AML/CFT Rules for Investment Advisers

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Webinar Handout

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- Expertise in financial crimes compliance policies and implementing relevant financing policies, procedures, and risk assessment tools
- Previously served as global director of regulatory compliance policies, programs, and governance at Meta FinTech Compliance and as the global head of FCC regulatory strategy for Credit Suisse's financial crime compliance division
- Spent ten years in Treasury's Office of Terrorism and Financial Intelligence, the last five as Director of the Office of Strategic Policy

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- Expertise in identifying, assessing, and mitigating risks associated with money laundering, terrorist financing, bribery and corruption, sanctions evasion, and other forms of illicit financial activity
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- Expertise in anti-money laundering and sanctions regulations, rules, and related issues governing their investment and business activities
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Background

Prior Rulemaking Attempts

- NPRM, Anti-Money Laundering Programs for Unregistered Investment Companies, 67 Fed. Reg. 60617 (Sept. 26, 2002)
- NPRM, Anti-Money Laundering Programs for Investment Advisers, 68 Fed. Reg. 23646 (May 5, 2003)
- Withdrawal of NPRM, Anti-Money Laundering Programs for Unregistered Investment Companies, 73 Fed. Reg. 65569 (Nov. 4, 2008)
- Withdrawal of NPRM, Anti-Money Laundering Programs for Investment Advisers, 73 Fed. Reg. 65568 (Nov. 4, 2008)
- NPRM, Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 80 Fed. Reg. 52680 (Sept. 1, 2015)
  - This proposed rule would have included RIAs within the definition of "financial institution" (FI) under the BSA and required them to maintain AML programs, report suspicious activity, and comply with other travel and recordkeeping requirements.
  - The proposed rule would not have defined ERAs as FIs under the BSA.

Recent Proposed AML Rules for Advisers

- NPRM, 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)
  - RIAs and ERAs (Covered Advisers) would be considered FIs under the BSA
  - Risk-based AML/CFT program
  - Due diligence for private bank accounts and correspondent accounts
  - 314(a) and 314(b) information sharing
  - SAR reporting
  - Recordkeeping and Travel Rule
- NPRM, Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44571 (May 21, 2024)
  - Risk-based CIP

Focus on ML/TF Risks of Investment Advisers

- Prepared Remarks of FinCEN Director Andrea Gacki During ACAMS (Oct. 3, 2023)
  - "Although certain categories of investment advisers may undertake some AML/CFT obligations in limited circumstances, the absence of comprehensive regulation under the BSA in this industry creates gaps in the U.S. AML/CFT regime."
- Treasury's 2022 National Money Laundering Risk Assessment
  - "Along with the lack of comprehensive AML/CFT regulatory requirements, other attributes of the investment advisory business create vulnerabilities that illicit actors may be able to exploit."
    - "First, the use of third-party custodians by RIAs separates the advisory functions of an RIA's business from the actual movement or transfer of client funds. While rules regulating the custody of client assets are intended to protect advisory clients from unscrupulous RIAs, the use of third-party custodians, when combined with the practice of pooling customer funds into omnibus accounts for trading and investment, can impede transparency, which is core to AML/CFT effectiveness.
    - "Second, it is common for RIAs who manage private funds to rely on third-party administrators who, depending upon the fund administrator's regulatory regime, perform compliance with core AML/CFT requirements on behalf of the RIA or another regulated entity for these funds. In many instances, such administrators are located in offshore financial centers where private funds are routinely registered, usually for tax or other commercial or non-AML/CFT regulatory advantages.
    - "Third, many of the existing federal and state investment advisory regulatory requirements are not designed to explicitly address ML/TF risks."

Focus on ML/TF Risks of Investment Advisers (cont.)

- The White House's 2021 United Strategy on Countering Corruption
  - The lack of comprehensive AML obligations "may allow corrupt actors to invest their ill-gotten gains in the U.S. financial system through hedge funds, trusts, private equity funds, and other advisory services or vehicles offered by investment advisers that focus on high-value customers."

