FACTCOALITION
Financial Accountability & Corporate Transparency

April 15, 2024

Andrea Gacki
Director
Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, VA 22183

Submitted electronically via www.regulations.gov

Re: FinCEN's Draft Rule Proposing AML/CFT Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers

Docket Number FINCEN–2024–0006; RIN 1506–AB58

Dear Director Gacki,

On behalf of the Financial Accountability and Corporate Transparency (FACT) Coalition, this letter responds to the request by the Financial Crimes Enforcement Network (FinCEN) of the United States Department of the Treasury (Treasury) for comment on a notice of proposed rulemaking (NPRM) to establish anti-money laundering (AML) regulations for U.S. investment advisers.

FACT welcomes this long-overdue extension of anti-money laundering requirements to Registered Investment Advisers (RIAs) and Exempt Reporting Advisers (ERAs), and encourages FinCEN to adopt these measures in a timely fashion. In particular, we welcome and strongly support:

- **The inclusion of both registered and exempt advisers**, in light of the well established money laundering vulnerabilities they present;
- **The application of standard safeguards to prevent money laundering and combat terrorism financing** including risk-based AML controls, recordkeeping obligations, suspicious activity reporting (SAR) requirements, and other measures to protect the integrity of the investment adviser industry; and

- ❖ **FinCEN's plans to collaborate with the Securities and Exchange Commission (SEC)** to develop specific know-your-customer (KYC) requirements for the investment advisory industry.

The FACT Coalition emphasizes that:

- ❖ The money laundering risks in the private investment advisory sector are **significant**, as outlined in Treasury's risk assessment accompanying the NPRM.
- ❖ This rule is necessary to track and tackle those money laundering risks. Existing SEC obligations and reporting requirements for investment advisers are designed to protect investors and capital markets. These requirements do not serve an AML purpose, and are no substitute for effective AML safeguards.
- ❖ The estimated costs of the proposed rule are ***insignificant*** compared to the size of this $130 trillion industry and the serious risks to U.S. economic and national security posed by the current lack of AML safeguards.
- ❖ The proposed AML obligations are comparable to those that have long applied to the banking industry, which is dwarfed by the investment advisory industry for private funds. Commercial banks hold around $23.3 trillion in assets while RIAs and ERAs account for $130 trillion in assets under management.[1] Given the massive illicit finance and national security risks present in the investment advisory industry, there is no reason that investment advisers should be excluded from complying with U.S. AML obligations that already apply to other financial institutions.

In addition, as described below, FACT recommends that FinCEN improve this proposed rule by taking the following steps:

- ❖ **Add foreign private advisers**: Foreign investment advisers pose a money laundering risk to the U.S. financial sector and national security. Covering those foreign private advisers that would otherwise remain unregulated under this proposal will help to close a potential money laundering avenue, and foreclose competition between U.S. and non-U.S. investment advisers based on who has AML obligations.
- ❖ **Add family offices**: Family offices employ investment advisers to transfer enormous sums around the world at the direction of wealthy individuals, posing inherent AML

[1]Board of Governors of the Federal Reserve System (US), Total Assets, All Commercial Banks https://fred.stlouisfed.org/series/TLAACBW027SBOG; RIA and ERA figures from Department of the Treasury, Financial Crimes Enforcement Network, "Notice of proposed rulemaking, Financial Crimes Enforcement Network: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Reporting Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers," Federal Register, Vol. 89, No. 32, Feb. 15, 2014 (NPRM), p. 12143.

risks. Family offices have already presented money laundering risks in other jurisdictions with advanced investment advisory industries. Covering family offices will help close this money laundering vulnerability, and prevent future abuses from tainting the growing global network of family offices.

- ❖ **Ensure real estate funds are covered**: While most pooled real estate investment vehicles are covered by this rule, a small subset may not be covered due to an SEC classification deeming interests in those funds not to be "securities." This subset functions in much the same way as other pooled investment vehicles, and its investment advisers should be subject to AML obligations to prevent creating a loophole that could be exploited by money launderers and other wrongdoers.
- ❖ **Swiftly finalize Customer Identification Program and Customer Due Diligence (CDD) rules**: To ensure effective AML safeguards in the investment advisory sector, FinCEN must move swiftly in concert with the SEC to finalize a Customer Identification Program (CIP) rule and **require covered investment advisers to know their customers, including the true, beneficial owners behind their legal entity clients.** Basic KYC rules for investment advisers should not be delayed while a separate rulemaking to conform the existing CDD rule for banks to the Corporate Transparency Act (CTA) is proposed and finalized, especially since pooled investment vehicles raise CDD issues that will not be addressed in that CTA rulemaking. **The effectiveness of AML safeguards proposed in this rulemaking rests on the ability of investment advisers to know their customers, the source of their funds, and the nature of their transactions.** FinCEN must not delay in ensuring that these basic KYC requirements are finalized and implemented.

Background

The FACT Coalition is a United States-based, non-partisan alliance of more than 100 state, national, and international organizations promoting policies to build a fair and transparent global financial system that limits abusive tax avoidance and curbs the harmful impacts of corrupt financial practices.[2] The FACT Coalition has a long-standing interest in closing money laundering loopholes in the private investment sector.[3] FACT and its members have also collected evidence of the

[2] A full list of FACT members is available at: Financial Accountability and Corporate Transparency (FACT) Coalition (March 2024), "Coalition Members," https://thefactcoalition.org/about-us/coalition-members-and-supporters/. The views presented in this comment are not necessarily endorsed by every member of the Coalition.

