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FinCEN Proposes Long-Expected AML Rule for Investment Advisers

On August 25th, 2015 the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") proposed a new rule applicable to investment advisers. At its core, the proposal seeks to extend anti-money laundering ("AML") obligations imposed under the Bank Secrecy Act ("BSA") to registered investment advisers. This proposal comes as little surprise, as the Treasury Department has long contemplated the extension of AML regulations to investments advisers. A similar rule was first proposed in 2003, though it was withdrawn 5 years later.

The proposal would apply to SEC-registered investment advisers, including advisers to certain hedge funds, private equity funds, and other private funds. Stated generally, the proposed rule would effect three regulatory changes of import to investment advisers. It would:

- Expand the definition of "financial institution" in the BSA regulations to include investment advisers (thereby subjecting investment advisers to the requirements of the BSA). It would also add a definition of investment adviser to the regulations [1];
- Require investment advisers to establish AML programs, which programs must meet the minimum standards prescribed by FinCEN; and
- Require investment advisers to report suspicious activity to FinCEN pursuant to the BSA in accordance with specified filing and notification procedures.

As stated in the proposal, FinCEN seeks to delegate its authority to examine investment advisers for compliance with these requirements to the SEC. The present proposal excuses small and mid-sized advisers – those with less than $100 million in regulatory assets under management – from the requirements. [2] But this may be a short-lived exemption, as "future rulemakings may include other types of investments advisers, such as state-regulated investment advisers or investment advisers that are exempt from SEC registration." [3]

If enacted, the proposal's expanded definition of "financial institution" would compel registered investment advisers to observe all applicable BSA regulatory requirements. This includes compliance with the Currency Transaction Report ("CTR") filing requirements, under which a financial institution must report any currency transaction for over $10,000 that is conducted by, through, or to the financial institution. Investment advisers, as "financial institutions," would also be subjected to information sharing requests pursuant to section 314(a) of the USA PATRIOT Act and various related recordkeeping and retention obligations.

With regard to AML practices, the proposal requires registered investment advisers to: (1) establish and implement policies, procedures, and internal controls reasonably designed to prevent money laundering or the financing of terrorist activities and to achieve and monitor compliance with the BSA; (2) conduct independent testing of the AML program; (3) designate an AML compliance officer; and (4) provide ongoing AML training for firm personnel. As the Investment Advisers Act of 1940 imposes a number of recordkeeping and reporting requirements on registered investment advisers, FinCEN contends that many investment advisers will simply adapt their existing policies to comply with the proposed AML rules. [4]

Finally, the proposal requires investment advisers to file suspicious activity reports ("SARs") in accordance with FinCEN's rules implementing the BSA. Investment advisers would be obligated to report any suspicious transaction involving funds or assets of at least $5,000. Institutions that file SARs also must maintain copies of the filed reports and the underlying related documentation for a period of 5 years from the date of filling. In isolation, this is not a particularly burdensome obligation. As noted by FinCEN, the

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10,000 regulated securities entities in the US file a total of 19,000 SARs per year, with most reports generated by large entities. But this added obligation could prove problematic, particularly if the proposed rules are expanded to cover small investment advisers. Representatives of the advisory industry view this – and the proposals as a whole – as a superfluous burden to investment advisers struggling to keep pace with a rapidly-expanding regulatory regime. [5]

[1] The proposed definition is: “[a]ny person who is registered or required to register with the SEC under section 203 of the Investment Advisers Act of 1940.”

[2] Advisers with regulatory assets under management below $100 million are generally exempt from SEC registration.

[3] https://www.fincen.gov/sites/default/files/shared/1506-AB10_FinCEN_IA_NPRM.pdf

[4] Note that this assertion has been met with skepticism from the investment adviser community, which has questioned the potential benefits of the proposal and expressed concern over its potential compliance costs. See https://www.financial-planning.com/news/regulatory_compliance/treasury-dept-proposes-aml-rule-for-advisors-2693979-1.html.

[5] See *Id.*