United States Senate

WASHINGTON, DC 20510

April 15, 2024

Secretary Janet Yellen
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20552

Re: 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 (Docket No. FINCEN-2024-0006; RIN 1506-AB58).

Dear Secretary Yellen:

We write in support of the Financial Crimes Enforcement Network's (FinCEN's) proposed rule to include investment advisers in the definition of "financial institution" in the Bank Secrecy Act (BSA), which would require them to maintain anti-money laundering (AML) programs, report suspicious activity to the government, file currency transaction reports, and keep records related to the transmittal of funds (the Proposal).[1] The Proposal would help regulators crack down on money laundering and sanctions evasion. It would also protect our Nation's financial system from abuse by sophisticated criminals, oligarchs, and our adversaries and strategic competitors.

We wrote to you in March 2022 asking FinCEN to extend the AML framework to advisers, and we are pleased that the Proposal is consistent with our request. We therefore urge FinCEN to finalize the Proposal as quickly as practicable.

I. Money laundering and sanctions evasion are occurring through investment advisers and private funds due to regulatory gaps.

While most investment advisers serve customers on Main Street and comply with the law, segments of the industry, in particular advisers to private funds, have been attractive to money launderers and sanctioned persons. One reason is that advisers are exempt from requirements to maintain AML programs, verify the identities of their customers, and report suspicious transactions to FinCEN. While other financial intermediaries, including banks, brokers, and insurance companies, are already subject to the basic requirements in the Proposal, coverage of advisers is uneven. For example, advisers affiliated with a broker or a bank generally fall under an enterprise-wide AML program. In other circumstances, an adviser may voluntarily implement AML measures. But the lack of standardized requirements has allowed bad actors to seek out an adviser that will turn a blind eye to the ultimate source of the money they are managing.

Treasury has tried to plug these regulatory gaps through proposals in 2002, 2003, and 2015. Unfortunately, those rules were never finalized due to strong opposition from Wall Street, the

[1] 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. 12108 (Feb. 15, 2024).

private equity lobby, and the hedge fund lobby. In the meantime, more economic activity is being conducted through asset managers. Since the 2015 proposal, assets under management with registered advisers has ballooned from approximately $60 trillion to $130 trillion. Around $20 trillion of that is attributable to private funds.[2]

National security risks posed by this regulatory gap have grown since 2015. The Federal Bureau of Investigation (FBI) recently indicated with "high confidence" that "threat actors likely use private placement of funds, including investments offered by hedge funds and private equity firms, to launder money, circumventing traditional AML programs."[3] Similarly, the United States Strategy on Countering Corruption notes that the lack of AML coverage "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."[4]

The Treasury Department also found that investment advisers "have served as an entry point into the U.S. market for illicit proceeds associated with foreign corruption, fraud, and tax evasion" in large part due to the "lack of comprehensive AML/CFT regulation."[5] Private funds have many other attributes that make them vulnerable to money laundering, including a wealthy investor base with a penchant for secrecy, the use of sprawling structures that include shell companies around the world, aggressive strategies to avoid taxation, limited public reporting obligations, and light-touch principles-based regulations. Indeed, you recently testified before the Senate Banking Committee that "it appears that some of those advisers who aren't subject to [AML] regulations are taking the money of Russians or Chinese [persons] and moving it through hedge funds and essentially washing it here in the United States. . . . And we have identified instances where investment advisers have worked with sanctioned individuals, corrupt officials, tax evaders, and criminals."[6] We strongly endorse Treasury's current efforts to finish the job it started in 2002.