[3] *See, for example,* FACT Coalition, "FACT Submits Comments to the SEC Encouraging Additional Due Diligence and Reporting Requirements for Financial Advisors," October 12, 2022, https://thefactcoalition.org/fact-submits-comments-to-the-sec-encouraging-additional-due-diligence-and-reporting-requirements-for-financial-advisors/. *See also,* FACT Coalition, "FACT, 10 Orgs Urge Treasury, FinCEN to Complete the Anti-Money Laundering Rule for Asset Managers," April 6, 2016, https://thefactcoalition.org/fact-10-orgs-urge-treasury-fincen-to-complete-the-anti-money-laundering-rule-for-asset-managers.

vulnerability of this sector to questionable funds, most recently in a 2021 report titled "Private Investments, Public Harm: How the Opacity of the Massive U.S. Private Investment Industry Fuels Corruption and Threatens National Security" (attached).

It is clear that the opaque and complex private investment industry has become increasingly vulnerable to illicit finance involving criminals, kleptocrats, sanctioned persons, and U.S. adversaries, as detailed in the attached 2021 report as well as in the proposed rule's accompanying risk assessment and the recent national risk assessment.[4] Each of those documents contains strong evidence that the opacity of the U.S. private investment industry and the current lack of AML controls have jeopardized the integrity of our financial system as well as our national security interests.

The dangers are particularly clear when considering recent investments financed with suspect funds from Russia. Consider, for example, suspect Russian money that has infiltrated Silicon Valley venture capital funds for years, including to finance technologies with national security implications.[5] Consider also Concord Management, a New York investment adviser that allegedly managed billions in hedge fund and private equity investments for now-sanctioned Russian oligarch Roman Abramovich, using companies based in the British Virgin Islands and Jersey to help obscure his ownership.[6] According to the Treasury Department, another sanctioned Russian oligarch, Suleiman Kerimov, formed and used a Delaware trust to conceal and invest over $1 billion in suspect funds in "large public and private U.S. companies," employing "a series of U.S. investment firms and facilitators" to manage his investments.[7] These examples show how vulnerable the investment advisory industry is to wrongdoers laundering funds through the U.S. financial system.

These examples also show how the money laundering vulnerabilities of the investment advisory industry pose national security risks to the United States. **Investments made without applicable AML safeguards have put U.S. adversaries within arm's reach of sensitive technologies, including military technologies.** This problem isn't limited to Russia. The attached 2021 report describes, for example, how Chinese state-owned venture capital firms have poured huge sums into Silicon Valley venture capital funds investing in U.S. technologies with civilian and military

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[4] This evidence is consistent with public reporting of a leaked 2020 FBI intelligence bulletin that the Bureau had evidence to believe with high confidence that "[t]hreat actors use the private placement of funds, including investments offered by hedge funds and private equity firms…the FBI assumes threat actors exploit this vulnerability to integrate illicit proceeds into the licit global financial system." Timothy, Lloyd, "FBI concerned over laundering risks in private equity, hedge funds - leaked document," Reuters, July 14, 2020, https://www.reuters.com/article/idUSKCN24F1TE/.
[5] Joseph Menn, Elizabeth Dwoskin, Douglas MacMillan and Cat Zakrzewski, "From Russia with money: Silicon Valley distances itself from oligarchs," Washington Post, April 1, 2022, https://www.washingtonpost.com/technology/2022/03/26/silicon-valley-russia-oligarchs/.
[6] Matthew Goldstein, "Regulators Charge Money Manager Tied to Russian Oligarch," New York Times, September 19, 2023, https://www.nytimes.com/2023/09/19/business/sec-concord-abramovich.html.
[7] "U.S. Treasury Blocks Over $1 Billion in Suleiman Kerimov Trust," U.S. Department of the Treasury (6/30/22), https://home.treasury.gov/news/press-releases/jy0841.

applications. A report issued by the Foundation for Defence of Democracy, *The Weaponization of Capital*, observes: "Chinese political and economic leaders appear to grasp the importance of these fields [the strategic role of private market capital flows] and how they could have outsized influence in the current U.S.-China competition."[8]

Most other major U.S. capital market participants – for instance, banks, broker-dealers, commodities traders, future commission merchants, and registered investment companies like mutual funds – already have AML obligations in place. This reality makes the private investment industry, along with its investment advisers, a singular outlier. **There is no apparent justification for this massive sector's lack of AML regulation.** The 2022 National Risk Assessment (NRA) also noted a growing industry shift away from broker-dealers, and toward the use of RIAs, which often have no AML obligations, signifying the growing illicit finance risk in the industry.[9]

Given the illicit finance and national security risks suffusing the investment advisory industry, FinCEN's proposed rule to apply standard AML safeguards to investment advisers is both necessary and overdue.

Definition of Investment Adviser

The key to the effectiveness of the proposed rule is its definition of "investment adviser," as the resulting scope will determine who has AML obligations. We broadly support the proposed clear and comprehensive definition of "investment adviser." It is important that FinCEN retain this proposed coverage in the final rule, as it encompasses key categories of investment advisers presenting significant risk for the placement of illicit funds in the U.S. financial system. At the same time, **considering the significant illicit finance risks at stake, we recommend that the definition be modestly expanded, as detailed below, to include foreign private advisers, family offices, and advisers to real estate investment funds.** We also encourage FinCEN to continue monitoring AML risks relating to state-registered investment advisers.

Retain coverage of RIAs and ERAs.

