BETTER MARKETS

July 22, 2024

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

Re: Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers (File No. S7-2024-02); 89 Fed. Reg. 44,571 (May 21, 2024).

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal" or "Release")[2] requiring investment advisers to implement reasonable procedures to verify the identity of their customers. The Proposal requires that investment advisers registered with the Commission have Customer Identification Programs ("CIPs") as part of an anti-money laundering/countering the financing of terrorism ("AML/CFT") program. Because other financial institutions such as banks, brokers, and investment companies are already required to have such programs, the Proposal fills an important gap in the AML/CFT regulatory framework by subjecting investment advisers to similar regulatory obligations as other market participants.

Investment advisers play a crucial role in our financial system. But because they "are not subject to consistent or comprehensive AML/CFT obligations in the United States," there is a "risk that corrupt officials and other illicit actors may invest ill-gotten gains in the U.S. financial system through hedge funds, private equity firms, and other investment services."[3] Although some investment advisers may have AML/CFT obligations because they are also broker-dealers or banks or affiliates of broker-dealers or banks, many investment advisers are not subject to any AML/CFT obligations whatsoever.[4] This "creates arbitrage opportunities for bad actors by allowing them to access the U.S. financial system through investment advisers with weaker or non-existent client

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 89 Fed. Reg. 44,571 (May 21, 2024).

3 Press Release, U.S. Dep't of the Treasury, *FACT SHEET: U.S. Department of the Treasury Actions to Prevent and Disrupt Corruption* (Dec. 11, 2023), https://home.treasury.gov/news/press-releases/jy1974.

4 U.S. DEP'T OF THE TREASURY, 2024 INVESTMENT ADVISER RISK ASSESSMENT (Feb. 2024), https://home.treasury.gov/system/files/136/US-Sectoral-Illicit-Finance-Risk-Assessment-Investment-Advisers.pdf, at 1; *see also* Financial Action Task Force, Anti-money laundering and counter-terrorist financing measures: United States (Dec. 2016), https://www.fatf-gafi.org/content/dam/fatf-gafi/mer/MER-United-States-2016.pdf.coredownload.inline.pdf, at 18 ("Another vulnerability is that not all investment advisers are implementing comprehensive AML/CFT requirements.").

due diligence."[5] An "investor or client seeking to obscure the origin of funds or its identity can choose an adviser that is not required to apply AML/CFT measures to its clients and activities."[6]

The Proposal would help mitigate these risks. As the Proposal states, "[o]btaining and verifying the identity of account holders or responding to circumstances in which the investment adviser cannot form a reasonable belief that it knows the true identity of a customer would reduce the risk of terrorists and other criminals accessing U.S. financial markets to launder money, finance terrorism, or move funds for other illicit purposes."[7] The SEC should move quickly to finalize the Proposal so that investment advisers are required to assist in achieving these laudable goals.

## BACKGROUND

Money laundering, terrorist financing, and sanctions evasion pose a grave threat to our financial system and national security. That is why the PATRIOT Act required that banks and brokers verify the identity of their customers through CIPs.[8] These measures prevent our financial system from being "an unwitting participant in crimes ranging from money laundering to the financing of terrorism."[9] However, an important loophole remains: investment advisers.

> This loophole has worried authorities for years, because although banks and most securities brokers are required by law to identify the true owners behind investments and report any red flags, private equity firms, venture capital funds, and hedge funds are not. The result is a puzzling hole in the regulations designed to stop criminals and corrupt politicians around the world from accessing the U.S. financial system—a situation the private investment industry has repeatedly downplayed as it has successfully fended off reform attempts by Treasury officials and anti-corruption groups.[10]

Indeed, federal regulators have twice proposed subjecting investment advisers to AML/CFT obligations prior to this latest attempt. The Financial Crimes Enforcement Network (FinCEN) proposed a rule in 2003 that would have required certain investment advisers that manage client assets to establish an AML program.[11] In that proposal, FinCEN recognized that investment advisers "are often in a critical position of knowledge as to the movement of large amounts of financial assets through financial markets."[12] Indeed, in some cases, "an investment adviser may be the only person with a complete understanding of the source of the invested assets, the nature of the clients, or the objectives for which the assets are invested."[13] FinCEN proposed the rule because if "some of the assets include the proceeds of illegal activities, or are intended to

