FINN DIXON & HERLING

FinCEN Finalizes Rule on AML Requirements for Investment Advisors

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On August 28, 2024, the Financial Crimes Enforcement Network ("FinCEN") issued a final rule (the "Final Rule")[1] that will significantly impact the obligations of most investment advisers – whether registered or exempt – with respect to anti-money laundering ("AML") and countering the financing of terrorism ("CFT"). The Final Rule will represent a significant change for many investment advisers as it imposes, for the first time, formal requirements with respect to AML/CFT. Among other obligations, the Final Rule will require investment advisers to adopt an AML/CFT program with an array of specific requirements applicable to the onboarding and ongoing monitoring of investors and clients. FinCEN delegated enforcement power to the Securities and Exchange Commission (the "SEC") and additional rulemaking is expected with respect to customer identification programs and customer due diligence, which are likely to apply additional compliance requirements to investment advisers. The effective date of this rule is ***January 1, 2026***.

Scope of the Rule

In the Final Rule, FinCEN amended the Bank Secrecy Act (BSA) to include investment advisers in the definition of "financial institution."[2] In addition to the requirement to implement a risk-based and reasonably designed AML/CFT program, the Final Rule will require investment advisers to file Suspicious Activity Reports ("SARs") with FinCEN, collect, retain, and transmit information required by the Recordkeeping and Travel Rule and respond to requests from FinCEN as well as participate in voluntary information sharing provisions of the BSA. The subjects and activities covered within the Final Rule's scope are discussed below.

Who does the Final Rule apply to?

- Registered Investment Advisers (RIAs) required to register with the SEC under section 203 of the Investment Advisers Act of 1940 (the Investment Advisers Act)[3]
- Exempt Reporting Advisers (ERAs) exempt from SEC registration under section 203(l) or 203(m) of the Investment Advisers Act[4]

Who is excluded?

- Mid-sized advisers (those that have between $25 million and $100 million in AUM)
- Pension consultants
- Multi-state advisers (those that are required to register with 15 or more states)
- Advisers that report zero AUM on their most recently filed Form ADV
- Foreign-located advisers without a U.S. nexus[5]

What activities does the Final Rule apply to?

- Advisory services provided to customers, which include management of customer assets and submission of customer transactions for execution.
- For private funds, advisory services do not include certain activities taken in connection with management and operations of portfolio companies, such as serving in management roles.[6] However, other activities relating to portfolio companies will be within the scope of the Final Rule, for example with respect to funding mechanics or investor access to technological information at the portfolio company level.

Purpose

FinCEN issued the Final Rule with the stated goal of applying a consistent set of AML/CFT regulations for investment advisers, as are applicable to banks and broker-dealers. FinCEN determined that investment advisers engage in activities that are "similar to, related to, or a substitute for" financial services that other BSA-defined financial institutions are authorized to engage in.[7] FinCEN expressed the view that investment advisers could serve as an entry point into U.S. financial system for illicit proceeds associated with foreign corruption, tax evasion, and other crimes.[8] In addition, FinCEN identified the risk that foreign states use or have the potential to use private funds and venture capital funds to access technology through investments in early-stage companies, creating national security risks.[9] According to FinCEN, regulating investment advisers as financial institutions would close this loophole.[10]

Specific Requirements for Investment Advisers

The Final Rule requires investment advisers to (1) establish a risk-based and reasonably designed AML/CFT program, (2) comply with a new SAR filing obligation, (3) collect, retain, and transmit information required by the Recordkeeping Rule and Travel Rule, and (4) respond to requests from FinCEN as well as participate in information sharing provisions of the BSA.

