May 20, 2024

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Comment on Rule Proposal S7-2024-02, Concerning Customer Identification Programs for Investment Advisers

Dear Ms. Countryman:

We oppose the adoption of the proposed rule (Release No. BSA-1; File No. S7-2024-02) that would impose on registered and other investment advisers a requirement to implement formal customer identification programs ("CIP's").

The Securities and Exchange Commission ("SEC") and the Financial Crimes Enforcement Network ("FinCEN") are relying, to a considerable degree, on the Department of the Treasury's "2024 Adviser Risk Assessment" ("Assessment"), as explicitly stated in the rule proposal. We note that the proposal is dated May 13, 2024 (issue date), and the Assessment is dated as of February 2024. That suggests that only a few months elapsed between the time the Assessment was published and the drafting of the proposed rule. That is not much time to think through the implications of the Assessment. We believe that the implications have not, in fact, been thought through. A careful review of the substantive findings, data, and inferences contained in the Assessment do not support a conclusion that the proposed rule is needed.

Disjointed facts, such as that investments advisers manage assets that "vastly exceed the holdings of U.S. banks" are not, in themselves, totally relevant to the question of identity risk. That fact would be indicative of a need for additional programs to determine identity veracity save for the fact that virtually all investment advisers introduce (or place, via means of discretionary authority) those same assets to banks and broker-dealers in the U.S. and in other countries with their own rigorous identity verification obligations pursuant to the Foreign Account Tax Compliance Act ("FATCA"), the Bank Security Act ("BSA")

and other statutes (see below). In most of Europe, the screens by banks and broker-dealers are quite stringent, in some cases more stringent (arguably) than those imposed by and on U.S. banks. So this "size-of-assets" argument, while apt, *prima facie*, is not truly indicative of a problem or weakness that obtains as regards investment advisers

The Assessment states (p. 1) that:

> A review of law enforcement cases, BSA reporting, and other information available to the U.S. government has identified several illicit finance threats involving investment advisers. First, IAs have served as an entry point into the U.S. market for illicit proceeds associated with foreign corruption, fraud, and tax evasion, as well as billions of dollars ultimately controlled by Russian oligarchs and their associates . . . IAs . . . and their advised funds, particularly venture capital funds, are also being used by foreign states, most notably The People's Republic of China (PRC) and Russia, to access certain technology and services with long-term national secure implications through investments in early-stage companies. Finally, advisers (RIAs, ERAs, and state-registered advisers) have defrauded their clients and stolen their funds.

This would seem to lump together disjointed issues and concerns that do not support the arguments in favor of the proposed rule.

First, and as we have indicated in a recent **comment** to a FinCEN proposed rule that would impose anti-money laundering program obligations on investment advisers), investment advisers are simply agents for the investment decisions of their principals, whether or not investment discretion is exercised.[1] They are in no better position to *force or place* illicit assets into the banking or brokerage system than the principals themselves, since banks and broker-dealers – *bona fide* "financial institutions" – are the mandated watchdogs pursuant to various statutes, and have robust programs to assess client/customer identity and the sources of their funds, pursuant to, *inter alia*, *The Anti-Money Laundering Act of 2020*,

[1] https://www.regulations.gov/comment/FINCEN-2024-0006-0052

The Intelligence Reform and Terrorism Prevention Act of 2004, the *United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terorism Act of 2001* (more commonly known as the "USA PATRIOT ACT"), the *Money Laundering and Financial Crimes Strategy Act* (1998), the *Money Laundering Suppression Act* (1994), *the Annunzio-Wylie Anti-Money Laundering Act* (1992), the *Anti-Drug Abuse Act of 1988*, the *Money Laundering Control Act of 1986*, the *Intelligence Reform and Terrorism Act of 2004*, and of course the BSA.

Second, the language in support of the proposed rule concerning illicit finance threats "involving" investment advisers is vague, as it is by no means clear what "involving" means. We have no doubt that there are many illicit finance threats, but it is not at all clear why investment advisers, as a class, are assumed to be especially implicated in them. Little data is provided in the Assessment that would lead to a conclusion that there is substantial involvement on the part of investment advisers to justify the proposed rule.

Third, as for the references to foreign governments, problematic penetration into the U.S. financial system via direct investment into the U.S. is already addressed elsewhere. For example, President Biden issued Executive Order 14083 on September 15, 2022, reflecting the evolving national security threat landscape and underscoring the critical role of the Committee on Foreign Investment in the United States ("CFIUS") in responding to new and emerging threats and vulnerabilities in the context of foreign investment. The Executive Order elaborates and expands on the existing list of factors that CFIUS considers, as appropriate, when reviewing transactions for national security risks, and describes potential national security implications in key areas. It is not clear that President Biden intended that investment advisers be, effectively, deputized into a gatekeeper or policing role concerning matters that are more properly the responsibility of the Department of Commerce, the Department of State, and law enforcement agencies such as the Federal Bureau of Investigation.

Fourth, the requirement for beneficial ownership transparency had been a priority at FinCen for some time. This has culminated in the Corporate Transparency Act ("CTA"), which is now the law of the land. The CTA has been effective for a few months, and there is a set timetable for entities to get into compliance, and there are penalties in the CTA for not disclosing accurate beneficial ownership information.

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Fifth, the point made in the Assessment that certain investment advisers have "defrauded their clients and stolen their funds" would seem to have nothing whatever to do with the goals of the proposed rule. Investment advisers that defraud and steal should be appropriately punished, as would any person or entity engaged in such activities.

Given the preceding, it is clear that existing legislation has already imposed very substantive obligations to determine the identity of persons whose assets are to be placed in the financial system. The proposed rule would simply duplicate the activities of *bona fide* and *de jure* financial institutions which have very ample identity programs in place, though, curiously, the statements published in favor of the proposed rule hold that:

> Investment advisers generally do not have obligations under the BSA specifically for customer identification programs. As a result, we have not identified any federal rules that would duplicate, overlap, or conflict with the proposed rule. If FinCEN's proposed AML/CFT Program and SAR Proposed Rule is adopted, section 326 of the USA PATRIOT Act requires Treasury and the Commission to prescribe regulations setting forth minimum standards for investment advisers regarding the identities of customers when they open an account. This congressional directive cannot be followed absent the issuance of a new rule. [See p. 73.]

But this logic begs the question. It is indeed true that investment advisers do not have obligations under the BSA, including identity verification obligations. That is because investment advisers were never deemed to be "financial institutions" which were on the front lines of attempts to infect the financial system with illegal assets or assets tied to illegality. Congress was wise to make the decision to exclude investment advisers from the definition of "financial institution," since investment advisers are not substantially similar to statutorily-defined financial institutions (banks and broker-dealers), nor are they substantially similar in their operations or activities.

We point out that nothing herein should be construed as suggesting that investment advisers have no concern about the identity of their clients or the source of their clients' funds or other assets. Nothing could be further from the truth. We know and have worked with many investment advisers that indicate their suspicions, when they have them, concerning both their clients' identities and their sources of

funds. Investment advisers, as a class, are not hapless, nor do they operate with no knowledge of the world or of enterprise risk. They are, as a rule, wary, prudent, and serious businesses and fiduciaries, fully aware of their obligations to know their clients, to protect their businesses, and to avoid legal and regulatory risks.

Sincerely,

Dr. David E. McClean
Principal
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