The US Treasury Department announces intention to extend anti-money laundering rules to private equity and venture capital funds

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On February 15, 2024, the Financial Crimes Enforcement Network, better known by the acronym "*FinCEN*," a division of the US Department of the Treasury, proposed new regulations that would extend Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) laws to investment advisers. Historically, investment advisers have escaped AML and CFT regulations, unlike banks, broker-dealers, and mutual funds, even though investment advisers do manage vast sums of money. As highlighted by the Treasury in its *2024 Investment Adviser Risk Assessment*, private funds held over US$20 trillion in assets under management in Q4 2022. In its assessment, the Treasury recognized the significant risk that investment advisers pose in enabling illicit actors to access the US market. The proposed regulations aim to mitigate this risk by addressing certain gaps in the AML/CFT laws that grant access to the US financial market to sanctioned individuals, drug traffickers, corrupt foreign officials, fraudsters, tax evaders and foreign adversaries, who are seeking to exploit weaker or non-existent AML/CFT compliance programs of certain investment advisers. Moreover, foreign adversaries may utilize investment advisers and the private funds they oversee to gain access to technologies and services crucial to US national interest. This could occur through investment in startups developing such technologies and services. Recognizing these risks, FinCEN proposed new regulations which could apply to advisers of both private equity firms and venture capital funds. In this insight, we explore the nature of these proposed regulations, the expectations for foreign advisers and the implications for Canadian private equity firms and Canadian venture capital firms.

Proposed regulations

Currently, "investment advisers" themselves are not subject to the AML and CFT requirement otherwise applicable to financial institutions under the *Bank Secrecy Act* (BSA). If the proposed regulations were enacted as provided, this gap would be closed. As a result, under the BSA, investment advisers will be subject to AML and CFT requirements similar to those to which registered broker-dealers and other financial institutions are subject thereby imposing a range of new obligations on them. The proposed definition of investment advisers, to be added to the BSA, would include both the category of Registered Investment Advisers (RIAs) and Exempt Reporting Advisers (ERAs). A common form of ERAs consists of venture capital managers, which are exempt from registration with the Securities and Exchange Commission if they provide investment services solely to venture capital funds regardless of the amount of assets under management. Another category of ERAs consists of smaller private-fund advisers who are exempt from registration if they exclusively advise private funds and have less than US$150 million in assets under management.

Therefore, these new obligations would require investment advisers to:

- Adopt and implement comprehensive AML/CFT programs to include risk-based procedures for conducting Customer Due Diligence (CDD);
- File Suspicious Activity Reports (SARs) with FinCEN;

- Keep and maintain records of originator and beneficiary information for certain transactions;
- Comply with the application of "information-sharing provisions between and among FinCEN, law enforcement government agencies, and certain financial institutions"; and
- Implement special due diligence requirements.

These new compliance regulations will impose a significant regulatory burden or cost on investment advisers. At the same time, under the proposed regulations, investment advisers would be able to delegate a range of compliance and administrative activities to third-party providers.

We note, however, that the proposed regulations would currently exempt state-registered investment advisers because the Treasury found this category of investment advisers to represent a lesser risk.

Treatment of non-US investment advisers

Non-US investment advisers are investment advisers whose principal place of business is physically located outside of the US. FinCEN announced that non-US investment advisers otherwise required to register with the SEC would need to comply with the proposed regulations as well. Currently, non-US financial institutions (e.g., banks, broker-dealers, mutual funds) required to register with the SEC are also required to comply with the provisions of theBSA. The same logic applies in the proposed regulations. Non-US advisers who "make use of the mails or any means or instrumentality of interstate commerce in connection with [their] business as an investment adviser" are obliged to register with the SEC, and therefore these same advisers will have to comply with the proposed regulations.

However, FinCEN is soliciting comments to alleviate concerns regarding conflicts with domestic and foreign laws. FinCEN is also requesting comments to assess whether the idea of requiring non-US investment advisers to file SARs is consistent with the current rules applicable to SARs which are applied to financial institutions. One possible concern regarding such a conflict between the proposed regulations, and foreign laws involves the compatibility of foreign privacy laws with the new obligation to file SARs. The application of the proposed regulations to non-US advisers may be subject to change based on these comments.

Additionally, the *Anti-Money Laundering Act* established an obligation that the enforcement and compliance of an AML/CFT program must be the responsibility of a physical person residing in the United States and accessible to relevant US authorities. However, this obligation may be an issue for foreign investment advisers who do not have any operations or branches in the United States. FinCEN is also soliciting comments on this issue and may add interpretive language to the final rule in order to address this.

Implications for Canadian private equity firms and Canadian venture capital firms

Generally, Canadian authorities are very conscious of what their US counterparts have done or are doing when they introduce new regulations. Often, the regulatory frameworks in Canada and the US frequently display numerous similarities and occasionally both frameworks are completely harmonized.

The proposed regulations present two key considerations for Canadian investment advisers. Firstly, if the Canadian investment adviser is already required to register with the SEC, they will have to comply with the proposed regulations and any new obligations it may impose on them. Secondly, as Canada strives to strengthen its measures against money laundering and terrorist financing, it is possible that Canadian authorities may impose new or other and more strenuous measures than the current framework. This regulatory commitment could have a long-term impact on the activities of Canadian private equity and venture capital firms.

Dentons, as the world's largest global law firm, can help you establish or update your AML/CFT compliance programs. Should you have any questions, please reach out to the authors of this insight, **Giancarlo Salvo** and **Louis-Philippe Otis**.

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