

# Regulatory Alert

## Regulatory Insights for Financial Services

February 2024

### Financial Crimes & AML: FinCEN Proposal and Treasury Actions

#### **KPMG Insights:**

- **“Closing the Gap”:** Expanding regulatory perimeter to “close the gap” in regulatory coverage and further mitigate potentially illicit finance risks through the investment adviser industry, including advisers to private funds.
- **AML/CFT/BSA Focus:** Expanding breadth/depth of supervisory, enforcement, and evolving regulatory expectations focused on AML/CFT/BSA requirements aligned with emerging threats and vulnerabilities (e.g., beneficial ownership reporting, CDD).
- **National Security Ties:** Treasury risk assessments identify illicit finance risks as a “common thread” across threats to national security.

Furthering efforts to combat illicit finance threats, vulnerabilities, and risks, the Department of the Treasury (Treasury) and its Financial Crimes Enforcement Network (FinCEN) each take action, including:

- A FinCEN proposal to “keep criminals and foreign adversaries from exploiting the U.S. financial system and assets through investment advisers.” FinCEN states the proposal complements other recent actions to prevent illicit finance risks from anonymous companies and all-cash real estate transactions (see KPMG Regulatory Alert, [here](#)).
- Four Treasury Risk Assessment reports, including one for the investment adviser sector, which provide updated information on the illicit finance environment and changes to the Anti-Money Laundering (AML)/ Countering the Financing of Terrorism (CFT) framework.

focus in areas such as Bank Secrecy Act (BSA), AML/CFT, Know Your Customer (KYC)/Customer Due Diligence (CDD), and suspicious activity detection will continue along with attention to continuously assessing risk and implementing risk-based compliance programs. (See KPMG Regulatory Alert [here](#)).

#### **FinCEN Proposed Rule for Investment Advisers**

FinCEN issues a [notice of proposed rulemaking](#) (NPRM) that would impose AML/CFT program and suspicious activity reporting requirements on certain investment advisers. FinCEN is seeking to “close the gap” in terms of regulatory coverage and further mitigate potentially illicit finance risks within the investment adviser industry. The proposed rule would apply to “investment advisers” that are Registered Investment Advisers (RIAs) and Exempt Reporting Advisers (ERAs), including investment advisers to private funds.

With the continuous evolution of sophisticated financial crime patterns, regulators are committed to providing guidance and support for institutions to effectively manage and mitigate financial crime risks. Regulatory

**Definitions.** FinCEN proposes to amend/add the following definitions:

- Financial Institution: amend the definition of "Financial Institution" in 31 CFR 1010.100(t) to include "Investment Adviser."
- Investment Adviser: add a definition of "Investment Adviser" to 31 CFR 1010.100 to include:
  - RIAs - Any person who is registered or required to register with the SEC under section 203 of the Advisers Act (15 U.S.C. 80b-3(a)), which includes investment advisers with more than \$110 million in assets under management (AUM) (unless eligible to rely on an exception).
  - ERAs - Any person that is exempt from SEC registration under section 203(l) or 203(m) of the Investment Advisers Act, which includes investment advisers that i) advise only private funds and have less than \$150 million AUM in the United States, or ii) advise only venture capital funds.
- Correspondent account: amend the definition of "account" in § 1010.605(c) as applied to the meaning of "correspondent account" to include for investment advisers "any contractual or other business relationship established between a person and an Investment Adviser to provide advisory services".
- Covered financial institution: add Investment Advisers to the definition of "covered financial institution." Note: This amendment would subject Investment Advisers to FinCEN's rules implementing special standards of due diligence for correspondent accounts established or maintained for foreign financial institutions and private banking accounts established or maintained for non-U.S. persons. See additional discussion below.
- Suspicious Activity Reports (SARs) detailing suspicious transactions involving or aggregating at least \$5,000 in funds or other assets (consistent with BSA requirements for financial institutions) as well as any suspicious transaction relevant to a possible violation of law or regulation.
- Comply with the Recordkeeping and Travel Rules (31 CFR 1010.410(e) and 31 CFR 1010.410(f), respectively), which require creating and retaining records for the transmittal of funds and passing certain information pertaining to the transaction on to the next financial institution in the payment chain, subject to some exceptions.
- Participate in FinCEN's information-sharing program under section 314 of the USA PATRIOT Act (i.e., between and among FinCEN, law enforcement, agencies, and certain financial institutions).
- Implement special due diligence requirements for correspondent and private banking accounts under section 312 of the USA PATRIOT Act, and comply with "special measures" under sections 311 of the USA PATRIOT Act and 9714(a) of the Combatting Russian Money Laundering Act related to a "primary money laundering concern".
- Fulfill other obligations applicable to financial institutions subject to the BSA and FinCEN's implementing regulations.