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2024 Treasury Risk Assessment – Investment Advisers

- Issued by Treasury in February 2024 in connection with Proposed AML/CFT Program Rule.
- Treasury identified three main illicit finance threats involving IAs:
  - IAs are an entry point into the U.S. market for illicit proceeds associated with foreign corruption, fraud, and tax evasion, as well as money ultimately controlled by Russian oligarchs and their associates.
  - IAs and their advised funds, particularly venture capital funds, are being used by foreign states, including China and Russia, to access technology and services with long-term national security implications through investments in early-stage companies.
  - IAs have defrauded their clients and stolen their funds.

Proposed AML/CFT Program and SAR Filing Requirements Rule

Advisers Covered by the Proposed Rule

- The AML/CFT Program Rule extends the BSA implementing regulations to two types of investment advisers:
  - Those registered or required to be registered with the SEC under Section 203 of the Advisers Act of 1940 (RIAs); and
  - Those that meet an exemption from SEC registration under Section 203(l) or Section 203(m) of the Advisers Act of 1940 and report to the SEC as an exempt reporting adviser (ERAs).
- Non-U.S. based RIAs and ERAs may be subject to this rule.
- State-registered investment advisers and advisers relying on the foreign private adviser are excluded.
- AML/CFT program must be extended to advisory activities, including sub-advisory activities.

AML/CFT Program

Covered Advisers would be required to adopt and implement a written, risk-based AML/CFT program that has five main components.

1. Written policies, procedures, and internal controls
    - Based on a risk assessment of the types of advisory services offered, types of accounts offered, types of customers, geographic location of customers, and sources of wealth for customer assets
2. Designation of a compliance officer
3. Ongoing training for appropriate persons
4. Independent testing
5. Risk-based procedures for:
    - understanding the nature and purpose of customer relationships for the purpose of developing an investor risk profile; and
    - conducting ongoing monitoring to identify and report suspicious transactions and maintain and update investor information.

AML/CFT Program (cont.)

- The AML/CFT program must be approved by the Covered Adviser's board of directors or trustees.
- AML/CFT Program Rule does not apply CIP and CDD obligations as such obligations will be established through separate rulemakings.

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Private Bank Accounts

Covered Advisers would be required adopt due diligence measures that enable Covered Advisers to detect and report suspicious activity involving high-net-worth foreign persons with private bank accounts, including:

- Ascertaining the identity of all nominal and beneficial owners of a private banking account;
- Ascertaining whether any such nominal or beneficial owners is a senior foreign political figure (SFPF) or family member or close associate of an SFPF;
- Ascertaining the source(s) of funds deposited into a private banking account and the purpose and expected use of the account; and
- Reviewing the activity of the account to ensure that it is consistent with the information obtained about the investor's source of funds, and with the stated purpose and expected use of the account.

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Correspondent Accounts

- Covered Advisers would be required to establish due diligence requirements to monitor correspondent accounts for foreign FIs (FFIs), including:
  - Obtaining and considering information relating to the FFI's AML program;
  - Obtaining the identity of any person with authority to direct transactions through any correspondent account that is a payable-through account, and the sources and beneficial owner of funds or other assets in the payable-through account;
  - Determining whether the FFI in turn maintains correspondent accounts for other FFIs; and
  - Determining, for any correspondent account established or maintained for a FFI whose shares are not publicly traded, the identity of each owner of the FFI and the nature and extent of each owner's ownership interest.
- The term account, in the phrase "correspondent account," would include "any contractual or other business relationship established between a person and an investment adviser to provide advisory services."

Section 314(a) and (b) Information Sharing

- Section 314(a) – Mandatory
  - Covered Advisers would be required, upon request from FinCEN, to expeditiously search their records for specified information to determine whether the Covered 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.
- Section 314(b) – Voluntary
  - Covered Advisers would be able to participate in voluntary information sharing arrangements with other FIs, under a safe harbor that offers protections from liability.
  - FIs may share information with each other regarding individuals, entities, organizations, and countries for purposes of identifying, and, where appropriate, reporting activities that may involve possible terrorist activity or money laundering.
  - This is meant to enable broader understanding of customer risk and aid in SAR filing, for example.

