FinCEN Proposes to Regulate Investment Advisers under the Bank Secrecy Act

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The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a notice of proposed rulemaking on August 25, 2015 which, among other things, would add SEC-registered investment advisers to the "financial institutions" regulated under the Bank Secrecy Act (BSA). This represents another step by the U.S. government to expand the professions and industries deemed anti-money laundering (AML) gatekeepers. Covered investment advisers will face new AML program, reporting and record-keeping requirements, with implications for hedge, private equity and other funds; money managers; and public or private real estate funds.

FinCEN has long expressed an interest in regulating investment advisers, which it believes may be vulnerable to or may obscure money laundering and terrorist financing. Should the rule become final, SEC-registered investment advisers would be included in the regulatory definition of "financial institution" and, as a consequence, required to establish and implement appropriately comprehensive written AML programs and comply with a variety of reporting and recordkeeping requirements under the BSA. Investment advisers that already implemented AML programs would need to evaluate them to ensure they comply with BSA requirements.

Who are Covered "Investment Advisers"?

Investment advisers provide advisory services, such as portfolio management, financial planning, and pension consulting, to many different types of clients, including institutions, private funds and other pooled investment vehicles, pension plans, trusts, foundations and mutual funds. According to the proposed rule, an "investment adviser" would be defined as "[a]ny person who is registered or required to register with the SEC under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(a))."

The definition would cover all investment advisers, including subadvisers, subject to Federal regulation which, generally speaking, would include advisers that have $100 million or more in assets under

management. This includes investment advisers engaging in activities with publicly or privately offered real estate funds. Small- and medium-sized investment advisers that are state-registered and other investment advisers that are exempt from SEC registration requirements would not be captured by the proposed rule. FinCEN indicated, however, that future rulemaking may include those types of advisers.

AML Program Requirements

The proposed rule would subject investment advisers to many of the same requirements already in place for other forms of financial institutions captured under the BSA, which include:

- Implementing and maintaining a written anti-money laundering program that complies with certain minimum standards and is adapted to the investment adviser's business and clients on a risk-adjusted basis;
- Filing suspicious activity and currency transaction reports; and
- Creating and maintaining adequate records for each transmittal of funds greater than or equal to $3,000, and, if required, making certain that specified information regarding the transmittal is communicated to the next financial institution in the chain.

AML programs must be approved by the board of directors, general partners or persons with similar functions. Although AML compliance may be outsourced, FinCEN emphasizes that investment advisers will be responsible for the efficacy of their AML programs and for ensuring that FinCEN and the SEC are able to obtain records and information about the programs.

Significantly, the proposed rule *would not* require investment advisers to implement a customer identification program, which is currently mandatory for certain other financial institutions, such as banks. Investment advisers also would not be subject to rules proposed in 2014 by FinCEN addressing knowledge of beneficial ownership. As a practical matter, however, some form of customer identification program may be required in order to operate an effective AML program.

Reporting Requirements

Suspicious Activity Reports (SARs). Under the proposed rule, investment advisers would be obligated to report suspicious transactions involving $5,000 or more in cash or other assets by filing an SAR (voluntary reporting under this threshold also is permitted). The reporting requirement applies where the transactions are conducted or attempted by, at or through the advisers. Investment advisers would be obligated to report a transaction that they know, suspect or have reason to suspect (i) involves funds derived from illegal activity or is intended to hide funds or other assets derived from illegal activity, (ii) is designed to evade BSA requirements, (iii) has no business or apparent legal purpose or (iv) involves the use of investment advisers to facilitate criminal activity.

Currency Transaction Reports (CTRs). Under the proposed rule, investment advisers would be required to file a CTR for transfers of more than $10,000 in currency in any single business day by, through or to the advisers. However, the proposed rule requires investment advisers to treat multiple transactions as a single transaction if they have knowledge that the transactions are conducted by or on behalf of the same person. The CTR would replace reporting requirements on Form 8300; therefore, transactions involving negotiable instruments no longer would be required to be reported.

Investment advisers would not incur liability in connection with mandatory or voluntary reporting or any failure to disclose reporting. Importantly, investment advisers would not be permitted to inform clients when SARs are filed.

Recordkeeping and Travel Rules

The proposed rule would require investment advisers to create and retain records of certain funds transmittals in excess of $3,000, and to ensure that certain information pertaining to the transmittal of funds "travels" to the next financial institution (Recordkeeping and Travel Rules). Certain existing exceptions to the general Recordkeeping and Travel Rules would apply to investment advisers to permit them to be treated in a manner consistent with banks, securities broker-dealers, mutual funds and certain other financial institutions. Investment advisers also would have to create and retain records of extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities and credit.

SEC to Act as AML Regulator

FinCEN indicated it would designate the SEC as having primary oversight responsibility for these new AML requirements. Investment advisers already have compliance policies and procedures and recordkeeping systems that are mandated by the SEC, and many may be able to adapt these for AML purposes. SAR reporting, however, likely will present a new challenge, as will the risk-adjusted implementation of the AML program. Additional resources may need to be added, which could be costly to some firms.

Comment Period and Next Steps

Once the proposed rule is published in the *Federal Register*, interested stakeholders will have 60 days to comment on it. FinCEN has a record of listening closely to industry feedback and at times adjusting or slowing its proposed implementation. Impacted companies should consider submitting comments.

In fact, the proposed rule serves as FinCEN's second attempt to regulate investment advisers. In 2002 and 2003, FinCEN proposed rules that would have required certain registered and unregistered investment advisers and unregistered investment companies to establish and implement AML programs. However, both proposals were delayed and ultimately withdrawn in 2008 due to a lack of regulatory activity.

It will bear watching whether, and how quickly, FinCEN is able to implement the proposed rule. However, investment advisers should begin now to consider how AML regulation and reporting would impact their business and clients.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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