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FinCEN AML/CFT Rule Proposal: Difficult Provisions, Potential SEC Examinations and Likelihood of Adoption (Part Two of Two)

CONTACTS

Genna Garver

Genna Garver, a partner in Troutman Pepper's Corporate Practice Group, was quoted in the May 2, 2024 *Private Equity Law Report* article, "[FinCEN AML/CFT Rule Proposal: Difficult Provisions, Potential SEC Examinations and Likelihood of Adoption \(Part Two of Two\)](#)."

Application of ERAs

As some ERAs do not have CCOs, implementing the proposed AML/CFT requirements would put a lot of pressure on them, asserted Troutman Pepper partner Genna Garver. The SEC historically has not conducted routine exams on ERAs absent indications they are necessary. However, FinCEN seems focused on ensuring investments advisers' compliance measures are inspected, which could be a game changer for ERAs, she added.

Further, some, but not all, ERAs have aggregate assets under management of under \$150 million, which makes it difficult to engage in any significant illicit activity, Garver observed. "Although some venture capital ERAs have significant assets because their exemption is conditioned only upon their investment strategy, overall, it is surprising that ERAs have been included in the scope of the Proposal."

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Enhancing Advisers' Existing AML/CFT Efforts

Unlike some of the recent rulemaking under the Advisers Act, the Proposal requirements have been in effect for banks and other financial institutions, so FinCEN's general expectations for an effective AML/CFT program are a known quantity, Garver said. However, some fund managers may struggle with implementing the rules given that some requirements – particularly regarding customer due diligence – will not be determined until future rulemaking. In addition, the body of the rule and its proposing release contains numerous cross-references to provisions in the Bank Secrecy Act of 1970 and the USA PATRIOT Act's existing regulatory framework, which may be unfamiliar to fund managers, she added.

Further, the Proposal adds to the continuously expanding creep of CCO responsibilities, Garver noted. CCOs may serve as the AML/CFT compliance officer – although not required by the rule – and there is an assumption that most ERAs and some other smaller advisers will have dual-hatted officers. Another hat for CCOs creates additional work and potential liability, however. Further, outsourcing AML/CFT tasks and responsibilities will not

provide a complete answer given the need to oversee and supervise, especially in light of the SEC's proposed rule on outsourcing, she said.

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Expanding SEC Enforcement Authority

Failure to file SARs is reasonably low-hanging fruit for SEC enforcement actions because it does not involve interpretative issues and is relatively straightforward to prove, Garver noted. The transaction thresholds are low, particularly for private fund advisers that have high transaction values. Investment advisers will already be taking some kind of action when they become aware of suspicious activity, but current best practices will be different from the proposed rules. "Technical violations around policies and procedures are more likely to be an issue than actual harm situations," she opined.

Assuming the Corporate Transparency Act remains in place, and it is necessary to report beneficial owners, it is unclear how all the information will be funneled into the SEC in a meaningful way for it to conduct an efficient and effective initiative-based exam, Garver said. "More data does not necessarily yield solutions to all your problems – you have to do something with that data."

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Anticipating the Final Rules

Rules that are not finalized by about June 2024 may be reopened if there is a change of administration following the election, Garver explained. "That is probably not enough time for the Proposal to be revised and adopted, so there is some uncertainty around its fate," she added.

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Offering Tips for Fund Managers

If they have not already, fund managers should seek to understand the existing AML requirements and ensure they have policies and procedures that address those current requirements, Garver said.

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