Lowenstein Sandler

Client Alert

Anti-Money Laundering

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Investment Advisers Prepare: The BSA is Here

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On August 28, the United States Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a final rule (the "Final Rule") subjecting certain registered investment advisers (RIAs) and exempt reporting advisers registered with the Securities and Exchange Commission (SEC) (ERAs; collectively with RIAs, Investment Advisers)[1] to the anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements of the Bank Secrecy Act and its amendments (BSA).[2] Investment Advisers that are subject to the BSA under the Final Rule have until January 1, 2026, to implement and operationalize a BSA compliance program (the "Compliance Date").

While the Final Rule is substantially in conformity with the notice of proposed rulemaking (BSA NPRM) issued by FinCEN in February,[3] it does differ in a number of key ways. The following are highlights from the Final Rule that Investment Advisers should be aware of for implementation of the BSA into their policies and procedures:

Definition of "Investment Adviser" for the purposes of the BSA

Unlike the BSA NPRM, which would have made all RIAs subject to the BSA, the Final Rule specifically excludes the following types of RIAs[4] from the definition of "financial institution"[5]:

- RIAs that register with the SEC solely as any of the following:
  - Midsize advisers
  - Multistate advisers
  - Pension consultants
- RIAs that do not report any assets under management on their Form ADV, i.e., they do not manage client assets as part of their advisory activities.

Thus, RIAs that fall within any of the excluded categories will not be subject to the BSA under the Final Rule. However, to the extent that an RIA's status changes in such a way that it is no longer exempt, that RIA will become subject to the BSA as of its next annual Form ADV filing.

Notwithstanding the foregoing, the Final Rule includes all ERAs pursuant to Sections 203(l) and 203(m) of the Investment Advisers Act of 1940. Additionally, for RIAs that have their principal place of business outside of the U.S., the BSA will only apply to activities that (A) take place within the U.S. (including through involvement of employees of the Investment Adviser who are U.S.-based) or (B) provide advisory services to a U.S. client. Importantly, if a non-U.S. private fund has one or more U.S. investors, directly or indirectly, the BSA will apply to that fund even Investment Adviser is a non-U.S. Investment Adviser.

Establishment of a BSA-compliant AML/CFT program

The Final Rule requires Investment Advisers to expand, as needed, their currently existing AML/CFT programs to conform to the BSA's regulatory requirements,[6] which include the implementation of a written AML/CFT program that

is (A) risk-based and (B) reasonably designed to prevent the Investment Adviser from being exploited by money launderers or other illicit actors. The BSA requires AML/CFT programs to, at a minimum, include the following elements: (1) policies, procedures, and internal controls designed to counter money laundering and terrorist financing; (2) independent testing of the AML/CFT program by a qualified internal or external party on a periodic basis; (3) designation of a person or persons responsible for implementing and monitoring the AML/CFT program; (4) provisions for ongoing training for applicable individuals employed or contracted by the Investment Adviser; and (5) ongoing customer due diligence (CDD) of customers and transactions as required by the USA PATRIOT Act (the "CDD Rule"). FinCEN emphasizes in the Final Rule that AML/CFT programs will expectedly vary based on the size and complexity of each Investment Adviser's business. At minimum, Investment Advisers will need to implement and operationalize a BSA compliance program by January 1, 2026.

Customer Identification Program (CIP)

Specifically regarding the CIP requirements under the CDD Rule, the Final Rule references the joint notice of proposed rulemaking issued by FinCEN and the SEC regarding CIP requirements for Investment Advisers (the CIP NPRM).[7] In the CIP NPRM, FinCEN and the SEC propose permitting Investment Advisers to rely on other financial institutions (including but not limited to certain custodians and administrators) to satisfy its CIP requirements under the CDD Rule subject to certain conditions. When the final rule related to the CIP NPRM is issued, FinCEN intends for the CIP final rule to also be effective as of the Compliance Date.

Regarding exclusions to the AML/CFT program, the Final Rule excludes any activities that the Investment Adviser undertakes in advising mutual funds from the foregoing AML/CFT program requirements, and Investment Advisers will not need to verify that the mutual fund has implemented an AML/CFT program. In addition, the Final Rule expanded the exclusion to also include (A) bank or trust company-sponsored collective investment funds that meet certain requirements and (B) any Investment Adviser also subject to the Final Rule that is advised by another in-scope Investment Adviser.

FinCEN also reiterated in the Final Rule that any Investment Adviser that is already subject to the BSA through a different licensing scheme can rely on the preexisting AML/CFT program as long as the existing program comprehensively covers the relevant activity of the Investment Adviser. Similarly, if an Investment Adviser is a subsidiary or affiliate of a financial institution already subject to the BSA, the financial institution can elect to extend its existing AML/CFT program to all affiliated Investment Adviser entities subject to the BSA, provided that the existing program addresses the Investment Adviser's relevant activity.

