Statement

Comment on FinCEN's AML/CFT Program and SAR Filing for Registered Investment Advisers and Exempt Reporting Advisers Proposal

Commissioner Hester M. Peirce

April 12, 2024

Re: FINCEN–2024–0006 and RIN 1506–AB58; Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers.

Dear Director Gacki:

The Financial Crimes Enforcement Network (FinCEN), the Treasury bureau responsible for administering the Bank Secrecy Act (BSA), once more has proposed to subject certain investment advisers to a range of anti-money laundering/countering the financing of terrorism (AML/CFT) regulations.[1] Eight and a half years have gone by since FinCEN's last proposal, so one would assume that the case for revisiting this initiative after so many years would be strong. Because it is not, I submit this comment in opposition to this proposal.

None of the justifications offered in support of this latest proposal is convincing or compelling. One concern is that registered investment advisers (RIAs) and exempt reporting advisers (ERAs) are an entry point for financial criminals and/or hostile state actors because they lack minimum standards for AML/CFT programs and need not report suspicious activity to FinCEN.[2] In a vacuum, this concern might hold water, but broker-dealers, mutual funds, futures commission merchants, and banks are all subject to the full panoply of BSA requirements. It is hard to conceive of an adviser-related activity that would not fall within the regulatory ambit of some or all of those covered financial institutions. The regulatory gap described, therefore, is more optical than substantive; closing it amounts to little more than grade-grubbing.[3]

The Proposal is thin on actual examples of RIAs serving as gateways to illicit activity. If the identified gap is really a problem, after so many years we should have a wide array of examples of how advisers were used by

financial criminals. Instead, the threat unregulated RIAs pose to our national security and financial system seems to be largely notional. For example, a 2024 Treasury analysis cited in support of imposing BSA obligations on RIAs and ERAs, indicates that "15.4 percent of RIAs and ERAs were associated with or referenced in at least one [Suspicious Activity Report (SAR)]."[4] Further, FinCEN explains that "the number of SAR filings associated with an RIA or ERA increased by approximately 400 percent between 2013 and 2021—a disproportionately higher increase than the overall increase in SAR filings, which was approximately 140 percent."[5] To be meaningful, however, those numbers need context, which the Proposal lacks. How many reports are actually in question? How many of the number are mentions of an adviser in a SAR narrative?[6] Moreover, as the "S" in S-A-R indicates, what is being reported on these forms is a reporting entity's *suspicion* that something may be amiss in a transaction; it is not proof and may reflect the filer's self-protective instinct, rather than a real suspicion of any wrongdoing.[7]

The Proposal's specific examples of adviser-related financial crime prove little. One of the leading examples — a private equity fund being used to launder criminal proceeds—involved an adviser *complicit* in the illegal activity.[8] The Proposal acknowledges that the adviser was actively engaged in the crime, but still treats this as evidence that, absent these proposed rules, otherwise innocent advisers might accidently facilitate financial crime.[9]

In another example, funds stolen from the Malaysian government were used to acquire a minority interest in a US private equity firm.[10] The funds "were moved through multiple accounts owned by different entities on or about the same day" to conceal their origin.[11] The Proposal accurately describes the transfers as "unnecessarily complex [] with no apparent business purpose,"[12] and argues that the way to prevent certain advisers from being used as conduits for dirty money in such circumstances is to require them to "determine the source of wealth and purpose for a customer."[13] FinCEN oversells the necessity of the proposed rules by downplaying that these malefactors were caught, perhaps because of the existing BSA rules for banks. Accordingly, before it adds yet another level of redundancy to the already multi-layered AML/CFT regulatory regime, FinCEN must do more than contend that the lack of omniscience equates to unacceptable vulnerability.[14]

The proposed rules would impose yet more costs on RIAs already staggering under the weight of two years of SEC regulatory excesses, along with new mandates from other regulators. I am particularly worried about how these new rules could affect smaller advisers, especially with a wholly unreasonable proposed compliance date of twelve months.[15]

I urge FinCEN to be mindful of the detrimental effect these proposed rules would have on adviser costs—especially for smaller advisers. If FinCEN decides to move forward with this Proposal, which I urge it not to do, please be open to commenter suggestions on how to reduce the scope of the rules to reflect actual, demonstrable risk.

Sincerely,

Hester M. Peirce
Commissioner

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[1] *See* Financial Crimes Enforcement Network: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 12108 (Feb. 15, 2024), https://www.govinfo.gov/content/pkg/FR-2024-02-15/pdf/2024-02854.pdf (hereinafter "Proposal"). FinCEN first published a proposal to require certain investment advisers to establish AML programs on May 5, 2003; this proposal was withdrawn on November 4, 2008. The

second proposal was published on September 1, 2015. *See* Proposal at 12116-12117.