We applaud FinCEN for including in its proposal both investment advisers required to register with the SEC, known as RIAs, and investment advisers exempt from SEC registration, known as

[8] Emily de La Bruyère and Nathan Picarsic, "The Weaponization of Capital: Strategic Implications of China's Private Equity/Venture Capital Playbook," Foundation for Defense of Democracies, September 15, 2022, https://www.fdd.org/wp-content/uploads/2022/09/fdd-memo-the-weaponization-of-capital.pdf.
[9] Department of the Treasury, "National Money Laundering Risk Assessment," February 2022 (2022 National Risk Assessment), p. 63-65, https://home.treasury.gov/system/files/136/2022-National-Money-Laundering-Risk-Assessment.pdf.

ERAs.[10] The definitions for both categories of investment advisers are clear and long established, and together encompass the greatest money laundering risks to U.S. financial and national security interests.

It is particularly critical that ERAs continue to be covered in the final rulemaking. The 2024 Investment Adviser Risk Assessment released by Treasury states:

> "The highest illicit finance risk lies among ERAs, where there are either more limited reporting requirements (under the federal securities laws) or none at all. Private funds, such as hedge funds or private equity funds, are not registered with the SEC, and may accept investors without knowing the ultimate beneficial owners or sources of funds. Further, approximately half of these funds are domiciled outside the United States, often in jurisdictions where the practice is to rely on representations and warranties from intermediaries who represent investors when it is not possible to obtain investor identity and source of funds information."[11]

To exclude a category of investment advisers with such clearly recognized illicit finance risks would open a massive loophole for exploitation by corrupt actors to launder ill-gotten gains or access sensitive proprietary technology in the U.S..

The evidence is clear that funds advised under 203(l) and 203(m) of the Advisers Act (venture capital and private funds) pose significant money laundering risks. A few notable examples include:

❖ Private equity played a key role in the 1MDB scandal in which hundreds of millions of dollars were layered through private investment funds before being pocketed by the perpetrators of the fraud.[12] Approximately $150 million was diverted from a 1MDB bond issuance into the U.S. financial system by Low Taek Jho (Low), the CEO of an investment advisory firm to a private equity fund in Asia. Low used a subsidiary of his investment advisory firm to purchase equity interests in an investment vehicle managed

[10] RIAs are generally investment advisers with over $110 million in assets under management, representing advisers with the largest investment portfolios in the United States. ERAs are investment advisers who: (1) advise only private funds and have less than $150 million in assets under management in the United States, or (2) advise only venture capital funds. While ERAs are exempt from SEC registration, they are still required to file certain information with the SEC.
[11] Department of the Treasury, "2024 Investment Adviser Risk Assessment," February 2024 (2024 Investment Adviser Risk Assessment), p. 32, https://home.treasury.gov/system/files/136/US-Sectoral-Illicit-Finance-Risk-Assessment-Investment-Advisers.pdf.
[12] Private Investments, Public Harm, p. 17.

by a private equity firm in the U.S., concealing the payments' origins by moving funds through multiple accounts.[13]

- ❖ Funds tied to Russian oligarchs have been prevalent in Silicon Valley venture capital, with risks emerging around national security. While Silicon Valley now considers Russian money to be 'tainted', some used to brag about their Russian connections, and the lack of regulation makes it difficult to discern between legitimate and illegitimate funding: "Undisclosed sources of investment are common in Silicon Valley, because venture capital firms and start-ups are not required to declare their backers. That murkiness also means many firms fear being unfairly tarred for having taken international funding or specialized in companies with Russian founders or technical talent, which are abundant."[14]
- ❖ Between at least 2017 and 2019, a Singapore based investment fund, Lang Capital Fund, invested in a California venture capital fund, 8VC, which in turn invested in a U.S. government contractor producing intelligence software and a company producing software that assists in crafting government regulations. Lang Capital's true owner was Kirill Androsov, former deputy chief of staff to Vladimir Putin and former chair of Russia's state-owned airline, who also has financial ties to Oleg Deripaska, a key figure in the allegations of Russian election tampering in the United States.[15] This example underscores that the current lack of regulation poses national security risks as well as illicit finance risks.
- ❖ As a scandal involving allegations of sexual abuse grew around the 'Legion of Christ,' trusts it controlled in New Zealand invested funds into U.S. real estate through private equity firm Pensam Capital, using a Delaware shell company to make the investments. Management pursued aggressive strategies to maximize investor value, leading to extra fees and evictions during the height of the Covid-19 pandemic.[16]

Numerous other examples of risks attached to hedge funds and private equity firms are included in the attached report, *Private Investments, Public Harm*. In addition, according to public reporting, a leaked 2020 FBI memo warned that U.S. private investment funds were being used in illicit finance schemes. The FBI memo reportedly stated that: Mexican drug cartels used hedge fund accounts to launder millions of dollars per week before purchasing gold to move money

[13] 2024 Investment Adviser Risk Assessment, p. 19.
[14] Joseph Menn, Elizabeth Dwoskin, Douglas MacMillan and Cat Zakrzewski, "From Russia with money: Silicon Valley distances itself from oligarchs," Washington Post, April 1, 2022, https://www.washingtonpost.com/technology/2022/03/26/silicon-valley-russia-oligarchs.
[15] Spencer Woodman, "How investment firms shield the ultrawealthy from the IRS," International Consortium of Investigative Journalists, April 3, 2024, https://www.icij.org/inside-icij/2024/04/how-investment-firms-shield-the-ultra-wealthy-from-the-irs/.
[16] Spencer Woodman, "As Catholic order fought sex abuse claims, secret trusts devoted to it poured millions into American rental properties," International Consortium of Investigative Journalists, October 5, 2021, https://www.icij.org/investigations/pandora-papers/legion-of-christ-us-property-evictions-offshore.

across international borders; a private equity firm in New York received over $100 million in wire transfers from a company with alleged ties to Russian organized crime; and that hedge funds were being used to facilitate trade-based money laundering and sanctions evasion.[17] In yet another example, from 2006 to 2012, U.S.-based operatives for a Russian-American organized crime enterprise moved about $50 million in illicit gambling proceeds through investments in hedge funds or real estate, using layers of shell companies.[18] While not all advisers implicated in these examples are necessarily ERAs, many private funds are advised by ERAs, highlighting the risk posed by investment advisers to U.S. venture capital and private equity funds.