A. Russian oligarchs have exploited private funds to launder proceeds of corruption and evade sanctions.

According to a top Treasury official, Russian oligarchs are exploiting "vulnerabilities in our AML system that may result from inadequate regulatory treatment" for private funds.[7] Treasury has identified more than 80 advisers in the United States that sponsored private funds in which Russian oligarchs have invested and 20 of those advisers had "significant ties" to these oligarch investors.[8] A recent Treasury risk assessment found that some advisers "manage billions of dollars ultimately controlled by sanctioned entities, including Russian oligarchs and their

[2] Securities and Exchange Commission, *Frequently Requested FOIA Document: Information About Registered Investment Advisers and Exempt Reporting Advisers* (last accessed Apr. 5, 2024).
[3] FEDERAL BUREAU OF INVESTIGATION, THREAT ACTORS LIKELY USE PRIVATE INVESTMENT FUNDS TO LAUNDER MONEY, CIRCUMVENTING REGULATORY TRIPWIRES 1 (2020).
[4] THE WHITE HOUSE, UNITED STATES STRATEGY ON COUNTERING CORRUPTION 22 (2021).
[5] U.S. DEP'T OF THE TREASURY, 2024 NATIONAL MONEY LAUNDERING RISK ASSESSMENT 87 (2024).
[6] *The Financial Stability Oversight Council Annual Report to Congress before the S. Comm. on Banking, Housing, and Urban Affairs*, 118th Cong. (2024) (testimony of Hon. Janet Yellen, U.S. Department of the Treasury).
[7] *Countering China: Advancing U.S. National Security, Economic Security, and Foreign Policy before the S. Comm. on Banking, Housing, and Urban Affairs*, 118th Cong. (2023) (testimony of Hon. Elizabeth Rosenberg, U.S. Department of the Treasury).
[8] Proposal at 12115.

associates who help facilitate Russia's illegal and unprovoked war of aggression against Ukraine."[9]

Russian billionaire Roman Abramovich, who was sanctioned by the United States in 2023, hired an adviser in New York in 1999 to manage and grow his fortune to over $7 billion, primarily through investments in over 100 different U.S.-based hedge funds and private equity funds.[10] We understand that several of these funds had voluntarily implemented AML programs or relied on the programs of their affiliated brokers. But those programs were not effective because they were not comprehensive, were not regularly examined for compliance, and did not result in the adviser confirming the ultimate identity and sources of funds of a major investor—in this case, "a Russian oligarch who has long and close ties to Vladimir Putin" and who has "been benefitting from Russian decision-makers responsible for the annexation of Crimea or the destabilization of Ukraine."[11]

In addition, these private equity funds presumably had long lock-up periods that prevented Mr. Abramovich from liquidating his investments for several years. The illiquid nature of private funds appeared to be a feature, not a bug, for Mr. Abramovich, whose goal was to stash wealth derived from his corruption and kleptocracy and safely grow it in U.S. markets over a period of decades. He had no intention or need to realize any investment gains until long after any initial lock-up period expired. This is just one example of how illiquid funds have become an attractive target for money laundering on a massive scale.

B. Chinese state-owned enterprises have exploited private funds to invest in sensitive sectors and technologies.

The Chinese Communist Party (CCP) has also exploited the opaque nature of private funds to sidestep restrictions on direct foreign investment and fly under the radar of regulators. Chinese sovereign wealth funds have cultivated ever closer ties to U.S. private equity funds to invest hundreds of billions of dollars in highly sensitive industries, including the defense sector, with long-term effects on our national security.[12] According to the FBI Director, the Chinese government actively conceals its ownership or control of private funds and steals sensitive technology, such as AI and quantum computing, that China can use to gain a military edge.[13] As investors in private funds, CCP-funded entities have new avenues to conduct espionage because they are able to request special access to details about portfolio company business and operations, under the guise of monitoring investment performance.[14] The government will continue to lack basic oversight about these flows of information and funds unless the Proposal is finalized.