AML/CFT Program Requirements

- In General:
  - Each adviser must develop 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 and to achieve and monitor compliance with the applicable provisions of the BSA and regulations thereunder.
    - The AML/CFT program must be approved in writing by the investment adviser's board of directors or trustees, as applicable, or persons having similar functions (for example, a general partner). The written program must be made available for inspection by the SEC and FinCEN.
- Minimum Requirements:
    - Internal policies, procedures, and controls *reasonably designed* to prevent the investment adviser from being used for money laundering, terrorist financing, or other illicit finance activities and to assure and monitor compliance with the applicable provisions of the BSA.
    - Independent testing
    - Designated person or persons responsible for implementing and monitoring the operations and internal controls of the program.
    - Ongoing training
    - Appropriate *risk-based* procedures for conducting ongoing customer due diligence.[11]

SAR Filing

- Investment advisers will be *required* to file with FinCEN a report of any suspicious transaction that it knows, suspects, or has reason to suspect relates to violation of law or regulation or has no business or apparent lawful purpose.
- Investment advisers will be permitted to voluntarily file with FinCEN a report of any suspicious transaction that it believes is relevant to the possible violation of any law or violation.[12]
- Multiple financial institutions may file a joint SAR.[13]

Recordkeeping Rule and Travel Rule

- Certain BSA recordkeeping regulations that apply more broadly to financial institutions will apply to investment advisers, notably, the Recordkeeping and Travel Rules.[14]
- Investment advisers will be required to create and retain records for certain transfers of funds in amounts over $3,000.[15]
- Investment advisers will be required to file a Currency Transaction Report and report transactions in currency over $10,000.[16]

FinCEN Requests and Information Sharing

- Investment advisers will be required to respond to information requests from FinCEN. In doing so, they must conduct an "expeditious" search of their records and submit a report to FinCEN if they identify an account or transaction identified in FinCEN's request.[17]
- Investment advisers will be permitted to share information with other financial institutions for the purposes of identifying and reporting activities that it suspects may involve potential money laundering or terrorist activities.[18]

Next Steps

The Final Rule and the application of BSA requirements to investment advisers creates the potential for regulatory scrutiny and enforcement penalties by the SEC or FinCEN for non-compliance. FinCEN will delegate enforcement of the Final Rule to the SEC when it goes into effect on January 1, 2026.[19] Investment advisers may face monetary penalties for technical non-compliance, with the potential for criminal penalties

for willful violations. Investment advisers should expect and prepare for SEC examination of their AML/CFT programs during routine examinations.

In advance of the effectiveness of the Final Rule, there are a number of steps that investment advisers should consider. In the first instance, these include reviewing existing AML/CFT programs and evaluating the scope of advisory activities and clients that will be subject to the Final Rule. Most investment advisers, in particular those without an affiliated broker-dealer, will need to update their AML/CFT programs – including policies and procedures, delegation arrangements with third-party service providers and internal staffing, training and oversight processes.

Investment advisers should also monitor future rulemaking developments with respect to their customer identification programs (CIPs) and customer due diligence (CDD),[20] which can be expected to supplement the obligations and requirements of the Final Rule summarized above.

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[1] Final Rule, 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), available here.

[2] *Id.* at 72274 (to be codified at 31 CFR 1032.100(t)(11)(nnn)).
[3] *Id.*
[4] *Id.*
[5] *Id.*
[6] Final Rule at 72181-82.
[7] *Id.* at 72166.
[8] *See* Fact Sheet; 2024 Investment Adviser Risk Assessment (February 2024), available here.
[9] *Id.*
[10] *Id.*
[11] Final Rule at 72275-76 (to be codified at 31 CFR part 1032, subpart B).
[12] *Id.* at 72276 (to be codified at 31 CFR § 1032.320).
[13] *Id.* (to be codified at 31 CFR § 1032.320(a)(3)).
[14] *Id.* at 72179; 31 CFR part 1010, subpart D.
[15] *Id.* at 72179, 72274 (to be codified at 31 CFR 1010.410(e)(6)(i)(K)); 31 CFR §§ 1010.410(e) & (f).
[16] *Id.* at 72179; 31 CFR § 1010.311.
[17] *Id.* at 72278 (to be codified at 31 CFR § 1032.520); 31 CFR § 1010.520.
[18] *Id.* (to be codified at 31 CFR § 1032.540); 31 CFR § 1010.540.
[19] *Id.* at 72275 (to be codified at 31 CFR § 1010.810(b)(6)).
[20] *Id.* at 72124.