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5 2024 INVESTMENT ADVISER RISK ASSESSMENT, at 1-2.
6 *Id.* at 1.
7 Release at 44,583.
8 Shima Baradaran et al., *Funding Terror*, 162 U. Pa. L. Rev. 477, 501 (2014).
9 Matthew Goldstein, *Lawmakers Join Calls to Close a Loophole Shielding Oligarchs' Investments*, N.Y. Times (Mar. 30, 2022), https://www.nytimes.com/2022/03/30/business/oligarchs-hedge-funds-russia.html.
10 Todd C. Frankel, *The search for oligarchs' wealth in U.S. is hindered by investment loopholes*, Wash. Post. (Mar. 16, 2022), https://www.washingtonpost.com/business/2022/03/16/private-equity-regulation-gap/.
11 *Anti-Money Laundering Program for Investment Advisers*, 68 Fed. Reg. 23,646, 23,646 (May 5, 2003).
12 *Id.* at 23,647.
13 *Id.*

further such activities, an anti-money laundering program should help discover them," and therefore investment advisers "have an important role to play in preventing the use of their services for money laundering and the financing of terrorism."[14] Despite this recognition, FinCEN did not adopt the proposed rule; after allowing it to languish for years, it finally withdrew it in 2008.[15]

Similarly, in 2015, FinCEN proposed a rule that would have required investment advisers to establish AML programs and report suspicious activity to FinCEN.[16] FinCEN again recognized that investment advisers were on the "'front lines'" in the fight against money laundering.[17] It also noted that the proposed rule was necessary to prevent illicit actors from accessing the U.S. financial system through an investment adviser "as a means to avoid detection of their activity which might otherwise occur in dealings with financial institutions that have AML programs and suspicious activity reporting requirements."[18] In order to remedy this situation, the proposed rule would have subjected investment advisers to similar obligations as other financial institutions such as banks and brokers and therefore "address[ed] money laundering vulnerabilities in the U.S. financial system."[19] Nonetheless, once again, FinCEN did not adopt the proposed rule.

The failure to adopt either the 2003 rule or the 2015 rule was due to "stiff industry opposition."[20] And that failure allowed the private funds industry to "in effect act[] as a new bright, blinking light for the world's worst actors to hide their wealth."[21] The private funds industry should not be allowed to again downplay the need to close the existing loophole. It is time to finally ensure that investment advisers are subject to the same obligations to verify their customers' identity as banks and brokers—a "minimal burden" long imposed on those firms.[22]

## OVERVIEW OF THE PROPOSAL

The Proposal requires that investment advisers establish, document, and maintain a written CIP as part of an AML/CFT program.[23] As a result, the CIP would not be a separate program but

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14 *Id.*

15 *FinCEN Withdraws Dated AML Rule Proposals for Unregistered Investment Companies, Commodity Trading Advisors, and Investment Advisers* (Oct. 30, 2008), https://www.fincen.gov/news/news-releases/fincen-withdraws-dated-aml-rule-proposals-unregistered-investment-companies.

16 U.S. Dep't of the Treasury, *FinCEN Proposed AML Regulations for Investment Advisers* (Aug. 25, 2015), https://www.fincen.gov/sites/default/files/news_release/20150825.pdf.

17 *Id.*

18 *Id.*

19 *Id.*

20 Eric Mikkelson, *FinCEN's Anti-Money Laundering Plan Should Put Advisers on Alert*, Bloomberg (Apr. 9, 2024), https://news.bloomberglaw.com/us-law-week/fincens-anti-money-laundering-plan-should-put-advisers-on-alert; *see also* Robert C. Grohowski, Investment Adviser Association, Comment Letter re: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers (Nov. 2, 2015) (urging that FinCEN "reconsider the scope of its proposal"), https://investmentadviser.org/wp-content/uploads/2021/09/151102cmnt.pdf, at 1.