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[9] U.S. DEP'T OF THE TREASURY, 2024 INVESTMENT ADVISER RISK ASSESSMENT 19 (2024).
[10] *Id.* at 20; Proposal at 12116; *Sec. and Exch. Comm'n v. Corcord Mgmt. LLC and Michael Matlin*, No. 23-cv-8253, (S.D.N.Y. Sept. 19, 2023); Matthew Goldstein and David Enrich, *How One Oligarch Used Shell Companies and Wall Street Ties to Invest in the U.S.*, N.Y. TIMES (Mar. 21, 2022).
[11] Council Regulation (EU) No. 2022/427 O.J. (L 87) 1/1.
[12] Proposal at 12114.
[13] Remarks by FBI Director Christopher Wray, "Countering Threats Posed by the Chinese Government Inside the U.S.," Jan. 31, 2022.
[14] *National Security Challenges: Outpacing China in Emerging Technology before the S. Comm. on Banking, Housing, and Urban Affairs*, 118th Cong. (2024) (testimony of Emily Kilcrease, Center for a New American Security).

II. The Proposal would help cut down on money laundering and sanctions evasion.

The Proposal would allow the government to protect the financial system from these alarming trends and limit illicit financial activity in the United States. It would require advisers to have policies, procedures, and internal controls designed to prevent the adviser from being used for money laundering or terrorist financing and to comply with the BSA. It would help ensure accountability by designating an AML compliance officer at each adviser. It would also establish minimum requirements for customer due diligence. Together, these requirements would prevent money from criminals and sanctioned persons from flowing through the cracks to advisers that do not have meaningful AML obligations.

The Proposal would also hand powerful examination and enforcement tools to the government to ensure compliance and extract significant civil and criminal penalties for violations. For example, Mr. Abramovich's U.S.-based investment adviser was sued in September 2023 by the Securities and Exchange Commission only for ministerial violations of the securities laws (i.e., failure to register under the Advisers Act),[15] and not for violations of the underlying AML laws, which carry much stiffer penalties. Had the Proposal been finalized, the government would have additional tools to bring civil and criminal cases under the BSA for this misconduct.

These requirements are especially important for advisers to private funds, which have pushed into just about every single industry in the United States ranging from healthcare to financial services to defense. They have grown beyond their roots in conducting leveraged buyouts or investing in public markets and now conduct all kinds of other financial activities, such as private credit or direct lending, that historically has been conducted by the regulated banking sector that has been subject to the BSA since its inception. The Proposal sensibly updates the AML rules to keep pace with the size, scope, complexity, and importance of the asset management industry. Advisers conduct similar activities to banks, brokers, and insurance companies. Therefore, they should be subject to similar AML obligations.

Requiring advisers to establish AML programs, report suspicious activity, and file currency transaction reports, among other requirements, would go a long way towards deterring Russian oligarchs, CCP-linked companies, and other illicit actors from using private funds to enter the U.S. financial system. Following Russia's unprovoked invasion of Ukraine, the United States has worked with its allies and partners to find the assets of sanctioned Russian oligarchs. But as the United States has been imposing unprecedented sanctions against Russia, sanctioned oligarchs are increasingly looking for places to stash their money outside the government's reach. Emily Kilcrease, a Senior Fellow at the Center for a New American Security, testified before the Senate Banking Committee, that the Proposal could help Ukraine by closing "evasion routes and loopholes to make sure that when [the United States] imposes these sorts of sanctions, they're really biting the way we want them to."[16] We agree that closing loopholes and vulnerabilities in our financial reporting laws through the Proposal will make it easier for federal investigators to identify where oligarchs and other criminal actors are placing their assets.

[15] *Corcord Mgmt. and Michael Matlin*, *supra* n.10.
[16] *Supra* n.14.

III. FinCEN should require advisers to comply with the Customer Identification Program (CIP) Rule and the beneficial ownership requirements of the Customer Due Diligence (CDD) Rule as soon as practicable.

In the Proposal, FinCEN stated its intention to apply customer identification and due diligence requirements to advisers in the future, and we encourage FinCEN to do so. Identifying and verifying the identity of investors, including beneficial ownership information, is foundational to any AML and sanctions screening program. For example, it is not possible for a firm to screen a potential customer against sanctions lists without this information.

