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Securities Alert

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New AML/SAR requirements for investment advisers

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FinCEN's Final Rule aims to safeguard the investment adviser sector from illicit financial activity by bad actors.

What's the impact?

- Certain registered investment advisers and exempt reporting advisers are added to the definition of "financial institution."
- The rule sets minimum standards for anti-money laundering and countering the financing of terrorism (AML/CFT) programs and requires that suspicious activity is reported to FinCEN.
- Financial services entities and professionals should prepare now to meet compliance standards by January 1, 2026.

On August 28, 2024, as part of ongoing efforts to combat illicit finance and protect U.S. national security, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a Final Rule to help safeguard the investment adviser sector from illicit finance. According to FinCEN, the rule delivers on key lines of effort outlined in the Biden-Harris administration's *U.S. Strategy on Countering Corruption*. The compliance date is January 1, 2026.

This rule aims to help address the illicit finance risks in the investment adviser sector in the United States, which the US Department of the Treasury documented in a February 2024 risk assessment. The risk assessment highlights numerous cases in which sanctioned persons, corrupt officials, fraudsters, and other criminals have exploited the investment adviser industry to access the US financial system and launder funds. Moreover, it finds that foreign states, most notably the People's Republic of China and the Russian Federation, leverage investment advisers and their advised funds through investment in early-stage companies to access certain technologies and services with national security implications.

"The Treasury Department has been hard at work to disrupt attempts to use the United States to hide and launder ill-gotten gains," said US Secretary of the Treasury Janet L. Yellen. "That includes by addressing our biggest regulatory deficiencies, including through these two new rules that close critical loopholes in the [US] financial system that bad actors use to facilitate serious crimes like corruption, narcotrafficking, and fraud. These steps will make it harder for criminals to exploit our strong residential real estate and investment adviser sectors."

This Final Rule adds certain registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to the definition of "financial institution" under the regulations that implement the Bank Secrecy Act (BSA), prescribes minimum standards for anti-money laundering and countering the financing of terrorism (AML/CFT) programs to be established by such RIAs and ERAs, requires RIAs and ERAs to report suspicious activity to FinCEN, and makes other related changes to FinCEN's regulations that implement the BSA.

How will the Final Rule impact advisers?

The main impact is the creation of a new, additional layer of requirements and costs for bringing in new investors for certain RIAs and ERAs. This is because the Final Rule adds certain RIAs and ERAs to the definition of "financial institution" under the BSA's implementing regulations, which include the requirement for a full national bank-style anti-money laundering (AML) program, with certain exclusions noted below:

- RIAs that register with the SEC solely because they are:
  - Mid-sized advisers (i.e., $25–100 million in AUM and are not required to be registered or examined as an adviser with their state security authority),
  - Multi-state advisers, or
  - Pension consultants.
- RIAs that are not required to report any AUM to the SEC on Form ADV.

For RIAs or ERAs that have a principal office and place of business outside the United States (defined in the Final Rule as "foreign-located investment advisers"), the Final Rule only applies to their advisory activities that (i) take place within the United States, including through the involvement of the investment adviser's US personnel, or (ii) provide advisory services to a US person or a foreign-located private fund with an investor that is a US. person. There is no requirement to have the responsible persons of the program be in the United States.

Going forward, covered RIAs and ERAs will need to consider their level of AML risk, as there will be higher costs and more regulatory scrutiny for higher-risk activities (e.g., those where an adviser attempts to and is unable to obtain identifying information about the investors).

What does an AML program entail for advisers?

The rule requires RIAs and ERAs to:

- Implement a risk-based and reasonably designed AML/combating the financing of terrorism (CFT) program;
- File certain reports, such as suspicious activity reports (SARs), with FinCEN;
- Keep certain records, such as those relating to the transmittal of funds (i.e., comply with the Recordkeeping and Travel Rules); and
- Fulfill certain other obligations applicable to financial institutions subject to the BSA and FinCEN's implementing regulations, such as special information-sharing procedures.