21 Casey Michel, *In America, there is finally good news on the anti-money laundering front*, Fin. Times (Feb. 27, 2024), https://www.ft.com/content/131ba949-57b4-452d-84fc-2657689e3f10.

22 *Id.*

23 Release at 44,574.

would be part of the AML/CFT program maintained by the investment adviser.[24] The Proposal requires that the CIP be appropriate for the investment adviser's size and businesses.[25]

The Proposal would also require that the CIP contain specific elements:

- The CIP must include risk-based procedures for verifying the identity of customers, and it must provide that verification occur within a reasonable time before or after the customer's account is opened. The procedures must enable the investment adviser to form a reasonable belief that it knows the identity of each customer.[26]
- The CIP must require that the investment adviser obtain certain identifying information with respect to each customer: (1) name; (2) date of birth (for an individual) or date of formation (for an entity); (3) address; and (4) id number.[27]
- The CIP must require that, after obtaining identifying information for each customer, the investment adviser follow risk-based procedures to verify the accuracy of the information in order to reach a point where it can form a reasonable belief that it knows the true identity of the customer.[28]

The Proposal would require further that the CIP include procedures for responding to circumstances in which the investment adviser cannot form a reasonable belief that it knows the true identity of a customer. These procedures should describe (1) when the investment adviser should not open an account; (2) the terms under which the investment adviser may provide advisory services to the customer while the investment adviser attempts to verify the customer's identity; (3) when the investment adviser should close an account after attempts to verify a customer's identity fail; and (4) when the investment adviser should file a Suspicious Activity Report ("SAR") in accordance with application laws and regulations governing SAR filings.[29]

## COMMENTS

### I. The Commission has the statutory authority to adopt the Proposal.

There should be no question that the Commission has the statutory authority to adopt the Proposal. Section 326 of the PATRIOT Act added a subsection to the Bank Secrecy Act ("BSA") requiring the Secretary of the Treasury to "prescribe regulations setting forth the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution."[30] The BSA defines "financial institutions" to include, among other entities, banks and securities brokers and dealers registered with the Commission; it also grants the Secretary the authority to define, by

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24 *Id.*
25 *Id.*
26 *Id.* at 44,575.
27 *Id.*
28 *Id.* at 44,576.
29 *Id.* at 44,577.
30 31 U.S.C. § 5318(l)(1).

regulation, additional types of businesses as financial institutions where the Secretary determines that such businesses engage in activities "similar to" or "related to" those in the statutory definition.[31] The Secretary has proposed a rule to define "financial institutions" as including investment advisers because they engage in activities similar to banks and broker-dealers.[32] And the BSA provides that implementing regulations for financial institutions that provide financial, investment, or economic advisory services be prescribed jointly with the appropriate federal regulator for the designated financial institution,[33] which in the case of investment advisers is defined by statute as the SEC.[34] Therefore, assuming the rule defining financial institutions as including investment advisers is adopted,[35] the SEC has explicit statutory authority to adopt rules setting forth the minimum standards for investment advisers regarding the identity of their customers that shall apply in connection with the opening of an account at the investment adviser.

## II. The Proposal is necessary to prevent bad actors from using investment advisers to facilitate money laundering and the financing of illicit activity by foreign states.

The SEC must use its statutory authority to prevent bad actors from exploiting the fact that investment advisers are not currently required to have CIPs. Almost a decade ago, FinCEN recognized that as "long as investment advisers are not subject to AML program and suspicious activity reporting requirements, money launderers may see them as a low-risk way to enter the U.S. financial system."[36] This has proven to be the case. Earlier this year, the Department of the Treasury published the 2024 National Risk Assessments on Money Laundering, Terrorist Financing, and Proliferation Financing, which found that the United States "continues to face both persistent and emerging money laundering risks related to . . . the lack of comprehensive AML/CFT coverage for certain sectors, particularly investment advisers."[37] The AML/CFT requirements for financial institutions such as banks and broker-dealers are of little value if bad actors can circumvent those measures by funneling their money through investment advisers.

