WHITE & CASE

FinCEN Issues Final Sweeping AML Requirements for Registered Investment Advisers & ERAs

On August 28, 2024, FinCEN issued a long-awaited final rule meant to address illicit finance activities and national security threats in the asset management industry. The new rule imposes similar requirements on investment advisers that have existed for broker-dealers since 2001 and ends a period of uncertainty for registrants in this area.

Background

The new rule by the Financial Crimes Enforcement Network (FinCEN), a division of the Department of Treasury, subjects most investment advisers to comprehensive regulatory requirements to reduce risk of investment of illicit funds in the US economy.[1]The final rule is a slightly scaled-back version of a proposal released earlier this year after the publication of the Department of Treasury's 2024 Investment Adviser Risk Assessment. FinCEN's new requirements are meant to address concerns that investment advisers have "served as an entry point into the US market for illicit proceeds associated with foreign corruption, fraud, and tax evasion."[2]The new rule closes a previous gap in these kinds of requirements, since investment advisers have historically not been subject to comprehensive anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements imposed on regulated institutions by the Bank Secrecy Act (BSA).[3]

New Rule Expands BSA Requirements to Investment Advisers

The rule subjects investment advisers to the BSA by expanding the definition of "financial institution" under the BSA to include both investment advisers registered with the Securities and Exchange Commission (SEC), as well as investment advisers that report to the SEC as exempt reporting advisers.[4]This change brings a vast majority of investment advisers within the ambit of the BSA, and thus requires significant overhauls at any investment adviser firm that does not currently have any AML/CFT compliance functions in place. Notably, FinCEN clarified that for investment advisers with a principal place of business outside the United States, the final rule applies only to their advisory activities that take place within the U.S. or involve advisory services to a US person or a foreign-located private fund with an investor that is a US person.

The rule requires advisers to implement an AML/CFT program, file SARs and reports with respect to currency transactions with FinCEN, and comply with recordkeeping requirements. The rule also applies "information-sharing provisions between and among FinCEN, law enforcement government agencies, and certain financial institutions" to investment advisers, along with subjecting investment advisers to the

special measures imposed by FinCEN pursuant to Section 311 of the USA Patriot Act, which allows the Treasury Department to take specific actions to target money laundering and terrorist financing risks.

The final rule does not include a proposed provision requiring that the duty to establish, maintain, and enforce an AML/CFT program remain the responsibility of, and be performed by, persons in the US who are accessible to and subject to oversight and supervision by the Secretary of the Treasury. The final rule also includes several exclusions in an effort to minimize potential burdens from duplication of existing AML/CFT measures. For example, the final rule permits investment advisers to exclude from its compliance obligations any mutual fund that is advised by the investment adviser, without verifying whether the mutual fund has itself implemented an AML/CFT program. The final rule similarly excludes bank and trust company-sponsored collective investment funds from compliance obligations. Notably, the rule includes neither a customer identification program requirement, nor the collection of beneficial ownership data and information for legal entity customers of investment advisers. However, FinCEN predicts that it will address these additional requirements in future rulemaking, some of which will be promulgated in joint rulemaking with the SEC. FinCEN delegated its examination authority over investment advisers to the SEC, "consistent with FinCEN's existing delegation to the SEC of the authority to examine brokers and dealers in securities and mutual funds for compliance with the BSA and FinCEN's implementing regulations."

Functionally, many investment advisers and other non-regulated financial entities have already adopted Know-Your-Customer (KYC) and Ultimate Beneficial Owner (UBO) policies in an effort to comply with routine BSA requirements, even though they were not previously required to do so. The final rule attempted to accommodate those existing policies by providing the exclusions discussed above, acknowledging that many investment advisers have already implemented robust AML/CFT compliance programs. However, as we noted in our previous alerts, formalizing the review process and mandating it as required under the BSA's implementing regulations will reduce the ability of foreign bad actors to shop around for investment advisers with lax AML/CFT protocols and enforcement and require such advisers to review their compliance programs in light of their compliance covenants in their various commercial agreements.

Recommended Next Steps

The date for compliance with the requirements of this rule is January 1, 2026. Once the rule goes into effect, investment advisers should expect the SEC's Examination Division to focus on these new requirements during examinations. Obligations under the current proposal include:

- development and implementation of an AML/CFT program that is risk- based and reasonably designed to prevent the investment adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to achieve and monitor compliance with the applicable provisions of the Bank Secrecy Act and other existing Treasury Regulations that apply to the same risks;
- adoption of policies and controls designed to prevent the investment adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to achieve compliance with the relevant provisions of the BSA;
- performance of independent testing;
- designation of a person responsible for implementing the program;

- provision of for training of appropriate personnel; and
- implementation of risk-based customer due diligence.

It is critical that all investment advisers implement sufficient internal controls to address AML/CFT concerns and ensure their policies will be sufficient to meet the requirements imposed under the BSA, and that their senior officers and board members understand these processes and requirements. Procedures best suited to investment advisers may vary from what have proven sufficient and appropriate for broker-dealers and other financial institutions. To that end, it will be important that investment advisers consult with counsel to ensure AML/CFT compliance programs are sufficient and will withstand regulatory examination based on the specific risk metrics of their unique circumstances, e.g., customer base, product, geographic exposure, etc. For investment advisers who do not currently have an AML/CFT program, this compliance obligation will create a large shift in the way the investment adviser operates and will require significant time and attention.

1 See our alerts here and here for background on the proposed rule.

2 Dep't of Treasury, 2024 Investment Adviser Risk Assessment ("Treasury Report"), at 1 (February 2024), available here.

3 FinCEN previously proposed rules which would have covered investment advisers in 2003 and 2013, both of which were not adopted (*see* https://www.fincen.gov/sites/default/files/federal_register_notice/352investmentadvisers_fedreg050503.pdf and https://www.govinfo.gov/content/pkg/FR-2015-09-01/pdf/2015-21318.pdf)

4 The final rule does not apply to state-registered investment advisers.