New FinCEN rules: A plan for private capital advisers

- **FinCEN's new AML and CFT regulations are transforming the regulatory landscape for private equity funds**
- **Advisers need to understand the implications for reporting and compliance**
- **To comply with the new regulations, there are certain steps that need to be implemented well ahead of the deadline**

FinCEN's new AML and CTF regulations are a significant shift in the regulatory landscape for private equity funds. Advisers need to understand the implications for reporting and compliance. Head of Investor Services, [Sadrack Belony], and Senior Client Relationship Manager, [Joanne Earles], lay out a roadmap to comply

In August 2024, the Financial Crimes Enforcement Network (FinCEN) in the U.S. introduced new anti-money laundering (AML) and counter-terrorist financing (CTF) regulations that will have far-reaching implications for private markets fund managers. The regulations are designed to improve and extend oversight in the financial services industry, to ensure that there is greater transparency and accountability across the sector.

Key to these new rules is that they apply to not only SEC-registered investment advisers (RIAs) but also to exempt reporting advisers (ERAs). Under the regulations these entities are now considered financial institutions and must implement an AML program, as well as file suspicious activity reports (SARs) with

FinCEN for any unusual or suspicious activity. Investment advisers are required to maintain accurate record-keeping and follow Travel Rules, which require financial institutions to create and retain records for transmission of funds that are equal to or greater than $3,000 and to ensure that certain information about the fund transmission “travels” with the transmittal to the next financial institution in the payment chain.

As the FinCEN fact sheet explains “this rule aims to help address the illicit finance risks in the investment adviser sector in the United States, which the U.S. Department of the Treasury documented in a February 2024 risk assessment. The risk assessment highlights numerous cases in which sanctioned persons, corrupt officials, fraudsters, and other criminals have exploited the investment adviser industry to access the U.S. financial system and launder funds.”

The goal of the new rules then is to help safeguard the investment adviser sector from illicit finance activity, including misuse by criminals, foreign adversaries, and other money laundering and terrorist financing threats.

U.S. Secretary of the Treasury Janet Yellen stated that the Final Rule will “close critical loopholes in the U.S. financial system that bad actors use to facilitate serious crimes like corruption, narcotrafficking, and fraud”.

The regulations come into force on January 1, 2026, so with little more than a year to get their operations ready to comply, fund managers need to understand what is required and start putting a framework in place to deliver that against budget and deadlines.

To comply, advisers will need to put the following 5 pillars in place as part of the program:

1. **AML compliance officer**: A compliance officer must be appointed to oversee AML operations.
2. **Internal controls**: Across the business internal control policies and procedures need to be implemented.
3. **Risk-based approach**: Managers must do risk-based Know Your Customer (KYC) and customer due diligence so that they can assess potential impact and put mitigation processes in place.
4. **Employee training**: Provide annual training for all employees so that the policy is understood and implemented throughout the business.

5. **Independent testing**: Conduct independent testing of the AML program. This needs to be done intermittently to test the system for weaknesses or gaps.

Operational changes for private capital

For advisers who were previously out of scope of these sort of requirements, it means assessing their current compliance frameworks and aligning these with the requirements of the new rules. This can have cost and time implications while putting in place fit-for-purpose technologies, implementing robust due diligence procedures as well as setting up systems to ensure reporting to the authorities is done effectively, efficiently and adheres to the requirements.

Perhaps most pressing of all will be fulfilling the need for skilled people to implement the relevant technology and the additional requirement to independently test the system. All this too will most likely increase operational costs for private capital managers.

A significant challenge for all – which will need to be met with best practice solutions – is beneficial ownership reporting. The rules require private markets managers to identify and verify the ultimate beneficial owners of their investments. This can be an onerous and complex process due to the multiple layers of ownership investors have.

For example, if a trust is owned by one or several entities, the rule stipulates that there must be a drill down into those entity owners to identify, at each level, if there is a person or another entity that owns 25% or more of it. This process should continue to several levels depending on the structure of the investor.

Another part of this challenge for managers will be effectively communicating the new compliance requirements to their investors and stakeholders. This will include explaining to investors the need for all the additional information needed to manage their investments to comply with the new rules.

To be in good time to meet the deadline managers should start preparing now, starting with an assessment of these three elements of their operations:

1. **Assess current compliance frameworks**: Conduct a gap analysis to identify areas that need improvement. As part of this ensure that AML/CFT programs in place include the 5 pillars of processes, procedures

and systems to identify and know who your investors are, implementing a risk-rating process for those investors, putting in place ongoing monitoring, as well as a mechanism to report suspicious activities (SAR).
2. **Invest in fit-for-purpose technology**: Implement technology solutions for due diligence, reporting, and document storage. An example of a technology intervention that supports a robust KYC program is Aztec Verify, it is designed to enhance the investor AML and Foreign Account Tax Compliance Act (FATCA) or Common Reporting Standard (CRS) onboarding experience. It integrates technology from multiple service providers to deliver a streamlined onboarding process, replacing paper-based verification methods with electronic verification tools.
3. **Engage third-party service providers**: Consider outsourcing compliance functions to third-party providers with expertise in AML/CTF regulations. The Final Rule also allows investment advisers to delegate the implementation and operation of some or all aspects of their AML/CFT programs to a third party, such as a fund administrator, if certain criteria are met. The investment adviser would still, however, remain fully responsible and legally liable for compliance with the requirements of the Final Rule.

Conclusion

The new AML and CTF regulations introduced by FinCEN will have an impact for private markets managers. To be prepared advisers need to know and understand the requirements and either establish an in-house team to deliver it on time or delegate compliance functions to a third-party service provider with extensive experience with regulation both in the U.S. and globally. Expert partners can help managers implement and maintain compliance more easily as they have the scale and expertise and have invested in the technology to do so for multiple clients.

To find out more about the requirements for compliance or to discuss how Aztec Group’s global experience in delivering compliance for clients could support your fund, contact Sadrack or Joanne directly.