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Unfinished Business: Investment Advisers Are Potentially Back on the Hook for Anti-Money-Laundering and Counterterrorism Reporting Requirements

Client Alerts

February 20, 2024
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In its latest attempt, the U.S. Department of Treasury, Financial Crimes Enforcement Network ("FinCEN"), will require certain investment advisers to implement compliance measures to detect and report suspected money laundering and the financing of terrorism. The newly proposed rule brings investment advisers under the purview of the Bank Secrecy Act ("BSA"), which requires financial institutions to implement risk-based anti-money-laundering and counterterrorism programs to protect the national security of the United States and aid law enforcement in the fight against money laundering. If the proposed rule is finalized, FinCEN could require investment advisers to collect records, such as those related to fund transfers, and file suspicious activity reports with FinCEN. The proposed rule would also allow information sharing between FinCEN and the SEC, who will be delegated with examination authority over investment advisers for compliance with the new rule.

In the press release announcing the proposed rule, FinCEN Director Andrea Gacki emphasized that "[i]nvestment advisers are important gatekeepers to the American economy" who "oversee [] the investments of trillions of dollars." In the absence of any rule directly on point, oversight of the investment adviser industry has been served by a patchwork of Federal and State securities regulations generally focused on protecting investors from fraud and manipulation rather than money laundering and the financing of terrorism. But without industrywide AML/CFT reporting requirements, investment advisers held wide discretion on what types of information to request from potential clients, including information on their customers' ultimate sources of wealth. A FinCEN risk assessment identified that the lack of uniform AML/CFT reporting requirements had left the industry vulnerable to illicit financers looking for investment advisers with weaker or non-existent customer diligence procedures.

This, of course, is not FinCEN's first attempt to put additional restrictions on investment advisers, including as recently as 2015. The rule proposed in 2015 failed after a White House imposed halt on new federal regulations at the start of the Trump Administration. But the proposal to further

regulate investment advisers has languished for decades, mainly because investment advisers typically work with clients, including brokerages and banks, that are already subject to AML/CFT rules and under the purview of FinCEN. Since then, however, the amount of assets under the hands of investment advisory firms has nearly doubled, putting more pressure on FinCEN and the SEC to ensure the industry is subject to oversight for anti-money-laundering and counterterrorism programs. In this rule proposal, FinCEN is proposing to include investment advisers in the definition of a financial institution and to impose anti-money-laundering compliance obligations similar to those expected of other financial institutions such as banks and broker dealers. Unlike the previous rule proposals, which were narrower in scope and expectations, the latest proposal lays out a comprehensive framework and expectations signaling FinCEN's observations of increased AML risk in this space.

Specifically, the proposed rule would apply to both registered investment advisers ("RIAs"), as well as exempt reporting advisers ("ERAs") such as private funds advisers with less than $150 million in assets or advisers who only advise for venture capital funds. The rule specifically exempts state registered investment advisers, and in fact, FinCEN explicitly states in its rule proposal that state registered investment advisers do not currently pose as significant of a money laundering risk as those implicated by the rule proposal. Investment advisers with dual registration (including RIAs and ERAs registered as broker-dealers or banks) will likely not be significantly impacted, because these advisers are already subject to AML/CFT provisions. Like other RIAs and ERAs, to the extent existing compliance programs do not comply with the rule's proposed requirements, investments advisers with dual registration should consider updating their risk-based AML/CFT program. With respect to non-U.S. advisers registered with the SEC, the proposed rule does not seek to apply the substantive requirements as applied to non-U.S. advisers' advisement of non-U.S. clients. Though non-U.S. advisers who meet the requirements to report as ERAs to the SEC should anticipate being subject to the proposed rule for its activities with U.S. clients. The proposed rule would also not apply to advisory work related to mutual funds, but investment advisers who are updating their own risk-based AML/CFT program can include mutual funds if they so choose.

If the proposed rule is finalized, investment advisers will have 12 months from its effective date to become compliant. Given the state registered investment advisers' carveout, the SEC will be the primary examining authority to carry out the enforcement of this rule proposal. As such, upon finalization of the rule, subject investment advisers can expect the SEC to examine its compliance with the rule requirements, which include:

- Establishing an adequate AML program that is commensurate and tailored to its business lines and risks
- Filing suspicious activity reports ("SARs") and Currency Transaction Reports ("CTRs") with FinCEN
- Complying with the Recordkeeping and Travel Rule(s) under the BSA

- Responding to § 314(a) requests, which allow for information sharing between and among FinCEN, law enforcement agencies, and financial institutions
- Implementing special due diligence measures for correspondent and private banking accounts
- Developing internal policies, procedures, and controls to comply with the requirements of the BSA and address money laundering, terrorist financing and other illicit finance risks
- Designating an AML/CFT compliance officer
- Instituting an ongoing employee training program
- Soliciting an independent test of AML/CFT programs for compliance
- Implementing risk-based procedures for conducting ongoing customer due diligence

Other Key Takeaways:

- The latest rule reflects FinCEN's increased scrutiny of investments with national security implications, including private investment funds being used by foreign states, such as Russia and the People's Republic of China. As one example, FinCEN identified U.S. investment advisers with significant ties to Russian oligarchs investing in companies developing technologies as wide ranging as artificial intelligence, autonomous vehicles, and military technologies.
- Even larger size investment advisory firms with compliance programs and AML/CFT measures already in place may want to reexamine their AML/CFT regulatory controls. In particular, FinCEN identified investment advisers who rely on third-party administrators for services such as investor due diligence and identity verification as particularly vulnerable to illicit finance risk.
- The proposed regulations would also remove the existing requirement that investment advisers file reports for the receipt of more than $10,000 in cash and negotiable instruments using the joint FinCEN/Internal Revenue Service Form 8300 (Form 8300). Investment advisers would instead be required to file a Currency Transaction Report (CTR) for a transaction involving a transfer of more than $10,000 in currency by, through, or to the investment adviser, unless subject to an applicable exemption.
- The instant rule does not go as far to propose AML/CFT program requirements obliging investment advisers to collect beneficial ownership information for legal entity customers, but we expect that FinCEN, in consultation with the SEC, to address a Customer Identification Program requirement via a future joint rulemaking effort.

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