Rule generally mirrors the Proposal in that it applies to SEC Advisers, the Final Rule narrows the definition of "investment adviser" to exclude RIAs that are *solely* required to register with the SEC because they are:

1. Mid-sized advisers, which are generally RIAs with between $25 million and $100 million of assets under management (AUM);[5]
2. Multi-state advisers, which are investment advisers that would be required to register with the state securities authorities of at least 15 states;[6] or
3. Pension consultants.

The Final Rule also excludes RIAs that do not report any regulatory AUM on the adviser's most recently filed Form ADV. As with the Proposal, the Final Rule does not include state-registered investment advisers (which FinCEN notes it will continue to monitor for indicia of illicit activity), exempt foreign private advisers, or excluded family offices.

FOREIGN-LOCATED INVESTMENT ADVISERS

The Proposal applied AML compliance obligations to all SEC Advisers, which would include SEC Advisers located outside the United States. The Final Rule clarifies that AML compliance obligations apply to SEC Advisers (subject to the exceptions discussed above) "wherever located" but imposes limitations on the types of activities that are subject to the Final Rule.

Specifically, the Final Rule defines a "foreign-located investment adviser" as an investment adviser whose principal office and place of business is outside the United States and limits the application of the Final Rule to advisory activities of a foreign-located investment adviser that: (i) take place within the United States, including through involvement of US personnel of the investment adviser, or (ii) provide advisory services to a US person or a foreign-located private fund with a US person investor.

For purposes of these descriptions, the Final Rule incorporates definitions and standards from the SEC for identifying US-person investors in foreign-located private funds.[7] This scoping is similar to, but not entirely the same as, the SEC's historical position that the substantive provisions of the Advisers Act should generally not apply to foreign-located investment advisers' dealings with non-US clients.

EXCLUSIONS FROM AML PROGRAM REQUIREMENTS

The Proposal provided that an investment adviser could deem its AML compliance obligations satisfied with respect to mutual funds that maintained AML compliance programs that complied with separate FinCEN regulations governing mutual funds. The Final Rule extends these exclusions to cover:

- Mutual funds subject to AML compliance obligations (rather than only those mutual funds for which the investment adviser has verified implementation of the related AML compliance program);
- Collective investment funds sponsored by banks or trust companies that comply with certain federal regulations; and
- Other investment advisers subject to the Final Rule.

With respect to the third of these exclusions, the Final Rule excludes other investment advisers that are advised by the investment adviser—for example, the Final Rule would permit a sub-adviser to exclude a primary adviser that is subject to the Final Rule where the primary adviser was directly advised by the sub-adviser, although the exclusion would not cover a sub-advisory relationship where the primary adviser's clients—rather than the primary adviser itself—were advised by the sub-adviser.

FinCEN appears to focus on whether there is direct contractual privity between the sub-adviser and the underlying client—not necessarily on longstanding SEC principles related to the identification of a "client" of a sub-adviser. This means that, generally, if a sub-adviser's contract is solely with a primary adviser subject to the Final Rule, the sub-adviser could exclude the primary adviser from its AML compliance program; in contrast, in a situation where the primary adviser, the client, and the sub-adviser have entered into a "tri-party" agreement, the underlying client would need to be included in the sub-adviser's AML compliance program.

TAKEAWAYS

The adoption of the Final Rule is another step by FinCEN —much like its adoption on the same day of its residential real estate rule discussed in a separate Legal Update —to close perceived regulatory gaps that could give illicit financial activity an entry point into the US financial markets. As FinCEN notes in the Final Rule, the adoption of investment adviser AML requirements also helps to bring the United States into full compliance with international AML standards established by the Financial Action Task Force (FATF), which has previously rated the United States as partially or non-compliant with certain recommendations, including several related to investment adviser AML compliance.

Although FinCEN largely adopted the Final Rule as proposed, it contains several new exceptions, exclusions, and limitations on its coverage. For certain types of investment advisers, these limitations may come as a welcome relief; however, for others, the contours of the limitations may introduce additional complexity in determining whether and how activities will be subject to the Final Rule.
With a compliance deadline of January 1, 2026, investment advisers subject to (or potentially subject to) the Final Rule should take steps to evaluate the Final Rule and establish required AML compliance programs. Investment advisers should also consider the impacts of FinCEN's proposed customer identification program (CIP) requirements for investment advisers, which were separately proposed by FinCEN and the SEC in May 2024 and discussed in our prior Legal Update. Although the CIP rule has not yet been finalized, FinCEN has indicated that it intends the compliance date for the Final Rule and CIP rule to be the same. Finally, investment advisers should continue to monitor for updates to FinCEN's customer due diligence (CDD) rule, which FinCEN has indicated will be revised to impose obligations on investment advisers to collect beneficial ownership information from legal-entity customers.

---

[1] 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 Fed. Reg. 72156 (Sept. 4, 2024).

[2] 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 Fed. Reg. 12108 (Feb. 15, 2024).

[3] *See* 31 U.S.C. § 5318(h).

[4] *See generally* 31 C.F.R. ch. X.

[5] *See* 15 U.S.C. § 80b-3a.

[6] *See* 17 C.F.R. § 275.203A-2.

[7] Because this standard uses the term "private fund," pooled investment vehicles that are organized outside the United States and rely on exceptions from the definition of "investment adviser" other than those provided in Section 3(c)(1) or (7) of the Investment Company Act of 1940 (or that are not "investment companies" at all) would be out of scope of the Final Rule, even if they admit US-person investors.

AUTHORS

PARTNER

MATTHEW BISANZ

WASHINGTON DC +1 202 263 3434

MBISANZ@MAYERBROWN.COM

PARTNER

ADAM D. KANTER

WASHINGTON DC +1 202 263 3164

AKANTER@MAYERBROWN.COM

PARTNER

BRAD A. RESNIKOFF

WASHINGTON DC +1 202 263 3110

PARIS

BRESNIKOFF@MAYERBROWN.COM

ASSOCIATE

KELLY F. TRUESDALE

WASHINGTON DC +1 202 263 3294

KTRUESDALE@MAYERBROWN.COM