The industry's arguments opposing the extension of AML/CFT requirements to investment advisers are not persuasive. Andreessen Horowitz has argued that there is little evidence that venture capital firms are a target for money launderers and that as a result application of the rule to such firms would result in "'expensive and duplicative regulation with no material benefit to

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31 31 U.S.C. § 5312(a)(2), (c)(1); 31 C.F.R. § 1010.100(t).

32 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. 12,108, 12,118 (Feb. 15, 2024).

33 31 U.S.C. § 5318(l)(4); 12 U.S.C. § 1843 (k)(4)(C).

34 *See* 15 U.S.C. § 6809(2).

35 Release at 44,572 n.11.

36 Financial Crimes Enforcement Network: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, https://www.fincen.gov/sites/default/files/shared/1506-AB10_FinCEN_IA_NPRM.pdf, at 8.

37 Press Releases, U.S. Dep't of the Treasury, *Treasury Publishes 2024 National Risk Assessments for Money Laundering, Terrorist Financing, and Proliferation Financing* (Feb. 7, 2024), https://home.treasury.gov/news/press-releases/jy2080.

law enforcement or a reduction in the risk of illicit financial activity.'"[38] But the application of the rule to private funds would not result in duplicative regulation; the rule is necessary precisely because it would "plug what some experts view as gaping holes in the U.S.'s anti-money-laundering protections."[39] Currently, AML/CFT rules do not apply to investment advisers to private funds, which "may allow corrupt actors to invest their ill-gotten gains in the U.S. financial system through hedge funds, trusts, private equity funds, and other advisory services or vehicles offered by investment advisers that focus on high-value customers."[40] So criminals could "'evade scrutiny more effectively by operating through investment advisers rather than through broker-dealers or banks directly."[41] Nor is it the case that money launders would not target venture capital firms. Although the longer lock-up periods in such funds "may deter criminals who need immediate access to illicit proceeds, they are unlikely to deter illicit actors who seek stable returns, have a medium- to long-term investment horizon, and do not need immediate access to capital."[42]

In any case, regardless of money laundering by private criminals, venture capital funds appear to be a prime target for the illicit financial activity of foreign states. According to the FBI, the People's Republic of China routinely conceals its ownership or control of investment funds, including venture capital funds, "to steal technology or knowledge."[43] And "Russian elites and government entities are moving hundreds of millions of dollars annually through the U.S. financial system by using U.S. and foreign venture capital firms to invest in U.S. technology companies."[44]

## III. The Proposal is especially important today given crypto's ability to facilitate money laundering and other illicit financial activity by criminal enterprises and foreign states.

Although the two previous failures to extend AML/CFT obligations to investment advisers undoubtedly harmed the ability of regulators to prevent money laundering and other illicit financial activity, the rise of crypto since those two attempts means that failing to adopt the Proposal now could be catastrophic. That is because cryptocurrencies have certain unique characteristics that

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38 Dylan Tokar, *Real Estate Agents, Investment Advisers Chafe at New Anti-Money-Laundering Rules*, The Wall Street Journal (Apr. 19, 2024), https://www.wsj.com/articles/real-estate-agents-investment-advisers-chafe-at-new-anti-money-laundering-rules-1a194fa0; *see also* Chris Cumming, *New Rules Will Force Buyout Firms to Flag Suspicious Investments*, The Wall Street Journal (Feb. 20, 2024), https://www.wsj.com/articles/new-rules-will-force-buyout-firms-to-flag-suspicious-investments-2c7d4449 (citing the American Investment Council as saying that private funds are a low money-laundering risk and that forcing such funds to follow the AML rules would be an unnecessary burden).

39 Tokar, supra note 38.

40 UNITED STATES STRATEGY ON COUNTERING CORRUPTION (Dec. 2021), https://www.whitehouse.gov/wp-content/uploads/2021/12/United-States-Strategy-on-Countering-Corruption.pdf, at 22.

41 *Id.*

42 2024 INVESTMENT ADVISER RISK ASSESSMENT, at 16; *see also* Cumming, supra note 38 (stating that a leaked FBI memo in 2020 said that criminals are laundering money through private funds and providing as an example a company tied to Russian organized crime passing more than $100 through a New York firm).

43 2024 INVESTMENT ADVISER RISK ASSESSMENT, at 21.