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SAR Reporting Requirements

- Covered Advisers would be required to file a SAR if a transaction is conducted or attempted by, at, or through a Covered Adviser; if it involves or aggregates funds or other assets of at least $5,000; and if the Covered Adviser knows, suspects, or has reason to suspect that the transaction:
  - Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;
  - Is designed, whether through structuring or other means, to evade any requirements of the BSA or its implementing regulations;
  - Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the Covered Adviser knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or
  - Involves use of the Covered Adviser to facilitate criminal activity.

SAR Reporting Requirements (cont.)

- Covered Adviser would be required to file a SAR no later than 30 calendar days after the date of the initial detection of the basis for filing the SAR.
- Covered Advisers would be required to maintain the confidentiality of SARs.

Recordkeeping Requirements

- Covered Advisers would be required to maintain copies of AML/CFT-related records for five years.
- These records include:
  - AML/CFT program documents
  - Training logs
  - Audit reports
  - SARs and SAR supporting documentation
  - Certain transaction records

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Funds Transfer and Travel Rule

- Covered Advisers would be required to maintain records of any transmittal of funds, such as originator and beneficiary information, for each transmittal order of funds in excess of $3,000.
- Covered Advisers would be required to obtain and retain the name, address, and other information about the transmitter and the transaction.
- Covered Advisers would be required to pass on this information to the next FI in the payment chain.
- Some transmittals involving Covered Advisers would fall within an existing exception to the Funds Transfer and Travel Rules designed to exclude transmittals of funds from these rules' requirements when certain categories of financial institutions are the transmitter and recipient.
- FinCEN recognizes that Covered Advisers operate varying business models and that in some circumstances, a Covered Adviser would not conduct transactions that meet the definition of "transmittal order."

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Other Requirements

- Special measures: Covered Advisers would be required to implement certain "special measures" if the Secretary of the Treasury determines that a foreign jurisdiction, institution, class of transaction, or type of account is a "primary money laundering concern."
- Currency Transaction Reports: Covered Advisers would be required to file reports for transactions involving more than $10,000 in currency.

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Delegation of AML/CFT Program

- Covered Advisers would be allowed to delegate the implementation and operation of their AML/CFT program to service providers, such as an administrator.
  - The Covered Adviser would remain responsible and legally liable for:
    - The AML/CFT program's compliance with regulations; and
    - Responding to requests from regulators
- The Covered Adviser would be required to undertake reasonable steps to assess whether the service provider carries out such AML/CFT procedures effectively.
- The duty to establish, maintain and enforce an AML/CFT program would be the responsibility of persons in the U.S. who are accessible to, and subject to oversight by, the Secretary of the Treasury and the appropriate federal regulator.

Timeline

- Comments were due by April 15, 2024.
  - FinCEN received 52 comments.
- The AML/CFT Program Rule will require implementation 12 months from the effective date of the final rule.

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Proposed Customer Identification Program Rule

Proposed CIP Requirements

- CIP requirements apply to the same set of Covered Advisers as the AML/CFT Program Rule.
- Covered Advisers would be required to establish, document, and maintain a written, risk-based CIP appropriate for the size and nature of its business.
- The CIP would be required to include procedures for identifying and verifying the identity of each customer to the extent reasonable and practicable to enable the Covered Adviser to form a reasonable belief that it knows the true identity of each customer, including:
  - Collecting certain minimum identifying information of customers prior to opening an account, including name, address, DOB/date of formation, identification number, and SSN/EIN;
  - Verifying the identity of each customer, through documentary or non-documentary means, within a reasonable time before or after opening the customer's account;
  - Addressing situations where the Covered Adviser will obtain information about natural persons with authority or control over a legal entity customer's account when a legal entity customer's identity cannot be verified using the methods described above; and
  - Responding to situations where the Covered Adviser cannot "form a reasonable belief" that it knows a customer's true identity.

