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### U.S. Treasury Renews Focus on AML Risks for Investment Advisors



In a May 25, 2022 speech at the annual Securities Industry and Financial Markets Association ("SIFMA") Anti-Money Laundering ("AML") and Financial Crimes Conference, Brian E. Nelson, the Under Secretary for Terrorism and Financial Intelligence at the U.S. Department of the Treasury ("Treasury"), described ongoing, government-wide efforts to identify and confront money laundering threats to the American financial system.

Of particular note, Under Secretary Nelson emphasized "money laundering risks associated with investment advisers" and revived a long-running debate about whether investment advisers should become subject to the Bank Secrecy Act ("BSA") and its attendant AML compliance and reporting requirements. Following his remarks, the continued viability of what some describe as a loophole in the current BSA/AML framework appears in doubt.

#### **Investment Advisers in the Crosshairs**

It is perhaps unsurprising that Under Secretary Nelson took the opportunity at the SIFMA conference to discuss investment advisers and the fact that they stand virtually alone among financial institutions that are not subject to BSA/AML requirements - a perennial criticism of the U.S. framework. The concern is all the more timely given rising fear of manipulation of the U.S. financial system by Russian oligarchs seeking to hide assets and evade sanctions.

Under Secretary Nelson pointedly announced a targeted review of investment adviser AML/CFT risks and explained that the Treasury is taking a fresh look at requiring investment advisers to meet the same standards as banks and broker-dealers, including a potential revival of the proposal to subject investment advisers to the BSA/AML compliance and reporting requirements that apply to other types of financial institutions. This comes as the latest in a series of statements regarding the risks presented by investment advisers.

For example, in February, the [2022 National Risk Assessments on Money Laundering](#) ("NMLRA") highlighted core risks related to the lack of AML/CFT obligations for investment advisers. While identifying "Entities Not Subject to Comprehensive AML/CFT Requirements," the [NMLRA](#) focused on "Investment Advisers and Private Investment Vehicles" and identified three major weaknesses:

- RIA's use of third-party custodians creates a wall segmenting the advisory functions of the RIA's business from the actual movement or transfer of client funds;
- RIAs who manage private funds commonly rely on third-parties that may be off-shore, with certain laws preventing U.S. access to certain key information, to perform compliance with core AML/CFT requirements on behalf of the RIA; and
- Current federal and state investment advisory regulatory requirements are not designed to address money laundering and terrorist financing risks.

Then, in May 2022, Treasury published the [2022 National Strategy for Combating Terrorist and Other Illicit Financing](#), a roadmap to close regulatory gaps that were being exploited by criminals, again citing increased transparency and addressing oversight gaps relating to investment advisers as a key priority.

Investment adviser money laundering risks have also received increasing media attention, with several recent articles in major newspapers spotlighting the involvement of U.S. financial advisers, hedge funds and private equity firms in managing assets suspected to be owned by Russian oligarchs (as well as other individuals raising enhanced money laundering risks).

### **Reviving the Long-Anticipated RIA Rule**

For years, federal authorities have expressed concern with the money laundering risks associated with investment advisers in the private investment fund industry largely due to the fact that investment advisers are not currently required to maintain AML/CFT compliance programs under the BSA or file suspicious activity reports ("SARs"). While it has long been best practice for investment advisers to maintain AML/CFT programs, the fact remains that the absence of mandatory compliance has left the industry vulnerable. As the 2022 NMLRA identified, this lack of regulation results in: (1) inconsistent standards among the various investment advisers, and (2) a segmented industry with limited transparency.

Recognizing that investment advisers were at risk of being used by money launderers, terrorist financiers, and other bad actors to fund illicit activity, in 2015, FinCEN attempted to close the gap by issuing proposed regulations ("[Proposed Rule](#)") requiring SEC-registered investment advisers to have a reasonably designed AML program setting out policies and procedures, providing for independent testing, designating an AML Officer and implementing ongoing AML training. Additionally, the Proposed Rule would have imposed an obligation on investment advisers to monitor client and investor accounts for suspicious activity and file SARs with the authorities. Importantly, for entities subject to BSA/AML obligations, the failure to meet these standards can result in significant liability, including potential criminal liability for willful failures. However, the Proposed Rule was never finalized; thus, investment advisers continue to operate without formalized BSA/AML compliance and reporting obligations.

Under Secretary Nelson's recent statement signaled the government's renewed interest in bringing investment advisers under the BSA, outlining an "information-gathering effort" to better understand whether rulemaking is necessary. He added that FinCEN is working with law enforcement, the SEC, FINRA, and the industry itself to examine the risk landscape and current vulnerabilities. The Under Secretary emphasized that enhancing transparency within the industry is critical priority across interested agencies.

### **What's Next?**

Under the current circumstances, it seems likely that the Proposed Rule will be finalized in some form. While many major firms already substantially comply with BSA/AML standards, the rule will bring uniformity - as well as regulatory examination - to bear on the industry's approach to compliance. In addition, bringing investment advisers under the BSA will equip law enforcement with additional tools to investigate—and prosecute—money laundering involving U.S.-managed investments, by providing the ability to pursue investment advisers for violation of their BSA/AML obligations in circumstances where money laundering involving assets under their management is detected or suspected.

In this context, investment advisers industry-wide would be wise to re-assess their AML compliance procedures to ensure that their policies and procedures are:

- Well-tailored to the risks their activities raise, including with respect to geographies implicated by their investors and investments and the structure of their operations/organization;
- Meet current regulatory compliance expectations, including those set out in DOJ's guidance on Evaluation of Corporate Compliance Programs; and
- Continuously monitoring relevant regulatory advisories, particularly the Office of Foreign Assets Control (OFAC) and FinCEN, and incorporating that guidance into their compliance procedures and risk assessments where appropriate.

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