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Client Alert | Investment Management

FinCEN Finalizes AML/CFT Rule: 6 Takeaways for Investment Advisers Facing New Regulatory Scrutiny

The Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury, announced August 28 it had adopted a final rule (Final Rule) creating and expanding certain obligations related to anti-money laundering and countering the financing of terrorism (AML/CFT) for investment advisers.[1] The Final Rule implements FinCEN's February proposed rule[2] (Proposal) to add certain registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to the definition of "financial institution" under the Bank Secrecy Act (BSA), with some modifications from the Proposal. The compliance date of the Final Rule is January 1, 2026.

Key Takeaways

1. The Final Rule applies to ERAs and RIAs, but not yet to state-registered advisers, nor to family offices or foreign private advisers.
2. The Final Rule permits an investment adviser acting as a subadviser to exclude the primary adviser from its AML/CFT programs when the subadviser has a direct contractual relationship with the primary adviser (rather than the underlying customer of the other investment adviser).
3. Advisers are permitted to exclude mutual funds[3] and certain collective investment funds they advise from their AML/CFT programs, provided the funds are subject to an AML/CFT program, but FinCEN did not categorically exclude registered closed-end funds.

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[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 (September 4, 2024) (to be codified at 31 C.F.R. pts 1010, 1032).

[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 (proposed February 13, 2024) (to be codified at 31 C.F.R. pts 1010, 1032); see also "Seeing SARs: FinCEN Proposes Bruising AML Rules for Investment Advisers" (February 22, 2024).

[3] In a departure from the Proposal, an investment adviser may categorically rely on this exclusion without verifying that the mutual fund has implemented an AML/CFT program.

4. The Final Rule delegates examination authority for the requirements of the Final Rule to the U.S. Securities and Exchange Commission (SEC) (consistent with its treatment of mutual funds and broker-dealers).
5. Consistent with the Proposal, dually registered broker-dealers and investment advisers will not be required to establish multiple AML/CFT programs as long as the existing AML/CFT program covers all of an adviser's activities.
6. By designating investment advisers as "financial institutions" under the BSA, the Final Rule opens the door for FinCEN's joint rulemaking with the SEC regarding customer identification programs (CIPs) and the collection of beneficial ownership information.[4] FinCEN intends for the compliance date of the AML/CFT Final Rule to align with the CIPs final rule, once adopted.

In a departure from the Proposal, the Final Rule excludes RIAs required to be registered with the SEC solely because they are (1) midsized advisers, (2) multi-state advisers or (3) pension consultants. The Final Rule also narrows the scope of the definition by excluding RIAs that are not required to report their assets under management to the SEC on Form ADV. Further, the Final Rule will only apply to RIAs and ERAs with principal offices and places of business outside the United States if they engage in advisory activities in the United States (including through the involvement of U.S. personnel of the investment adviser) or provide advisory services to a U.S. person or a foreign-located private fund with an investor who is a U.S. person.

Overview of Requirements

- Implement AML/CFT programs.
- File suspicious activity reports (SARs)/currency transaction reports (CTRs).
- Participate in information sharing with FinCEN and other regulators.

Implement an AML/CFT Program

The Final Rule requires investment advisers to implement an AML/CFT program that is risk-based and reasonably designed to comply with the requirements of the BSA and regulations thereunder. Investment advisers will be required to apply the AML/CFT program to their advisory services for all customers, with the exception of mutual funds, collective investment funds and other investment advisers (such as another adviser to which the adviser provides subadvisory services) already subject to the Final Rule. An investment adviser will not be required to apply its AML/CFT program to non-advisory services, such as making managerial or operational decisions about the activities of portfolio companies. Additionally, a subadviser may exclude the primary adviser from its AML/CFT program as long as the subadviser has a contractual relationship with the primary adviser.