[2] *See*, *e.g*., Proposal at 12131 ("Requiring investment advisers to report suspicious activity would also narrow the regulatory gap that may be exploited by money launderers, terrorist financiers, or other illicit actors seeking access to the U.S. financial system through financial institutions not required to report suspicious transactions.").

[3] *See* "grade-grubbing," TheFreeDictionary.com, https://idioms.thefreedictionary.com/grade-grubbing (Apr. 12. 2024) ("1. n. working hard at one's studies in hopes of a high grade. [] 2. n. flattering a teacher in hopes of a higher grade. [] 3. mod. having to do with students who are only concerned with getting high grades. []"). In this scenario, the Financial Action Task Force (FATF) is the grader. *See* FATF (2020), Anti-money laundering and counter-terrorist financing measures – United States, 3rd Enhanced Follow-up Report & Technical Compliance Re-Rating ("In its 4th round MER, **the U.S was rated [Partially Compliant]** with R.10 based on the following deficiencies: []; **investment advisers (IAs) were not directly covered by Bank Secrecy Act (BSA) obligations** (some IAs were indirectly covered through affiliations with banks, bank holding companies and broker-dealers)"), https://www.fatf-gafi.org/content/dam/fatf-gafi/fur/Follow-Up-Report-United-States-March-2020.pdf.coredownload.pdf (emphasis added).

[4] Proposal at 12114.

[5] *Id.*

[6] *Id.* ("That analysis found that 15.4 percent of RIAs and ERAs were associated with or referenced in at least one SAR (*i.e*., they were identified either as a subject or in the narrative section of the SAR) during this time.")

[7] *See*, *e.g*., Matthew Collin, "What the FinCEN leaks reveal about the ongoing war on dirty money," (Brookings, Sept. 25, 2020) ("In response to a surge in regulatory pressure, banks and other financial institutions responded not only by investing more in their compliance departments: They also began sending in more SARs to FinCEN. This behavior made sense because banks will get into serious trouble with the authorities if they fail to file a SAR on a client who later ends up getting caught laundering money, but there are no repercussions to filing a report that ends up being a false alarm. This leads banks to file 'defensively,' issuing a SAR on a client if there is even a whiff of suspicion, shunting the investigation over to FinCEN employees to deal with.") https://www.brookings.edu/articles/what-the-fincen-leaks-reveal-about-the-ongoing-war-on-dirty-money/.

[8] *See* Proposal at notes 74-76 and accompanying text. *See also* description of OneCoin fraud described at 12149 of the Proposal.

[9] Proposal at 12115 ("While in this instance the adviser was complicit in the fraudulent scheme, a client could also direct an unwitting investment adviser to create a private fund to specifications that facilitate money laundering. In the absence of an AML/CFT program requirement for investment advisers, the investment adviser might not have any obligation to evaluate such risks.").

[10] *See* Proposal at 12115 (explaining: "In December 2012, investment funds affiliated with Low Taek Jho (Low) laundered approximately $150 million diverted from 1Malaysia Development Berhad's (1MDB) 2012 bond issuance into the U.S. financial system." and citing Verified Compl. for Forfeiture (Dkt. 3) ¶ 760, United States v. Real Property Located in London, United Kingdom Titled in the Name of Red Mountain Global Ltd., No. 19-cv-1326, (C.D. Cal. Feb. 22, 2019), https://www.justice.gov/opa/press-release/file/1134376/download).

[11] Proposal at 12115.

[12] *Id*.

[13] *Id*.

[14] *See*, *e.g.*, Proposal at p.12113 ("**Without complete information**, such an institution may not have sufficient information to file a SAR, or it may be required to file a SAR that only has **partial information** concerning the investment adviser's transactions on behalf of a particular customer. This limits the ability of law enforcement to identify illicit activity that may be occurring through investment advisers.") (emphasis added); *id*. ("Other financial intermediaries providing services to an investment adviser or its customers, such as banks, clearing brokers, executing brokers, and futures commission merchants, may have AML/CFT obligations, but often, **they may not be well-positioned to have a complete understanding of the identity, source of funds, and investment objectives of the adviser's underlying customer**.") (emphasis added).

[15] Proposal at 12130 ("Section 1032.210(c) states the effective date by which an investment adviser would be required to comply with this section. Specifically, under this proposed rule, an investment adviser would be required to develop and implement an AML/CFT program that complies with the requirements of this section on or before twelve months from the effective date of the regulation.").