

AML/CFT Requirements for Investment Advisors



Summary of Proposed Regulation

Regulation Overview

On February 15, 2024 Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury, issued a notice of proposed rulemaking (NPRM) to prescribe minimum anti-money laundering/countering the financing of terrorism (AML/CFT) program standards for investment advisers. It also proposes that investment advisers report suspicious activity to FinCEN pursuant to the Bank Secrecy Act (BSA), and make several other related changes to FinCEN regulations. FinCEN is proposing these rules to address gaps in the existing AML/CFT regulatory framework in this sector, as there are currently no Federal or State regulations requiring investment advisers to maintain AML/CFT programs.

Regulatory Timeline



Following the comments period deadline FinCEN may publish Final Rules at a later date materially different than these proposed rules.

Summary of Proposed Rule Requirements

In summary the proposed rules would require investment advisers to:

- ① Establish AML/CFT programs, to include risk-based procedures for conducting ongoing customer due diligence (CDD);
- ② File Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs) with FinCEN;
- ③ Maintain records relating to the transmittal of funds (Recordkeeping and Travel Rule);
- ④ Apply information-sharing provisions between and among FinCEN, law enforcement, agencies, and certain financial institutions; and
- ⑤ Implement special due diligence requirements for correspondent and private banking accounts and special measures under section 311 of the USA PATRIOT Act.

Investment Advisors Covered By the Proposed Rule

- **SEC-Registered Investment Advisers (RIAs):** Unless eligible to rely on an exception, this includes investment advisers that manage more than \$110 million AUM must register with the SEC.
- **Investment advisers that report to the SEC as Exempt Reporting Advisers (ERAs):** These are investment advisers that (i) advise only private funds and have less than \$150 million in AUM in the United States, or (ii) advise only venture capital funds.

The proposed rule also applies to **non-U.S. Investment Advisers** registered with the SEC, whose principal offices and places of business are outside the United States but solicit or advise “U.S. persons”, only to the extent of their U.S. clients.

AML/CFT Requirements for Investment Advisors



AML/CFT Program Requirements

Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) Programs

The proposed rule requires each investment advisor to develop and implement a written 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. Each investment advisor would also be required to make its AML/CFT program available for inspection by FinCEN or the SEC.

Required Elements of the ALM/CFT Program:

Details of the Required Elements:

(a) Required Policies, Procedures, and Internal Controls

Investment advisers shall establish and implement policies, procedures, and internal controls reasonably designed to prevent money laundering, terrorist financing, and other illicit finance activities. Advisors are required to do a risk assessment to identify its AML vulnerabilities and adapt policies and procedures based on the risks identified.

(b) Provide for Independent Testing for Compliance To Be Conducted by Company Personnel or by a Qualified Outside Party

Independent testing shall be conducted on a frequency that depends on the risks of the adviser and the adviser's overall risk management strategy, and if errors or deficiencies have been identified. It could occur over periodic intervals or when there are significant changes in the adviser's risk profile, systems, compliance staff, or processes.

(c) Designate a Person or Persons Responsible for Implementing and Monitoring the Operations and Internal Controls of the Program

The person or persons designated shall have full responsibility and authority to develop and implement appropriate policies, procedures, and internal controls reasonably designed to prevent the investment adviser from being used for those risks. They should also be knowledgeable about AML/CFT requirements, and the advisors AML/CFT risk.

(d) Provide Ongoing Training for Appropriate Persons

The training program should provide a general awareness of overall AML/CFT requirements and risks, as well as more job-specific guidance tailored to particular employees' roles and functions. Such training may be conducted through, among other things, outside or in-house seminars, and may include computer-based or virtual training.

(e) Ongoing Customer Due Diligence (CDD)

Investment advisers shall implement appropriate risk-based procedures for conducting ongoing CDD that includes (i) understanding the nature and purpose of the customer relationships for the purpose of developing a customer risk profile; and (ii) conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

AML/CFT Requirements for Investment Advisors



Other Key Proposed Requirements

Investment Advisers' Proposed Obligation to File SARs and CTRs Instead of Form 8300

Suspicious Activity Report (SAR): Under the proposed rules, investment advisers would be required to report suspicious transactions that are conducted or attempted through the investment adviser and involve at least \$5,000 in funds or other assets. Within 30 days of initially detecting a suspicious transaction the investment advisor would be obligated to file a SAR with FinCEN. The advisor would need to maintain copies of its filed SARs and the underlying related documentation for five years from the date of filing.

Currency Transaction Report (CTR): Investment advisors would be required to file CTRs with FinCEN when transactions in currency of more than \$10,000 are conducted during a single business day.

To avoid duplicative requirements, investment advisers would no longer have to (i) voluntarily report suspicious transactions, and (ii) report transactions of more than \$10,000 using Form 8300.

Proposed Recordkeeping Requirements for Investment Advisers

Investment advisers would be required to comply with the Recordkeeping and Travel Rules when they engage in transactions that meet the definition of a transmittal order. Under the Recordkeeping and Travel Rules investment advisors would be required to:

- ① Create and retain records for transmittals of funds that equal or exceed \$3,000. Investment advisors would need to retain the name, address, and other information about the transmitter and the transaction;
- ② Ensure that certain information pertaining to the transmittal of funds “travels” with the transmittal to the next financial institution in the payment chain;
- ③ Create and retain records for extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit in amounts exceeding \$10,000.

Special Information-Sharing Procedures to Deter Money Laundering and Terrorist Activity

The proposed rule requires investment advisers to be subject to special information sharing procedures.

When there is reasonable suspicion or credible evidence of money laundering and terrorist activity, FinCEN may require investment advisors to expeditiously search their records to determine whether they maintain an account or have executed transactions with an individual, entity, or organization named in FinCEN's request. An investment advisor would then be required to report any identified information to FinCEN law enforcement.

In addition, investment advisers would be able to participate in information sharing arrangements with other financial institutions to better understand customer risk and to file more comprehensive SARs.

AML/CFT Requirements for Investment Advisors

Botsford Team Contacts



For additional information about this Regulatory brief or Botsford Associates Financial Services Regulatory Practice, and how we can help you, please contact:

Jon Block
Managing Partner
Financial Services
NYC: 917.647.3434 / TOR: 416.915.0438
jblock@botsford.com

Andrew Moreira
Managing Director - Consulting
Financial Services
NYC: 917.722.0939 / TOR: 647.361.4404
amoreira@botsford.com

Gordon Wong
Managing Director - Advisory
Financial Services
NYC: 917.722.1200 ext 319 / TOR: 437.253.4933
gwong@botsford.com