Given Treasury's assessment of the ERAs as having the "highest illicit finance risk" in the investment advisory industry, it is critical that ERAs be retained in the final rule.

Add foreign private advisers.

Foreign private advisers, a subset of non-U.S. investment advisers, should also be covered by the final rule. Current SEC rules provide that foreign private advisers do not need to register or file with the agency when they have no place of U.S. business, fewer than 15 clients in the United States, less than $25 million in funds under administration, and do not hold themselves out as offering U.S. investment advisory services.[19] As currently proposed, the rule would not subject these foreign private advisers to any AML obligations. FinCEN proposes to cover domestic private fund advisers, and larger foreign private advisers, to the extent that they have U.S. clients.

Foreign investment advisers, whether or not they fall under the exemption for foreign private advisers, pose a money laundering risk to the U.S. financial system. FinCEN should apply the definition of "investment adviser" to all non-U.S. investment advisers with U.S. clients and including foreign private advisers who are exempt from SEC registration. Whatever purpose the SEC registration exemption for foreign private advisers serves in the securities regulatory context, it serves no such purpose in the AML context and would provide corrupt actors with an easy way to circumvent AML safeguards that protect U.S. financial and national security interests.

According to the 2024 Investment Adviser Risk Assessment, foreign wealth management firms, located in places like Bermuda, the Cayman Islands, and Cyprus are frequently used as intermediaries for Russian political and economic elites to invest in U.S. public or private

[17] Private Investments, Public Harm, p. 25; see also Timothy Lloyd, "FBI concerned over laundering risks in private equity, hedge funds - leaked document," Reuters, July 14, 2020, https://www.reuters.com/article/idUSKCN24F1TE/.
[18] Private Investments, Public Harm, p. 26.
[19] NPRM, fn 38.

companies. Transactions are variously conducted by a foreign firm directly, or through a U.S.-based RIA or ERA.[20] The resulting AML risks are compounded by low levels of enforcement in jurisdictions such as the Cayman Islands:[21] According to the Caribbean Financial Action Task Force Mutual Evaluation of the Cayman Islands, fund administrators in the Cayman Islands filed only 37 SARs in all of 2017.[22]

Covering all foreign investment advisers with U.S. clients would help prevent loopholes that would otherwise expose the United States to illicit finance and national security threats funneled through foreign channels.

Add family offices.

Congress excluded family offices from the Advisers Act on the grounds that "[t]he Advisers Act is not designed to regulate the interactions of family members, and registration would unnecessarily intrude on the privacy of the family involved."[23] But that rationale does not apply in the anti-money laundering context, and FinCEN should include family offices in the definition of investment adviser for the purposes of this rulemaking.

Family offices handle billions of dollars in investments each year. A 2023 report by Camden Wealth Management, which surveyed 144 single and multi-family offices in the United States and Canada, found that those offices collectively managed $126 billion in assets in 2022, with each office managing an average of $900 million.[24] The data included family offices located in 25 U.S. states.[25] The report stated that family offices were directing an "ever-increasing allocation" of investments to private markets, in particular private equity and venture capital.[26] It also indicated that family offices had spent an average of $5.7 million on their 2022 operational costs, indicating the breadth of these operations.[27] Another report discloses that the "family office

[20] 2024 Investment Adviser Risk Assessment, p. 20.
[21] 2024 Investment Adviser Risk Assessment, p. 26
[22] "Anti-money laundering and counter-terrorist financing measures, Cayman Islands, Mutual Evaluation Report," Caribbean Financial Action Task Force, March 2019, p. 117, https://www.fatf-gafi.org/content/dam/fatf-gafi/fsrb-mer/CFATF-Cayman-Islands-Mutual-Evaluation.pdf.
[23] S. Conf. Rep. No. 111-176, at 75 (2010), https://www.congress.gov/111/crpt/srpt176/CRPT-111srpt176.pdf.
[24] "The North America Family Office Report 2023," Campden Wealth Ltd., p. 6, (based on information gathered between April and September 2023), https://www.rbcwealthmanagement.com/en-ca/campaign/the-north-america-family-office-report.
[25] Id., p. 10.
[26] Id., p. 6. The report also states, "An overwhelming 90 percent of North American family offices have a stake in private equity. Of this investment, 42 percent is achieved through direct participation, and 49 percent through holdings of funds or fund of funds."; id., p. 28.
[27] Id., p. 7.

sector has been increasing at a rapid pace, with the number of family offices nearly doubling between 2008 and 2018."[28]

While Treasury considers family offices to have a "relatively lower risk for illicit finance,"[29] they are currently not without risk, and – should they be excluded from this rulemaking – will likely present a much more significant risk in the future.