Strong CIP and CDD requirements are particularly important for the opaque private markets. Indeed, private funds currently enjoy special treatment allowing them to conceal information about their investors. For example, the Corporate Transparency Act exempts pooled investment vehicles from reporting beneficial ownership information to FinCEN.[17] This loophole hamstrings FinCEN's efforts to crack down on the use of private funds to facilitate illicit financial flows. Further, the securities laws limit the circumstances in which the SEC can obtain information about the "identity, investments, or affairs of any" private fund.[18] In short, there is currently no public disclosure or regulatory reporting of beneficial ownership information for private funds under the securities laws, national security laws, or state corporate law—making it all the more important for advisers to collect, verify, and screen against this information.

In order to guard against AML and other national security risks, FinCEN should quickly move forward with additional rulemaking to subject advisers to similar CIP and CDD requirements as those applicable to brokers and dealers. FinCEN is required to revise the final rule entitled "Customer Due Diligence Requirements for Financial Institutions" by January 1, 2025, and that rulemaking is a logical vehicle to address this issue for advisers.[19]

IV. The Proposal should cover exempt reporting advisers.

The Proposal would extend AML obligations to a segment of advisers called exempt reporting advisers (ERAs), which are advisers solely to private funds with less than $150 million under management in the United States or solely to venture capital funds. There are approximately 6,000 ERAs with at least $6 trillion under management.[20] Many of these ERAs are foreign advisers that manage billions of dollars for U.S. investors, but use creative tactics and complex structures to qualify for the exemption. It is critical for these advisers and these assets to be brought under the BSA framework. This aspect of the Proposal should be finalized as proposed.

Although ERAs are not required to register with the SEC, they remain subject to many of the same obligations as registered advisers. These include public disclosure of information regarding the private funds that they sponsor, regulatory reporting of systemic risk information, a fiduciary duty to clients, restrictions on conflicted practices like principal trades and cross transactions, rules against committing fraud on investors in private funds, requirements to have insider trading policies, and restrictions on political contributions to state and local officials.

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[17] 31 U.S.C. 5336(a)(11)(xviii).
[18] 12 U.S.C. 80b-10(c).
[19] 31 U.S.C. 5311 note.
[20] S*upra* n.2.

AML obligations bear a very close resemblance to items on this list. If ERAs are already required to maintain insider trading policies in order to prevent fraud on our financial markets, then they should also be required to maintain AML policies in order to prevent the financial system from being abused by criminals and sanctioned persons. The baseline set of rules and prohibitions that apply to ERAs are designed to root out egregious misconduct that can cause a loss of confidence in our markets and financial system. AML program requirements fall squarely within this category.

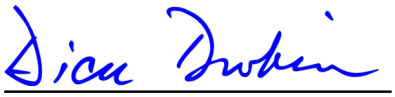
V. Conclusion

Investment advisers have an important role to play in safeguarding the U.S. financial system from crime. They can be valuable partners for FinCEN as it seeks to meet our enormous challenges to combat not only money laundering, but also fraud and other financial crimes. Such a partnership is also important to ensure the effectiveness of U.S. sanctions programs, which have expanded significantly during the pendency of FinCEN's rulemaking. Accordingly, it is important to our national security that rigorous AML and sanctions compliance standards finally are extended to investment advisers. For these reasons, we respectfully request that you move as quickly as practicable to finalize the Proposal.

Thank you for your consideration of these comments.

Sincerely,

Jack Reed
United States Senator



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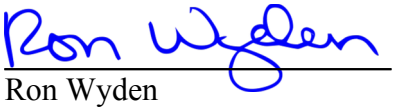
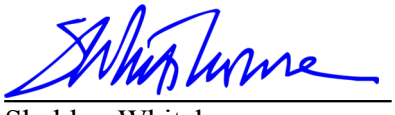


Ron Wyden
United States Senator



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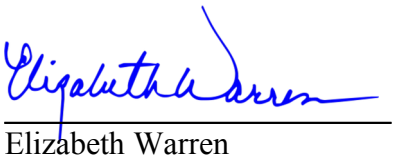

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