44 *Id.*

> make them appealing for conducting illegal activities: (1) they are decentralized, unsupervised by any government or central bank, and therefore, like cash, preserve a high degree of anonymity; (2) they are virtual and therefore generally unbounded by geographical borders; and (3) they do not require transactions be conducted in person.[45]

For these reasons, crypto "pose[s] significant illicit finance risks, including money laundering . . . and terrorism and proliferation financing."[46] Crypto "may also be used as a tool to circumvent United States and foreign financial sanctions regimes and other tools and authorities."[47] Indeed, crypto is "increasingly used for illicit activities" and has become "a haven for criminals, terrorists, and sanctions evaders."[48] The risks of money laundering, illicit financing, and sanctions evasion that crypto poses means all possible means of effective AML/CFT programs must be implemented.

The gap in the AML/CFT regime between the way banks and broker-dealers are regulated and the way investment advisers are regulated is especially problematic when viewed through the crypto lens. It is now "clear that any contention that existing anti-money laundering (AML) requirements apply only to the 'legacy financial system,' and not to the cryptocurrency ecosystem, is false."[49] For example, for over a decade, FinCEN "has had a well-developed regulatory scheme that applies to cryptocurrency as well as fiat currency and legacy financial institutions."[50] But with respect to investment advisers, the problem is that existing AML requirements do not apply. In addition to an AML/CFT regime governing crypto specifically, investment advisers must be subject to the same AML/CFT requirements as other financial institutions so that banks, broker-dealers, and investment advisers all have programs to prevent the use of crypto for illicit purposes.

The stakes should not be underestimated. The rise of crypto "could circumvent the AML/CFT regime."[51] That would be disastrous. As the International Monetary Fund has stated,

> Effective anti-money laundering and combating the financing of terrorism (AML/CFT) policies and measures are key to the integrity and stability of the international financial system and member countries' economies. Money laundering (ML) and related underlying crimes . . . are crimes with economic effects—they can threaten the integrity and stability of a country's financial sector and a country's external stability more generally. . . . In an increasingly interconnected world, the harm done by these crimes is global, affecting the integrity and stability of the international financial system. AML/CFT policies and measures

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45 Shlomit Wagman, *Cryptocurrencies and National Security: The Case of Money Laundering and Terrorism Financing*, 14 Harv. Nat'l Sec. J. 87, 88 (2022).

46 Executive Order 14067, *Ensuring Responsible Development of Digital Assets*, 87 Fed. Reg. 14143, 14144 (Mar. 7, 2022).

47 *Id.*

48 Wagman, 14 Harv. Nat'l Sec. J. at 87.

49 Sanjeev Bhasker, Michael P. Grady, and Kevin G. Mosley, *Cryptocurrency and Anti-Money Laundering*, 38-SUM Crim. Just. 3, 4 (2023).

50 *Id.*

51 Wagman, 14 Harv. Nat'l Sec. J. at 90.

> are designed to prevent and combat these crimes and are essential to protect the integrity and stability of financial markets and the global financial system.[52]

For these reasons, the fact that crypto is so susceptible for use in money laundering and similar financial crimes poses "challenges to national security and the integrity of financial systems."[53]

We agree that AML/CFT policies and measures are essential to protect the U.S. economy and security and the global financial system. But those policies and measures will only be effective if they are comprehensive. The failure to require that investment advisers have AML/CFT policies that include CIPs is a fundamental weakness in those policies and measures. Bad actors have taken, and will continue to take, advantage of that vulnerability. One way to address that vulnerability is to ensure that traditional market participants such as investment advisers have AML/CFT programs that include CIPs so that they know the identity of their customers regardless of whether their customers seek to use their services to transact in crypto or in other assets. As a result, the Proposal is an essential measure to ensure that our AML/CFT policies are able to prevent money laundering and other illicit financial activity, and the Commission should adopt it forthwith.

Conclusion

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

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[52] International Monetary Fund, Anti-money laundering and Combating the Financing of Terrorism (AML/CFT), https://www.imf.org/en/Topics/Financial-Integrity/amlcft.

[53] Wagman, 14 Harv. Nat'l Sec. J. at 88-89.