Corrupt figures can and have turned to family offices to manage and launder their ill-gotten gains. For example, Jahangir Hajiyev, former chair of the largest bank in Azerbaijan – later convicted of looting that bank – spent tens of millions of dollars in suspect funds in London along with his wife using family offices and other gatekeepers.[30] More recently, family offices played a role in a major money laundering scandal in Singapore which, like the United States, is a significant investment hub. Uncovered in August 2023, the money laundering scheme involving more than SGD2.8 billion (over US$2 billion) led to the arrest of 10 persons reportedly using at least five family offices among them.[31] Even before the scandal, Singapore had proposed revising its regulatory framework for family offices due to a perceived AML vulnerability.[32] In the wake of the scandal, Singapore extended the scope of its AML due diligence and documentary checks to a wider group of individuals and entities associated with family offices.[33] These examples show how family offices can easily be misused to further illicit finance.

[28] Josipa Majic Predin, "The Rise and Rise of the Family Office: An Analysis," Forbes, January 11, 2024, https://www.forbes.com/sites/josipamajic/2024/01/11/the-rise-and-rise-of-the-family-office-an-analysis/?sh=2eb3315a12ed (citing data from "The Family Office Boom: Contrasts between East and West," The Economist Intelligence Unit and DBS Bank, 2020, https://impact.economist.com/perspectives/sites/default/files/eiu_dbs_the_family_office_boom_0114.pdf.

[29] 2024 Investment Adviser Risk Assessment, p. 33.

[30] Edward Robinson and Gavin Finch, "Dirty Money Spotlights Role of Family Offices as Enablers," Bloomberg, July 30, 2019, https://www.bloomberg.com/news/features/2019-07-30/dirty-money-spotlights-role-of-family-offices-as-enablers; Aoife White and Ellen Milligan, "Jailed Banker's Wife Loses Final Appeal on U.K. Asset Freeze," Bloomberg, December 21, 2020, https://www.bloomberg.com/news/articles/2020-12-21/jailed-banker-s-wife-loses-final-appeal-on-u-k-asset-freeze.

[31] Angela Tan, "One or more in $2.8b money laundering case may be linked to family offices given tax incentives in S'pore," The Straits Times, October 4, 2023, https://www.straitstimes.com/singapore/politics/one-or-more-in-28b-money-laundering-case-may-be-linked-to-family-offices-that-got-tax-incentives; Chanyaporn Chanjaroen and Low De Wei, "How Suspects Laundered Billions in Singapore for Years," Bloomberg, December 3, 2023, https://www.bloomberg.com/news/articles/2023-12-04/how-suspects-spent-billions-in-singapore-s-biggest-money-laundering-case.

[32] Prisca Ang, "MAS seeks views on framework to combat potential money laundering at single-family offices in S'pore," The Straits Times, July 31, 2023, https://www.straitstimes.com/business/mas-seeks-views-on-framework-to-combat-money-laundering-among-single-family-offices-in-s-pore; "Consultation Paper on Proposed Framework for Single Family Offices," Monetary Authority of Singapore, July 2023, https://www.mas.gov.sg/-/media/mas/news-and-publications/consultation-papers/2023-consultation-paper-on-proposed-framework-for-single-family-offices/consultation-paper-on-proposed-framework-for-single-family-offices.pdf.

[33] "Wealth Management," Monetary Authority of Singapore, last accessed April 15, 2024, https://www.mas.gov.sg/development/wealth-management.

If the proposed exemption is retained, private investment firms registered with the SEC can easily and quickly convert to unregistered family offices and thereby circumvent all AML obligations. A recent example of that type of conversion is CaaS Capital Management, a U.S. private fund led by Frank Fu. According to press reports, Mr. Fu wanted to hire an investment adviser, Pawan Passi, who had been banned by the SEC from the brokerage industry for one year due to block trading abuses, had entered into a six-month deferred prosecution agreement with the Department of Justice, and had been fired by his employer Morgan Stanley which paid a $249 million fine for his misconduct.[34] Mr. Fu simply terminated CaaS Capital's registration with the SEC as an investment adviser, declared itself a family office, and hired Mr. Passi.[35]

Excluding family offices from the final rule because they are not currently sufficiently "high risk" would be short-sighted, since that exemption alone would immediately change the incentives for corrupt actors to begin utilizing family offices. Once other RIAs and ERAs are subject to AML due diligence and SAR requirements, it may well be that family offices become the path of least resistance for dirty money. At the same time, it is clear that family offices already have both the sophistication and funds needed to comply with AML safeguards critical to protecting U.S. financial and national security interests. Due to the clear risks at stake, we urge FinCEN to include family offices in the definition of investment advisers subject to AML obligations.

Ensure real estate investment funds are covered.

To the extent not already covered, investment advisers for real estate investment funds should be included in the final rule. In particular, certain real estate funds that solely hold real estate in fee simple ownership form may not be covered by the Investment Advisers Act, because such real estate investments do not always fall under the definition of a "security" for SEC purposes. As with family offices, while the distinction between a security and a real estate investment may serve a purpose in the SEC context, it has no AML relevance, and given the considerable AML risks of real estate investments, it is critical they are covered by the final rule.

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[34] See, e.g., Sridhar Nataajan and others, "Barred Morgan Stanley Banker Joins Firm That Got His Trading Leaks," Bloomberg News, April 10, 2024, https://www.bnnbloomberg.ca/barred-morgan-stanley-banker-joins-firm-that-got-his-trading-leaks-1.2057285; See also "U.S. Attorney Announces Agreements with Morgan Stanley and Former Senior Employee, Pawan Passi, In Connection with Deceptive Practices in Block Trades Business," U.S. Department of Justice, January 12, 2024, https://www.justice.gov/usao-sdny/pr/us-attorney-announces-agreements-morgan-stanley-and-former-senior-employee-pawan-passi.

