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SEC and FinCEN propose rule to require investment advisers to establish Customer Identification Programs (CIPs)

Initial perspectives related to joint SEC and Financial Crimes Enforcement Network (FinCEN) rule proposal

Center *for* **Regulatory Strategy US**

On May 13, 2024, the Securities and Exchange Commission (SEC) and the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a joint notice of proposed rule-making (NPRM, proposed rule hereafter) that would require SEC-registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to establish, document, and maintain written customer identification programs (CIPs). The proposal is designed to prevent illicit finance activity involving the customers of investment advisers by strengthening the anti-money laundering and countering the financing of terrorism (AML/CFT) framework for the investment adviser sector, by making it more difficult for persons to use false identities to establish customer relationships with investment advisers for the purposes of engaging in money laundering, terrorist financing, or other illicit activities. If implemented, the new rule would require RIAs and ERAs to set forth a written CIP that would include procedures for (1) verifying the identity of each customer to the extent reasonable and practicable and (2) maintaining records of the information used to verify a customer's identity. If adopted, the effective date of the rule will be 60 days after the date on which the final rule is published in the Federal Register. As proposed, RIAs and ERAs would have 6 months from the effective date of the rule to develop and implement a CIP.

5 insights you should know

Scope: The proposal complements a FinCEN proposal from February 14, 2024 that proposes to designate certain investment advisers as "financial institutions" under the Bank Secrecy Act (BSA) and to subject them to AML/CFT Program requirements, in addition to, suspicious activity report (SAR) filing obligations. As with the AML/CFT Program and SAR proposed rule, this proposed rule would apply to SEC-registered investment advisers (RIAs) and exempt reporting advisers (ERAs).

Customer and account definitions: Under the proposed rule, a customer is defined as a natural person, or legal entity, who opens a new account with an RIA or an ERA[1]. Furthermore, the proposed CIP rule defines an account as, "any contractual or other business relationship between a person and an investment adviser under which the investment adviser provides investment advisory services."[2] RIAs and ERAs will be required to look across their business to assess whether the proposed rule would apply to other nontraditional relationships.

CIP minimum elements: CIPs are long-standing, foundational components of financial institutions' anti-money laundering programs. At a minimum CIPs require: (1) verifying the identity of any person seeking to open an account to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity including name, address, and other identifying information; and, (3) consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.

Customer information required: Under the proposed rule, investment advisers are required to obtain the following information prior to opening an account: (1) name; (2) date of birth for an individual or date of formation for a person that is not an individual; (3) address (residential or business street address for an individual; (4) principal place of business, local office, or other physical location for a person that is not an individual); and, (5) identification number.

Mutual funds exception: Under the proposed rule, investment advisers may deem these requirements satisfied for any mutual fund it advises if the mutual fund has implemented a CIP that is compliant with CIP requirements applicable to mutual funds under the relevant provision.

5 considerations to evaluate

1. **Conduct a gap assessment of existing CIPs:** In anticipation for the final rule, investment advisers should review and analyze their existing CIP procedures, if any, to assess their current state of compliance. CIP programs should include prescriptive mechanisms for investment advisers to obtain necessary identifying information from customers and verify the identity of its customers through documentary and/or non-documentary verification. Investment advisers should also assess procedures for providing required notification to customers that the investment adviser is requesting information to verify their identities.
2. **Update policies, procedures, and systems to meet requirements:** Investment advisers who have yet to implement an AML/CFT program should consider updating their policies, procedures, processes and systems in anticipation of the final rule to include: (1) obtaining required identifying information for customers; (2) establishing processes to verify the identity of new customers through documentary and/or non-documentary means, such as third party identity verification vendors or public databases, or both; and, (3) maintaining records in accordance with record retention requirements.
3. **Have a risk-based approach:** The proposed rule would require investment advisers to implement a risk-based approach when establishing CIP procedures. Investment advisers must consider their relevant risks when designing and implementing their CIP program, including such risk factors as the type of account, methods available for account opening, types of identifying customer information available, and size, location, and customer base.
4. **Leverage reliance agreements:** The proposed rule does recognize that investment advisers may rely on certain other financial institutions to perform the CIP. However, reliance must be documented in a written agreement and: (1) must be reasonable under the circumstances; (2) the financial institution is required to maintain an AML/CFT program under the BSA and is regulated by a federal functional regulator and (3) the financial institution must enter into a contract with the investment adviser requiring it to annually certify that it has implemented its AML/CTF Program and will perform the specified requirements of the investment adviser's CIP.
5. **Prepare to direct more resources toward CIP compliance:** In preparation for the final rule, ERAs and RIAs should begin directing resources toward CIPs. Specifically, Investment advisers may need to devote more compliance, legal and operational personnel to designing and implementing CIP processes and may need to evaluate vendor relationships for identity verification. Additionally, investment advisers may need to dedicate more resources to training as investment advisers will need to implement CIP training for employees.

Definitions:

Securities and Exchange Commission (SEC). Financial Crimes Enforcement Network (FinCEN), Anti-money laundering/countering the finance of terrorism (AML/CFT), Notice of Proposed Rulemaking, Registered investment adviser (RIA), Exempt reporting adviser (ERA), Customer Identification Program (CIP), Suspicious activity report (SAR), Bank Secrecy Act (BSA)

Endnotes

1. Securities and Exchange Commission (SEC), "Joint notice of proposed rulemaking: Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers" press release May 13, 2024.

2. SEC, "Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers" May 13, 2024.

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