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FinCEN extends anti-money laundering requirements to investment advisers

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On August 28, 2024, the Financial Crimes Enforcement Network (FinCEN) issued a final rule (the Final Rule) aimed at combatting illicit financial activities and national security threats in the investment adviser sector. This new rule extends certain anti-money laundering (AML) and countering financing of terrorism (CFT) compliance obligations to registered investment advisers (RIAs) and exempt reporting advisers (ERAs), such as requiring RIAs and ERAs to adopt AML/CFL compliance procedures and report suspicious activity to FinCEN.

FinCEN believes the requirements will "address the current uneven application of AML/CFT requirements across the investment adviser sector"[1], and bring the United States into greater compliance with international AML/CFT standards.

Investment advisers affected by the Final Rule have until January 1, 2026 to ensure their compliance.

What you need to know

- The Final Rule includes investment advisers as a category of "financial institution" under the Bank Secrecy Act, thereby subjecting investment advisers to certain AML compliance requirements.
  - For foreign investment advisers with a principal place of business outside the U.S., the Final Rule only applies to advisory activities that (i) occur within the U.S., including through the involvement of the adviser's U.S. personnel or (ii) involve advisory services to a U.S. person or a foreign-located private fund with a U.S. investor.
- It aims to benefit investors by bringing more transparency to the U.S. financial system and provides uniformity to the application of AML/CFT requirements, in order to prevent "shopping around" by illicit investors for an investment adviser that doesn't apply strict AML/CFT controls.
- It is likely to impose a heavy time and financial burden on smaller advisers that do not already have AML/CFT programs in place.

Investment advisers covered by the Final Rule

The Bank Secrecy Act (BSA) requires "financial institutions" to establish and maintain AML/CFT compliance programs meeting certain minimum standards. The definition of "financial institution" covers several categories of financial businesses, including broker-dealers, banks, credit unions and mutual funds. While large financial institutions were already subject to stringent AML/CFT regulations imposed by the BSA, many smaller entities, including RIAs and ERAs, have now been brought within its scope.

The Final Rule adds "investment adviser" to the definition of "financial institution", thereby broadening the class of regulated institutions. FinCEN defines "investment advisers" as including both investment advisers registered with the U.S. Securities and Exchange Commission (SEC), and investment advisers that report to the SEC as ERAs.

The category of "investment adviser" substantially covers all RIAs. However, FinCEN clarified that for those investment advisers with a principal place of business outside the U.S., the Final Rule applies only to their advisory activities that (a) take place within the U.S, including through the involvement of the investment adviser's U.S. personnel or (b) involve advisory services to a U.S. person or a foreign-located private fund with an investor that is a U.S. person. The Final Rule does not apply to state-registered advisers, foreign private advisers or family offices (as defined in SEC regulations).

Requirements of the Final Rule

The Final Rule will require RIAs and ERAs to:

- implement a risk-based and reasonably designed AML/CFT program that meets the BSA's minimum standards, including:
  - developing internal policies, procedures and controls to prevent money laundering, terrorist financing, or other illicit finance activities;
  - designating a compliance officer to oversee the AML/CFT program;
  - establishing an ongoing employee training program;
  - implementing an independent audit function to periodically evaluate the effectiveness of the AML/CFT program; and
  - adopting risk-based procedures for conducting ongoing customer due diligence.
- file certain reports, such as Suspicious Activity Reports (SARs), with FinCEN;
- comply with recordkeeping obligations, such as retaining records relating to the transmittal of funds; and
- fulfill certain other obligations applicable to financial institutions subject to the BSA and FinCEN's implementing regulations, such as special information-sharing procedures.

FinCEN has delegated its examination authority for the requirements of the Final Rule to the SEC, the federal functional regulator responsible for the oversight and regulation of investment advisers.

Special considerations for private funds

The Final Rule acknowledges that some types of customers or investors pose greater risks than others for money laundering, terrorist financing or other illicit finance activities, and that the level of risk for private funds may vary due to factors such as the individual fund's investment strategy, targeted investors, and jurisdiction. Thus, FinCEN expects an investment adviser that is the primary adviser to a private fund or other unregistered pooled investment vehicle to

make a risk-based assessment of the illicit finance activity risks presented by the investors in such investment vehicles. To make these assessments, FinCEN recommends considering the minimum subscription amount, restrictions on investor types, restrictions on redemptions or withdrawals, and any currency transactions conducted with investors.

The risk-based approach of the Final Rule aims to provide investment advisers the flexibility to design their programs to meet the specific risks presented by their customers. The Final Rule does not require investment advisers to collect beneficial ownership information for legal entity investors.

Next steps for RIAs and ERAs

The Final Rule has wide-ranging implications for RIAs and ERAs. By requiring affected investment advisers to implement AML/CFT programs, FinCEN aims to close the gaps in the financial regulatory framework that have historically allowed for illicit financial activities. While many investment advisers have already voluntarily adopted Know-Your-Customer (KYC) procedures and AML/CFT programs to comply with industry best practices, FinCEN's formalization of such processes will require advisers to review the sufficiency of their procedures in light of the mandated minimum standards.

RIAs and ERAs should begin preparing now for the January 1, 2026 deadline, as compliance with the Final Rule will be a lengthy process and require meaningful consideration on a case-by-case basis. For investment advisers that already have robust AML/CFT programs, minimal to moderate effort may be required to ensure their procedures can be conformed to the Final Rule, but others will have to develop entirely new programs. The AML/CFT procedures currently employed by other financial institutions may not suffice for investment advisers to meet their new obligations. Consequently, it will be important for investment advisers to consult with their legal counsel and compliance consultants to ensure that their AML/CFT programs will withstand regulatory scrutiny.

While an investment adviser will be allowed to delegate all or parts of its AML/CFT operations to certain third-party service providers[2], such as fund administrators or broker-dealers, the investment adviser will still be fully responsible and liable for their program's compliance with FinCEN's Final Rule. Thus, it is imperative that affected investment advisers act now to prepare their AML/CFT programs and train their senior officers and employees on the new compliance requirements.

FOOTNOTES

To discuss these issues, please contact the author(s).