

Investment Advisers Beware: The BSA is Coming (Maybe)

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The United States Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has issued a notice of proposed rulemaking (NPRM) that would subject registered investment advisers (RIAs) and exempt reporting advisers (ERAs; collectively with RIAs, Investment Advisers)¹ to the anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements of the Bank Secrecy Act (BSA).²

As discussed in our prior Client Alert,³ FinCEN previously advised that an NPRM regarding Investment Advisers would be issued in early 2024, remarking that Investment Advisers are "gatekeepers to the American economy" that are at risk of being used by illicit actors.⁴ As proposed, the rule broadens the definition of "financial institution" under the BSA by classifying Investment Advisers as financial institutions.⁵ As we wrote in January, this is the fourth attempt by regulators to subject Investment Advisers to the BSA, most recently with an NPRM issued in 2015. Prior attempts failed to gain traction due to heavy opposition from the private fund industry. This NPRM notably differs from the 2015 NPRM by including ERAs in the BSA framework.

The following is a high-level description of each requirement the NPRM would impose on Investment Advisers:

1. Establish a BSA-Compliant AML/CFT Program

FinCEN acknowledges that many Investment Advisers already have some form of AML/CFT program in place. Under the NPRM, however,

Investment Advisers now would be required to expand these programs to conform with the BSA's requirements, which include, among other things, the implementation of a written AML/CFT program that is (i) risk-based and (ii) reasonably designed to prevent the Investment Adviser from being exploited by money launderers or other illicit actors.

Specifically, the AML/CFT program will require the following elements, as enumerated by the BSA: (1) policies, procedures, and internal controls designed to counter money laundering and terrorist financing; (2) independent testing of the AML/CFT program by a qualified internal or external party on a periodic basis; (3) designation of a person or persons responsible for implementing and monitoring the AML/CFT program; (4) provisions for ongoing training for applicable individuals employed or contracted by the Investment Adviser; and (5) ongoing customer due diligence (CDD) of customers and transactions. Importantly, however, FinCEN specifies in the NPRM that certain elements of CDD will not apply to Investment Advisers under this rule if passed, but FinCEN "anticipates addressing customer identification program requirements for investment advisers in future joint rulemaking with the SEC."⁶ Accordingly, until such joint rulemaking occurs, unlike other "financial institutions," Investment Advisers would not be required to identify and verify the identity of customers and the beneficial ownership of legal entity customers. The NPRM also excludes any activities that the Investment Adviser undertakes in advising mutual funds from the foregoing AML/CFT program requirements.

¹ As defined by the Investment Advisers Act of 1940, 31 U.S.C. 80b-1 et seq.

² "FinCEN Proposes Rule to Combat Illicit Finance and National Security Threats in Investment Adviser Sector," available at <https://www.fincen.gov/news/news-releases/fincen-proposes-rule-combat-illicit-finance-and-national-security-threats>. For the full NPRM, see <https://www.federalregister.gov/public-inspection/2024-02854/anti-money-launderingcountering-the-financing-of-terrorism-program-and-suspicious-activity-report>.

³ See "U.S. Treasury Renews Push to Make Investment Advisers Subject to the BSA," available at <https://www.lowenstein.com/news-insights/publications/client-alerts/us-treasury-renews-push-to-make-investment-advisers-subject-to-the-bsa-aml>.

⁴ *Id.*

⁵ The BSA is codified in 31 U.S.C. 5311-5314, 5316-5336.

⁶ "Fact Sheet: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers Notice of Proposed Rulemaking (NPRM)," available at <https://www.fincen.gov/news/news-releases/fact-sheet-anti-money-laundering-program-and-suspicious-activity-report-filing>.

2. Report Suspicious Activity and File Suspicious Activity Reports (SARs)

The most significant proposed change that would affect Investment Advisers' regulatory obligations is the requirement to report suspicious activity conducted through the Investment Adviser when the activity involves or aggregates to at least \$5,000 in assets. While currently, Investment Advisers may file SARs on a voluntary basis, the proposed rule would impose an affirmative obligation to do so. The rule would also provide the filing Investment Adviser with safe harbor protections not otherwise available for nonfinancial institutions. SAR filings would be required for any transaction the Investment Adviser knows, suspects, or has reason to suspect involves funds from illegal activity or is potentially structured to avoid transaction reporting. All the reporting deadlines and attendant confidentiality requirements currently applicable to financial institutions would also apply to Investment Advisers.

FinCEN notes that this requirement will be supplemental to and not replace any similar reporting obligations imposed by the SEC. Activity for mutual funds by Investment Advisers is excluded from the SAR reporting obligations.

3. Keep Transmission Records

Investment Advisers would also be required to comply with the Recordkeeping and Travel Rules⁷ codified in the BSA under the NPRM. This would entail keeping records of any fund transmissions (e.g., documentation indicating the name, address, and other information about the transmitter, recipient, and transaction) equal to or exceeding \$3,000. The same exemptions that apply to other BSA-compliant entities would apply to Investment Advisers. In addition, this rule would not apply to transmissions made by any mutual funds the Investment Adviser services.

4. Allow Information Sharing With Other Financial Institutions and Law Enforcement

The NPRM would subject Investment Advisers to the information-sharing provisions of the BSA, i.e., Sections 314(a) and 314(b) of the USA PATRIOT ACT.⁸ This would require Investment Advisers to share information about suspected terrorist or money laundering activities with law enforcement and voluntarily share information with other covered financial institutions, with a safe harbor from liability. This rule would not exclude activity for mutual funds, unlike the above proposed rules.

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FinCEN is accepting comments on the NPRM until April 15. However, we encourage Investment Advisers to become familiar with the proposal now in order to be adequately prepared. Our prior Client Alert⁹ discusses AML best practices for private fund managers. Lowenstein will be monitoring further developments to the NPRM and subsequent rule. For any questions about this Client Alert or the NPRM, please contact the authors at LSAMLEam@lowenstein.com.

⁷ 31 CFR 1010.410(e)-(f).

⁸ Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Public Law 107-56.

⁹ See "AML Best Practices for Private Fund Managers: The Prudence of Establishing an AML Compliance Program," 2023.02.17, available at <https://www.lowenstein.com/news-insights/publications/client-alerts/aml-best-practices-for-private-fund-managers-the-prudence-of-establishing-an-aml-compliance-program-investment-management>.

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