The AML/CFT program requires that resources be devoted where they are likely needed the most and provides for compliance under the Final Rule by allowing more limited measures to those customers or activities identified as lower risk. The AML/CFT program shall, at a minimum:

- Establish and implement 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 achieve compliance with the applicable provisions of the BSA and implementing regulations. Such procedures should encompass:
    - Verifying a client's identity during the account opening process by reference to differing factors depending on the type of client (e.g., Is enhanced due diligence required?). This should extend to beneficial ownership;
    - Comparing information provided by a client against government-maintained lists of criminal, terrorist, and sanctioned parties;
    - Safeguarding client information in accordance with applicable data privacy rules and notifying clients of the reason and purpose for collecting personal/sensitive information;
    - Maintaining and safeguarding records related to the above for a minimum of five years;
    - Conducting ongoing monitoring of client accounts or transactions involving the RIA or ERA (relating to those clients) for suspicious activity through the use of "red flags," such as unusual money movements or unnecessarily unwinding transactions at a loss;
    - Reporting any escalation of suspicious activity to the relevant party internally and filing applicable reports to external bodies (e.g., SARs);

  - Ensuring internal confidentiality amongst persons handling any SAR, CTR or other anti-money laundering filings;
  - Ensuring appropriate supervision of staff to prevent breaches (e.g., tipping off); and
  - Annually revaluating such procedures and seeking external assistance to test AML/CFT procedures.

- Provide for independent compliance testing to be conducted by the investment adviser's personnel or by a qualified outside party;
- Designate a person or persons responsible for implementing and monitoring the operations and internal controls of the program;
- Provide ongoing training for appropriate persons; and
- Implement appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
  - Understanding the nature and purpose of customer relationships to develop a customer risk profile and
  - Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, maintain and update customer information.

The Final Rule includes several exclusions that endeavor to tailor the requirements to minimize the potential burden from duplication of existing AML/CFT measures while pursuing transparency initiatives to safeguard the US financial system and national security. For example, the rule permits an investment adviser to exclude from its obligations (i) any mutual fund advised by the investment adviser (without obligating the adviser to verify that the mutual fund has implemented an AML/CFT program), (ii) bank-and-trust-company-sponsored collective investment funds, and (iii) any other investment adviser subject to the Final Rule advised by the investment adviser.

FinCEN will permit an investment adviser to delegate contractually the implementation and operation of some or all aspects of its AML/CFT program to a third-party provider, including a fund administrator. However, if an investment adviser delegates the implementation and operation of any aspects of its AML/CFT program, the investment adviser will remain fully responsible and legally liable for and be required to demonstrate to examiners the program's compliance with AML/CFT requirements and FinCEN's implementing regulations.

The investment adviser will also be required to ensure that FinCEN and the SEC are able to obtain information and records relating to the AML/CFT program. The investment adviser would still need to identify and document the procedures appropriate to address its vulnerability to money laundering and terrorist financing and then undertake reasonable steps to assess whether the service provider would carry out such procedures effectively. For example, it would not be sufficient to simply obtain a certification from a service provider that the service provider "has a satisfactory anti-money laundering program." This means it is not permissible to simply rely on an intermediary-covered institutions.

Will these AML programs mean new costs for advisers?

Yes, covered investment advisers may have to set up new compliance programs as discussed above (e.g., if they are not already required to have an AML/CFT program due to being broker-dealer registered or affiliated). Even if an RIA or ERA had a pre-existing AML/CFT program, there would be additional costs to ensure compliance with the new rule, as it will now cover investment advisory clients that were not broker-dealer clients. There is an estimated cost breakdown in the Final Rule. As a whole, the industry received some reprieve in the exemptions FinCEN provided.

Notably, the AML/CFT requirements in this rule are designed to be risk-based, and so their cost will vary with the size of the business and the risk level of the business's advisory activities and customers.

Smaller advisers would be expected to adopt AML/CFT programs consistent with their (often) simpler, more centralized organizational structures, and so would be more likely to have lower implementation-related costs, absent other high-risk attributes for illicit finance risks.

How will advisers react to this new rule?

While many advisors may be on board with the new rules, others may feel as if the Treasury is reaching. But as a whole, these rules seem more likely to avoid legal challenges even though they impact ERAs. This is because of the authority used to issue them under the BSA and the background of national security concerns. Nixon Peabody's securities lawyers regularly counsel clients on compliance and reporting obligations, and we can help financial services entities and professionals understand their requirements in advance of the 2026 compliance date.

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