Proposed CIP Requirements (cont.)

- A CIP would also be required to include:
  - Making and maintaining a record of information collected and the verification performed under the CIP, for at least five years;
  - Determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any federal government agency and designated as such by the Department of the Treasury within a reasonable period of time after the account is opened; and
  - Providing customers with adequate notice of the CIP requirements in a manner designed to ensure that a prospective customer is able to view the notice before opening an account.

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Proposed CIP Requirements (cont.)

- The CIP identification and verification requirements would apply upon the opening of each new account.
  - For a customer whose identity has been previously verified, identification and verification is not required if:
    - The Covered Adviser previously verified the customer's identity; and
    - The Covered Adviser continues to have a reasonable belief that it knows the true identity of the customer.
- Covered Advisers that are dually registered or affiliated with a bank or broker-dealer would not be required to establish a separate CIP for their advisory activities.
- A Covered Adviser would be able to deem the CIP requirements satisfied for any mutual fund that it advises that has developed and implemented a CIP compliant with CIP requirements applicable to mutual funds.

Proposed Reliance Provision

- Covered Advisers would be permitted to rely on another FI to perform any of the procedures of the Covered Adviser's CIP if:
  1. The reliance is reasonable under the circumstances;
  2. The FI being relied upon is subject to a rule implementing 31 U.S.C. 5318(h) and regulated by a federal functional regulator; and
  3. The FI being relied upon enters into a contract with the Covered Adviser requiring the FI to certify annually to the Covered Adviser that it has implemented its AML/CFT program, and that it will perform (or its agent will perform) specified requirements of the Covered Adviser's CIP.
- If the three conditions are met, the Covered Adviser would not be held responsible for the failure of the other FI to fulfill the CIP requirements.
- While Covered Advisers would be permitted to delegate a CIP to service providers, such as administrators, the reliance provision would not permit Covered Advisers to avoid liability for the failures of a service provider to perform proper CIP if the reliance conditions are not otherwise met.

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Proposed CIP Key Terms

Customer

- A “customer” would be a natural person or legal entity that opens a new account.
- The customer would be the person identified as the account holder, except for:
  - An individual who lacks legal capacity, such as a minor.
  - Non-legal entities, such as civic clubs.

  Where the account holder is not the customer, the customer would be the individual who opens the new account for the minor or non-legal entity.

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Customer (cont.)

- *Exclusions* - Customers would not include:
  - Individuals with authority or control over an account.
  - Persons who fill out account opening paperwork or provide information necessary to set up an account.
- *Exemptions* - Customers would not include:
  - FIs regulated by a federal functional regulator and banks regulated by a state bank regulator.
  - Certain entities that are publicly listed on U.S. securities exchanges.
  - Persons that have an existing account with the Covered Adviser, provided the Covered Adviser has a reasonable belief that it knows the true identity of the person.
  - *Unlike CIP rules applicable to other FIs, ERISA accounts would not be excluded from the definition of customer.*

Account

- An “account” is “any contractual or other business relationship between a person and a Covered Adviser under which the Covered Adviser provides investment advisory services.”
- Account excludes accounts that the Covered Adviser acquires through any acquisition, merger, purchase of assets, or assumption of liabilities.
- *Application to Investors in Private Funds*
  - The definition of account requires a contractual or other business relationship to provide advisory services, which would likely cause CIP to be applicable to:
    - Private funds
    - Separately managed account relationships
  - Investors in private funds would not generally be considered customers of Covered Advisers and would be out of scope of the CIP obligation.

Timeline

- Comments are due by July 22, 2024.
- The CIP Rule would require implementation of a CIP the earlier of:
  - Six months following the issuance of a final CIP Rule
  - The compliance date for the AML/CFT Program Rule.

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Takeaways

Key Takeaways

- Finalized rules may add significant compliance obligations.
- Understand unfamiliar requirements (e.g., SAR filing).
- Consider how Proposed Rules will impact delegation to service providers.
- Comments on Proposed CIP are due by July 22, 2024.

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