[35] Sridhar Nataajan et al., "Barred Morgan Stanley Banker Joins Firm That Got His Trading Leaks," Bloomberg News, April 10, 2024, https://www.bnnbloomberg.ca/barred-morgan-stanley-banker-joins-firm-that-got-his-trading-leaks-1.2057285.

Real estate investments have long provided an attractive option for corrupt actors seeking to conceal and launder their ill-gotten gains, and are currently the subject of a separate FinCEN rulemaking. The same AML risks apply to real estate investment funds. Consider, for example, Sefira Capital LLC, a Florida-based investment company that operated real estate investment funds targeting high-end residential and commercial properties primarily in the southwestern United States.[36] From 2016 to 2019, Sefira Capital accepted and invested millions of dollars of what turned out to be drug trafficking proceeds, eventually laundering over $50 million. Some of the money had been supplied by the Drug Enforcement Administration (DEA) as part of a covert sting operation in which DEA agents invested funds at the direction of money laundering brokers working with drug cartels. Without any AML obligations, Sefira Capital had accepted the transferred funds without asking about the source of the money or who was supplying it. The group's laundering of drug proceeds came to light solely because of the DEA sting operation. In 2021, the Department of Justice filed a civil forfeiture action against Sefira Capital, which settled the matter by forfeiting $29 million in dirty money. In the settlement, Sefira Capital also agreed to conduct due diligence reviews of future investors and accept funds only when sent directly by the investors who passed muster.

Suspect funds have also come to be implicated in a concerning trend of private equity ownership of residential property, with a United Nations Special Rapporteur describing the "expanding role and unprecedented dominance of financial markets and corporations in the housing sector" as contributing to increasing poverty and homelessness.[37] Consider the following examples:

- ❖ From 2011, now-sanctioned Russian billionaire Mikhail Fridman, co-founder of Alfa Bank, Russia's largest private bank, launched a U.S.-based real estate fund worth $1 billion to acquire distressed properties all along the East Coast, from Boston to Miami.[38]
- ❖ In 2014, a now-sanctioned Cyprus resident, Demetris Ioannides, and his relatives became the largest investor in an otherwise ordinary four-story mixed residential and commercial apartment building in Queens, New York. After a pitch from a New York private equity company Triena Capital Partners, Ioannides, who made his money helping move vast sums of questionable origin out of Russia, purchased the property through shell

[36] "Acting Manhattan U.S. Attorney Announces Settlement Of Civil Forfeiture Claims Against Over $50 Million Laundered Through Black Market Peso Exchange," U.S. Attorney's Office, Southern District of New York, January 12, 2021, https://www.justice.gov/usao-sdny/pr/acting-manhattan-us-attorney-announces-settlement-civil-forfeiture-claims-against-over; see also Lakshmi Kumar & Kaisa de Bel, "Acres of Money Laundering: Why U.S. Real Estate is a Kleptocrat's Dream," Global Financial Integrity, August 2, 2021 (Acres of Money Laundering), Case 12 at p. 56, https://gfintegrity.org/report/acres-of-money-laundering-why-u-s-real-estate-is-a-kleptocrats-dream.

[37] "Report of the Special Rapporteur on Adequate Housing as a Component of the Right to an Adequate Standard of Living, and on the Right to Non-Discrimination in This Context," United Nations General Assembly Human Rights Council A/HRC/34/51, January 18, 2017, https://digitallibrary.un.org/record/861179?ln=en&v=pdf.

[38] Craig Karmin, "The Russians Are Coming," Wall Street Journal, December 21, 2011, https://www.wsj.com/articles/SB10001424052970204058404577109073899340722

companies in the British Virgin Islands. Management raised the rent, driving out some of the building's original tenants, and then sold the building after a few years for a massive profit.[39]

The above examples show how lax AML safeguards can enable abusive housing investments. They also demonstrate the illicit finance risks inherent in pooled real estate investment funds, especially when investment advisers are allowed to accept millions of dollars without any AML safeguards. If advisers to some real estate investment funds are allowed to operate outside of AML obligations while other investment advisers are covered by the proposed rule, it would open up a potentially significant loophole for dirty money. To prevent that outcome, the final rule should make clear that investment advisers to all real estate investment funds, regardless of whether a fund also qualifies as a security, must comply with AML requirements.

To further address the AML concerns raised by real estate investment funds, we also urge FinCEN to swiftly introduce a proposed rule to prevent money laundering using commercial real estate and to address the AML risks posed by pooled real estate investment vehicles in that rule.

Retain subadvisers.

We commend FinCEN for coverage of subadvisers in the proposed rule, regardless of whether or not they manage assets. As the NPRM notes, "subadvisers and advisers who do not manage assets may nonetheless afford their clients access to the U.S. financial system, inadvertently guide the layering or integration of illicit proceeds or other illicit finance activity, or have relationships that provide insight to the investment adviser's AML/CFT program."[40] If subadvisers, who often perform managerial and operational decisions for private funds, were to be exempt from this rule, it would encourage complex contractual arrangements to enable investment advisers to circumvent their AML obligations. As digital advice platforms are incorporated into services offered by overseas advisers and larger investment firms, their coverage is critical to preventing future loopholes. Further, as FinCEN notes, "subadvisers" is an industry distinction, not a legal one. The SEC treats subadvisers as advisers under the Advisers

[39] Spencer Woodman, "Oligarchs' fixer made fortune from New York apartment building," International Consortium of Investigative Journalists, November 15, 2023, https://www.icij.org/investigations/cyprus-confidential/new-york-property-real-estate-cyprus-financial-services.