An investment adviser's AML/CFT program must, at a minimum: (1) establish and implement policies, procedures and controls that are reasonably designed to prevent the adviser from

[4] SEC, FinCEN Propose Customer Identification Program Requirements for Registered Investment Advisers and Exempt Reporting Advisers, SEC Release No. BSA-1 (May 13, 2024) (CIP Proposal); see also "Your ID, Please: An Investment Adviser's Guide to the Proposed Customer Identification Program" (May 23, 2024).

being used for money laundering, terrorist financing or other illicit finance activities; (2) provide for independent testing of the AML/CFT program; (3) designate a compliance officer or other person(s) responsible for implementing and monitoring the internal policies, procedures and controls of the adviser's AML/CFT program; (4) implement an ongoing employee training program for relevant employees; and (5) develop risk-based procedures to conduct ongoing customer due diligence. FinCEN noted that the AML/CFT program requirement is not a one-size-fits-all requirement and requires the implementation of a risk-based and reasonably designed AML/CFT program. FinCEN stated that this approach is intended to give advisers flexibility in designing their programs, such that the programs are commensurate with the specific risks of the advisory services they provide and the customers they advise. The AML/CFT program will require the approval of an investment adviser's board of directors/trustees or, if the adviser does not have a board, the relevant person who serves in a similar function.

File SARs/CFTs

The Final Rule adopts without significant change the proposed requirement that investment advisers file SARs for suspicious transactions. Advisers will also be required to file CTRs. Some of the types of suspicious activity transactions an investment adviser may identify and report are:

- Transactions that are designed to hide the source or destination of funds and fraudulent activity.
- Private fund investors that request access to certain nonpublic information about a portfolio company.
- Investments that use multiple wire transfers from different accounts at different financial institutions.
- An investor that requests that transactions be processed in a manner to avoid transmitting funds through certain jurisdictions.
- Unusual wire activity that does not align with the investor's investment objective.
- The transfer of funds to third-party accounts with no plausible relationship to the customer or to suspicious counterparties (i.e., shell companies).
- Activity that suggests that the customer is acting as a proxy for a third party.
- Unusual withdrawal requests by customers with ties to activities, individuals or entities subject to U.S. sanctions, among others.

FinCEN noted that the techniques of money laundering, terrorist financing and other illicit finance activities are continually evolving, and it is not possible to provide a definitive list of suspicious transactions. FinCEN further noted that reporting requirements may differ depending on the adviser's operations and that advisers will not be required to gather information beyond what they would ordinarily possess or what is required by their AML/CFT programs. An adviser's obligation to file a SAR would be based on the adviser's due diligence and the information the adviser obtains in the course of its advisory services. Nevertheless, if an investment adviser has information causing it to know, suspect or have reason to suspect suspicious transactions by, at,

or through the adviser that involves funds it does not advise (such as in a “funds of funds” structure) or portfolio companies, the adviser would be obligated to file a SAR.

Other Requirements

- Advisers will be required to file SARs with FinCEN within 30 days of the advisers’ initial detection of facts that may constitute a basis for filing a SAR. In connection with the filing, an adviser will be required to collect and maintain supporting documentation. The adviser may delay the filing for 30 additional days if it is unable to identify the suspect but may not delay the filing beyond 60 days from the initial detection.
- Advisers will be required to maintain copies of SARs filed (and the underlying documentation) for a period of five years from the filing date.
- Advisers will not be permitted to disclose a SAR or share information that would reveal the existence of a SAR (except under limited circumstances), including by sharing information with an affiliate.
- The Final Rule will provide a safe harbor for advisers and their officers, directors, employees and agents to shield them from civil liability for filing SARs and for failing to disclose to a person identified in the SAR that the SAR had been filed.

Information-Sharing Procedures

The Final Rule subjects investment advisers to FinCEN regulations that require an adviser to provide, upon the request of FinCEN, to expeditiously search its records for certain information to determine whether the adviser maintains or has maintained an account for, or has engaged in any transaction with, the individual, entity or organization named in FinCEN's request. FinCEN noted that advisers may not have all the information about underlying investors in a private fund, and in such a situation, the adviser would only be expected to respond with information about the fund rather than the underlying investors in the fund. In a departure from the Proposal, mutual funds will be excluded from the information-sharing requirements.

CIPs

FinCEN and the SEC have also promulgated a proposed joint rulemaking to require that advisers, upon their inclusion in the definition of a “financial institution” under the BSA, implement CIPs.[5] As such, advisers can expect that FinCEN and the SEC will move forward to adopt a final rule with respect to CIPs.

[5] See CIP Proposal, *supra* n.4.

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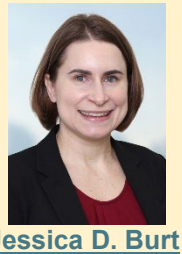

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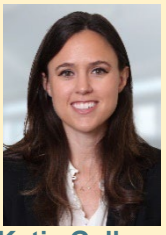

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