Suspicious Activity Report (SAR) Filings

The Final Rule now requires that any Investment Advisers subject to the BSA file SARs for any suspicious activity that could demonstrate violation or attempted violation of applicable laws and regulations. Specifically, the Investment Adviser will have to file a SAR for any transaction involving (or group of transactions aggregating to) at least $5,000 by, at, or through the Investment Adviser that the Investment Adviser knows, suspects, or has reason to suspect involves funds from illegal activity or is potentially structured to avoid transaction reporting. FinCEN notes in the Final Rule that this filing obligation is only applicable after the Compliance Date and Investment Advisers are not expected to perform a lookback to activity that occurred prior to the Compliance Date. Importantly, as is the case currently, SAR filings are strictly confidential and must be handled on a limited need-to-know basis within the organization making the SAR filing, and there are potential criminal consequences for "tipping off" the party about whom a SAR filing is being made.

Recordkeeping Provisions

The Final Rule mirrors the BSA NPRM with respect to recordkeeping requirements to be imposed on Investment Advisers. Investment Advisers will now be required to comply with the Recordkeeping and Travel Rules[8] codified in the BSA. This entails keeping records of any fund transmissions (e.g., documentation indicating the name, address, and other information about the transmitter, recipient, and transaction) equal to or exceeding $3,000. The same exemptions that apply to other BSA-compliant entities would apply to Investment Advisers, including where the customer has a direct account relationship with a qualified custodian that is subject to AML/CFT requirements. In addition, under the Final Rule, Investment Advisers will now report transactions in currency over $10,000 using a Currency Transaction Report instead of a Form 8300.

Information Sharing with Other Financial Institutions and Law Enforcement

The Final Rule subjects Investment Advisers to the information-sharing provisions of the BSA (i.e., Sections 314(a) and 314(b) of the USA PATRIOT Act).[9] This requires Investment Advisers to share information about suspected terrorist or money laundering activities with law enforcement and voluntarily share information with other covered financial institutions, with a safe harbor from liability. Notably, the Final Rule differs from the BSA NPRM, as the Final Rule permits Investment Advisers to exclude mutual funds, collective investment funds sponsored by a bank or trust company subject to the BSA, and any other Investment Adviser subject to the Final Rule that is advised by the Investment Adviser.

While the Compliance Date is more than a year away, we encourage Investment Advisers to become familiar with the Final Rule to make any applicable changes required to their AML/CFT programs. Our prior Client Alert[10] discusses AML best practices for private fund managers. Lowenstein will be monitoring further developments to the Final Rule and is available to assist our clients with implementing the necessary changes. For any questions about this Client Alert or the Final Rule, please contact the authors at LSAMLTeam@lowenstein.com.

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[1] As defined by the Investment Advisers Act of 1940, 31 U.S.C. 80b-1 *et seq.*

[2] "FinCEN Issues Final Rules to Safeguard Residential Real Estate, Investment Adviser Sectors from Illicit Finance," available at https://www.fincen.gov/news/news-releases/fincen-issues-final-rules-safeguard-residential-real-estate-investment-adviser. For the full NPRM, *see* https://www.federalregister.gov/public-inspection/2024-19260/anti-money-launderingcountering-the-financing-of-terrorism-program-and-suspicious-activity-report.

[3] For more information on the NPRM and Lowenstein's prior coverage on regulatory attempts to add investment advisers to the definition of "financial institution" under the BSA, see "Investment Advisers Beware: The BSA Is Coming (Maybe)," available at https://www.lowenstein.com/news-insights/publications/client-alerts/investment-advisers-beware-the-bsa-is-coming-maybe-aml; *see also* "U.S. Treasury Renews Push to Make Investment Advisers Subject to the BSA," available at https://www.lowenstein.com/news-insights/publications/client-alerts/us-treasury-renews-push-to-make-investment-advisers-subject-to-the-bsa-aml.

[4] *Id.* at fn 1.

[5] *See* 31 CFR §1010.100(t).

[6] *See* 31 U.S.C. 5318(h)(1)-(2).

[7] *See* "Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers," available at https://www.federalregister.gov/documents/2024/05/21/2024-10738/customer-identification-programs-for-registered-investment-advisers-and-exempt-reporting-advisers. For Lowenstein's Client Alert on the CIP NPRM, *see* "SEC and FinCEN Propose Customer Identification Obligations for Investment Advisers," available at https://www.lowenstein.com/news-insights/publications/client-alerts/sec-and-fincen-propose-customer-identification-obligations-for-investment-advisers-aml. Note that the comment period for the CIP NPRM closed on July 22.

[8] 31 CFR 1010.410(e)-(f).

[9] Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Public Law 107-56.

[10] *See* "AML Best Practices for Private Fund Managers: The Prudence of Establishing an AML Compliance Program," 2023.02.17, available at https://www.lowenstein.com/news-insights/publications/client-alerts/aml-best-practices-for-private-fund-managers-the-prudence-of-establishing-an-aml-compliance-program-investment-management.

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