[40] NPRM p. 12123. See also U.S. Attorney's Office, Eastern District of New York press release covering indictment of two investment subadvisers to an SEC-registered investment firm for fraud, money laundering and other crimes, demonstrating how subadvisers deal directly with clients, make independent investment and operational decisions, and can engage in illicit finance without the knowledge of the firm they are associated with: "Long Island Investment Advisers Indicted for Defrauding Clients of Millions of Dollars," U.S. Attorney's Office, Eastern District of New York, July 25, 2023, https://www.justice.gov/usao-edny/pr/long-island-investment-advisers-indicted-defrauding-clients-millions-dollars.

Act, and FinCEN should do the same for AML purposes. To create exceptions on this basis would add unnecessary complexity and confusion to the rule while also inviting arbitrage.

AML obligations for subadvisers are not necessarily duplicative. First, as FinCEN acknowledges, there may be funds that are not advised by an investment adviser covered by the proposed rule, but that do involve covered subadvisers. Second, it is unlikely that a relevant beneficial owner would need to provide information more than once. Third, adequate recordkeeping by relevant advisers will minimize any duplication of efforts or costs downstream by relevant subadvisers, while also better identifying increased risks that are presented by poor record-keeping or verification efforts. Because imposing obligations on subadvisers is not necessarily duplicative, it is not necessary for FinCEN to consider ways to address potential duplication, such as allowing subadvisers to rely on the primary adviser or allowing the primary adviser to delegate all AML/CFT obligations to the subadviser. This approach is analogous and consistent with the guidance provided for banks regarding their non-bank financial institution accounts, including regarding whether/extent to which the customer/investing fund has AML obligations.[41]

Continue monitoring risks relating to state-registered investment advisers.

We agree with the proposed approach to state-registered investment advisors, whereby FinCEN plans to obtain additional information to determine whether state-registered investment advisers should be included within the scope of the definition of "investment advisers" subject to this AML rule or a future rulemaking. According to the North American Securities Administrators Association (NASAA), every state requires investment advisers doing business with the state to register with the state securities regulator, unless an exemption applies.[42] NASAA estimates about 17,500 investment advisers are currently registered with a state and operate under a variety of state regulations.[43]

It is important for FinCEN to carefully consider this group of investment advisers, because no state currently imposes AML obligations on their registered investment advisers, and state-registered investment advisers are less likely to have AML programs in place. At the same time, state-registered investment advisers may still present money laundering vulnerabilities. There is a risk that exempting state-registered investment advisers from the AML obligations

[41] "Risks Associated with Money Laundering and Terrorist Financing," FFIEC BSA / AML InfoBase, BSA / AML Manual, last accessed April 15, 2024, https://bsaaml.ffiec.gov/manual/RisksAssociatedWithMoneyLaunderingAndTerroristFinancing/22.
[42] "State Investment Advisor Information," North American Securities Administrators Association, last accessed April 15, 2024, https://www.nasaa.org/industry-resources/investment-advisers/state-investment-adviser-registration-information.
[43] Id.

that will apply to their colleagues may drive wrongdoers to employ them rather than covered investment advisers. We urge FinCEN to continue to monitor money laundering associated with those advisers, in case the regulation of other categories of investment advisers at the federal level changes the future risk profile of state-registered advisers.

AML / CFT Program Requirements

The proposed AML requirements for investment advisers under the BSA do not duplicate existing requirements under the Advisers Act. The two sets of requirements serve fundamentally different purposes. SEC rules exist to protect investors and encourage vibrant capital markets; they do not serve an AML purpose. Similarly, disclosure rules required by the Committee on Foreign Investment in the United States (CFIUS) focus on national security concerns arising from specific investments and are not meant to address AML/CFT risks.[44] In addition, the information gathered to carry out each set of objectives is not necessarily comparable (for example, SEC and AML rules define beneficial owners differently and request different data,) and the resulting information is not necessarily accessible to the same regulators or law enforcement personnel.

The information that investment advisers collect to fulfill their SEC obligations may, for example, help them understand their client's business, financial viability, and tolerance for investment risk, but not necessarily their client's beneficial owners or illicit finance risk profile. While information and understanding gained by investment advisers under their SEC obligations may inform their AML analyses, that does not make those two sets of obligations duplicative. For that reason, we strongly support the proposed rule's inclusion of requirements key to performing effective AML due diligence reviews and risk analysis needed to prevent or expose illicit finance.

Identification, Verification of Beneficial Owners of Legal Entity Customers

The FACT Coalition strongly supports FinCEN's decision to implement CDD obligations for investment advisers, including obtaining beneficial ownership information for legal entity customers. Understanding who the real client is and the source of their funds, determining the nature and purpose of the customer relationship and the client's risk profile, and conducting ongoing monitoring to identify and report any suspicious transactions are key elements to effective AML safeguards protecting U.S. financial and national security interests.

[44] NPRM, at 12,149.

We note the four core elements of CDD outlined in the proposed rule: (1) identifying and verifying the identity of customers, (2) identifying and verifying the identity of beneficial owners, (3) understanding the nature and purpose of customer relationships, and (4) conducting ongoing monitoring,[45] and also note that only the third and fourth elements are addressed by the proposed rule.