The proposal would not:

- Require investment advisers to apply AML/CFT program or SAR report requirements to mutual funds (which are currently identified as "financial institutions" under the BSA and 31 CFR 1010.100(t)).
- Include a customer identification program (CIP) requirement or an obligation for investment advisers to collect beneficial ownership information for legal entity customers. FinCEN states it will address each of these requirements through future rulemakings.
- Cover State-registered investment advisers.

**Proposed Requirements.** The proposal would require investment advisers to:

- Develop and implement a board-approved risk-based AML/CFT program applicable to all advisory activities.
- File reports with FinCEN, including:
  - Currency Transaction Reports (CTRs) for a transaction or series of transactions conducted in one day involving the transfer of more than \$10,000 in currency by, to, or through the investment adviser (the existing requirement to file Form 8300 when the investment adviser received more than \$10,000 in cash and negotiable instruments would be removed).

**Examination Authority.** In line with FinCEN's existing delegation of authority to the SEC for examining brokers, dealers, and mutual funds regarding compliance with the BSA and FinCEN's implementing regulations, the proposed rule intends to assign the SEC the authority to examine investment advisers' compliance with AML/CFT requirements.

**Comment period.** Under the proposed rule, an investment adviser would be required to develop and implement an AML/CFT program on or before the date

that is twelve months after the effective date of the final rule. FinCEN seeks comment on the proposed AML/CFT requirements for investment advisers by April 15, 2024.

## Treasury Actions

As part of an ongoing review of the U.S. AML/CFT framework and illicit finance risk environment, Treasury publishes four new Risk Assessment reports that inform its rulemaking activities.

1. [2024 Investment Adviser Risk Assessment](#): Concurrent with the release of the FinCEN proposal for investment advisers, the Treasury issues its 2024 Investment Adviser Risk Assessment report. The report identifies illicit finance threats and vulnerabilities in the sector, including the “uneven application” of AML/CFT requirements. Notably, the assessment finds that “the highest illicit finance risk in the investment adviser sector is among ERAs (who advise private funds exempt from SEC registration), followed by RIAs who advise private funds, and then RIAs who are not dually registered as, or affiliated with, a broker-dealer (or is, or affiliated with, a bank).
2. [2024 National Money Laundering Risk Assessment](#): The report finds the U.S. faces both persistent and emerging money laundering risks related to: (1) the misuse of legal entities; (2) the lack of transparency in certain real estate transactions; (3) the lack of comprehensive AML/CFT coverage for certain sectors, particularly investment advisers; (4)

complicit merchants and professionals that misuse their positions or businesses; and (5) pockets of weaknesses in compliance or supervision at some regulated U.S. financial institutions.

3. [2024 National Terrorist Financing Risk Assessment](#): Identifies the complexity of the international security environment and particular terrorism threats to the U.S. as well as “other major security threats” that may impact the current terrorism landscape, including international challenges such as “humanitarian crises, international health concerns, and rapidly emerging or evolving technologies with the potential to disrupt traditional business and society”.
4. [2024 National Proliferation Financing Risk Assessment](#): Identifies proliferation financing (PF) threat actors that pose a risk to the U.S. and actions that U.S. authorities have taken to mitigate gaps in Anti-Money Laundering, Combating the Financing of Terrorism and Combating Proliferation Financing (AML/CFT/CPF) frameworks.

Treasury states that these risk assessments directly inform its 2024 National Strategy for Combatting Terrorist and Other Illicit Finance, which is expected to be released “in the coming weeks”.

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