Is Your RIA Firm Ready for the New AML Rule?

By Alan Abel, CPA, CFF, CFE, and Meghan C. Burns, J.D., CAMS
In all likelihood, the federal government is about to increase its scrutiny of a financial services sector that drug traffickers, terrorists, and other criminals might use to launder money. In 2015, the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury, proposed a rule requiring certain investment advisers – including those registered with the Securities and Exchange Commission (SEC) – to establish anti-money laundering (AML) programs and adhere to reporting requirements similar to those required of banks, broker-dealers, mutual funds, and insurance organizations.

The rule would bring registered investment advisers (RIAs), including private equity fund and hedge fund advisers, under the umbrella of “financial institutions” covered by the Bank Secrecy Act; require them to file currency transaction reports (CTRs) and suspicious activity reports (SARs); and enforce recordkeeping requirements related to the transmittal of funds. The rule would not apply to exempt reporting advisers currently not required to register with the SEC. However, an expansion of the scope could eliminate these exemptions from the final rule. In addition, FinCEN would delegate to the SEC the authority to examine compliance with the final rule.

FinCEN hopes the actions mandated by the rule will mitigate potential money laundering vulnerabilities in the U.S. financial system while aligning investment advisers to the standard of AML compliance required of banks, broker-dealers, mutual funds, and insurance organizations. “Investment advisers are on the front lines of a multi-trillion-dollar sector of our financial system,” FinCEN Director Jennifer Shasky Calvery said when announcing the notice of proposed rulemaking on Aug. 25, 2015. “If a client is trying to move or stash dirty money, we need investment advisers to be vigilant in protecting the integrity of their sector.”

What RIAs Would Need to Do

Under the proposed rule, RIAs would need to establish a formal, written BSA/AML compliance program approved by their board of directors.

Banks were among the first financial services organizations to be subject to BSA/AML regulations. RIAs would be expected to use the conventional “four pillars” of BSA/AML compliance, the standard approach that BSA-covered financial services organizations follow when creating their own industry-specific programs. The four pillars are:

1. A strong system of internal controls to foster and confirm ongoing compliance
2. The designation of an individual or individuals responsible for managing BSA/AML compliance
3. Independent testing of BSA/AML compliance
4. BSA/AML training for boards, covered employees, and contractors
As proposed, a BSA/AML compliance program should cover all aspects of an RIA’s advisory activities, including those that the RIA performs, either directly or through subadvisers – such as client asset management, pension consulting, research reports, financial planning, and services to real estate funds.

When developing their programs, RIAs might want to refer to the SEC’s Anti-Money Laundering Source Tool for Broker-Dealers. The tool provides links to many useful resources, and its structure provides an idea of how the SEC looks at AML compliance during examinations. (Although the tool can be a valuable resource for RIAs, the SEC points out that it is not comprehensive and that AML laws, rules, and orders are subject to change.)

Banks use guidance provided by the Federal Financial Institutions Examination Council (FFIEC), which describes these program elements in detail in its BSA/AML Examination Manual. Although the SEC would be charged with examining compliance if the proposed rule becomes final, the FFIEC’s examination manual offers substantive guidance and would be an additional valuable resource for RIAs assessing and developing their BSA/AML compliance programs.

The road to compliance is likely to be easier for RIAs that own broker-dealers, or are part of larger organizations that own broker-dealers, because broker-dealers are already required to have AML programs in place under the Financial Industry Regulatory Authority’s Rule 3310. Known as “dual broker-dealers” or “hybrid RIAs,” these firms experienced nearly 15% growth in assets managed between 2008 and 2013, just below the rate of stand-alone RIAs. Although these firms would need to adapt their existing broker-dealer AML programs to comply with FinCEN’s new rule, they are likely to be ahead of many of their competitors.

SARs and More

The classification of RIAs as financial institutions for AML purposes would impose additional reporting and recordkeeping requirements. If FinCEN’s proposed rule goes into effect, RIAs would be required to file CTRs and SARs with the agency. RIAs would have to file SARs within 30 days of becoming aware of suspicious transactions of at least $5,000 in funds or other assets. In addition, RIAs would be required to notify law enforcement by telephone of certain SARs and retain SAR documentation for five years from the filing date.

RIAs would be required to file CTRs instead of IRS Form 8300, “Report of Cash Payments Over $10,000 Received in a Trade or Business.”

RIAs would also have to create and retain records for certain fund transmittals and see that key transaction details travel with the order as it moves from firm to firm, thus minimizing the opportunity for money laundering. In addition, they would be required to report cross-border transactions – including extensions of credit and transfers of currency, monetary instruments, checks, investment securities, and credit – greater than $10,000.
Other Possible Requirements

As FinCEN works to finalize the AML rule, there is a possibility that the agency will revise its proposal to include additional requirements, such as a customer identification program, customer due diligence provisions, and compliance with certain requirements of the USA PATRIOT Act. It’s also possible that subsequent regulations will expand the scope of the AML final rule.

Any RIA that has not already done so is advised to thoroughly review the proposed rule and stakeholder comment letters received by FinCEN as well as to monitor the status of the proposal. A comprehensive assessment and gap analysis of the current state of its AML program would give an RIA an early jump on developing and implementing its BSA/AML program. Further, as a best practice, an RIA would be expected to tailor its program to its particular client base, business model, and business risk.

The proposed rule requires compliance within six months of finalization of the rule, while comment letters are encouraging FinCEN to consider an 18-month implementation of the rule, given the complexity of implementing such programs. Regardless of the timeframe, it is prudent to begin the process early of assessing the current state, gaps, and resource requirements to remediate those gaps and allow time to address issues rather than be forced to overextend resources to launch a mandated program.

Whether based on prudent business practice or required due to agreement with their broker-dealer, many RIAs already have an AML program in place. For those that do not, it is time to begin developing one.

1 Generally, advisers with $100 million or more in assets under management are required to register with the SEC.