Regarding the missing first element, identifying and verifying customers, FinCEN proposes to address that core AML obligation in a future rulemaking with the SEC. That rulemaking should be initiated and completed promptly by FinCEN and the SEC. Regarding the second element, under the current proposal investment advisers would not be required to identify and verify the beneficial owners of their legal entity clients until anticipated changes to the CDD rule come into effect, presumably by January 1, 2025. If, however, the anticipated changes to the CDD rule are delayed for any reason, the requirement that investment advisers identify and verify customers and beneficial owners should not be similarly delayed. While banks would remain subject to existing CDD rules under such a scenario, investment advisers would be operating without any requirement to comply with the most basic AML standard of all – to know their customers. For that reason, FinCEN should consider requiring investment advisers to begin customer and beneficial ownership identification and verification within a set timeframe, not specifically linked to the CDD update, ideally within one year of finalization of this rule.

Another reason not to link an investment adviser-specific rulemaking to the effort to revise the CDD rule is that pooled investment vehicles may require different approaches to the identification and verification of customers and beneficial owners than other types of legal entities. Banks typically identify and verify the beneficial owners of corporations or LLCs which, in the United States, usually means a bank can look at corporate share records or reports filed with the new beneficial ownership registry. In contrast, investment advisers may need to identify and verify the beneficial owners of pooled investment vehicles which may be exempt from the beneficial registry, may be structured as partnerships, and may include numerous unrelated beneficial owners. In short, unique issues related to pooled investment vehicles mean there may be little advantage to delaying a CDD rule for investment advisers to see what happens with a revised CDD rule for banks.

As noted in the 2024 Investment Adviser Risk Assessment, tracing beneficial owners behind legal entity clients is key to halting the flow of illicit finance. While investor funds may sit with a BSA-regulated financial institution, investment advisers are often the actor with the most direct client relationship and the greatest capacity to determine the beneficial owner and source of the

[45] NPRM p. 12128.

invested funds. Without CDD information compiled by investment advisers, law enforcement may be left seeking information from entities that lack any direct access to the underlying client.[46]

CDD has little meaning unless investment advisers are able to identify and verify the customers they serve, as well as the beneficial owners who sit behind legal entity clients. Financial crime is predicated upon, and thrives off of, anonymity. For example, FATF notes the value of beneficial ownership information gathered from investment advisers in contributing to the combat against illicit finance.[47] As is borne out in many of the examples above, corrupt actors abuse the opaque nature of investments to facilitate the concealment and laundering of dirty money. It is the identification of the beneficial owners of a legal entity that most often leads to the identification of high risk clients, triggers suspicions that an investment has an ulterior and illicit purpose, and leads to the type of careful AML assessment that safeguards U.S. financial and national security interests. As such, the effectiveness of this rule will be greatly enhanced when those identification and verification obligations come into place; until they do, the investment advisory industry will remain highly vulnerable to bad actors engaging in illicit finance.

Proposed Suspicious Activity Reporting (SAR), Currency Transaction Reporting (CTR), Recordkeeping and Travel Requirements, and Special Measures

We applaud FinCEN for including in the proposed rule SAR and CTR obligations for investment advisers along with record keeping and travel rules, and Section 311 special measures obligations. The investment advisory industry is massive with $130 trillion in assets under management and poses correspondingly significant money laundering risks and vulnerabilities. Requiring compliance with SAR, CTR, recordkeeping and travel requirements, and special measure obligations that have proven effective in other financial sectors are key to deterring money laundering and terrorist finance in the investment advisory industry.

In 2020, a report by the Government Accountability Office (GAO) documented the important role that SARs serve for U.S. law enforcement.[48] It stated:

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[46] 2024 Investment Adviser Risk Assessment, p. 17, 27.
[47] Interpretive Note to Recommendation 25 (Transparency and Beneficial Ownership of Legal Arrangements, clause 5(c), "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation," Financial Action Task Force, 2012 (Updated November 2023), (FATF Recommendations), www.fatf-gafi.org/en/publications/Fatfrecommendations/Fatf-recommendations.html.
[48] "ANTI-MONEY LAUNDERING: Opportunities Exist to Increase Law Enforcement Use of Bank Secrecy Act Reports, and Banks' Costs to Comply with the Act Varied," GAO, No. GAO-20-574, September 2020, at 'GAO Highlights: What GAO Found,' https://www.gao.gov/assets/d20574.pdf.

> Many federal, state, and local law enforcement agencies use Bank Secrecy Act (BSA) reports for investigations. A GAO survey of six federal law enforcement agencies found that more than 72 percent of their personnel reported using BSA reports to investigate money laundering or other crimes, such as drug trafficking, fraud, and terrorism, from 2015 through 2018.

Brokers and mutual funds already file SARs. SARs filed by a broader cross-section of investment advisers would provide further assistance to law enforcement.

FinCEN estimates that investment advisers would file an average of approximately 60 SARs per year.[49] Filing an average of five SARs per month is not a significant burden considering the size of the investment advisory industry, its corresponding risks, and the presence of sophisticated financial personnel used to assessing clients, complying with complex financial requirements, and filing forms. In addition, since 75 percent of existing investment advisers reportedly already engage in AML practices, many should already employ personnel versed in AML issues and capable of filing effective SARs.[50]

In addition to being well within their professional capacity, SARs filed by investment advisers should provide law enforcement with a valuable new source of information. As noted in the 2024 Investment Adviser Risk Assessment, investment advisers often have a more direct relationship with clients than other AML-regulated entities like banks.[51] SARs filed by persons with direct knowledge of their clients should make SARs filed by investment advisers extremely useful in helping law enforcement identify and prosecute bad actors seeking to abuse the U.S. financial system.

The final rule should not include an exception to the proposed SAR filing requirement for violations reported to the SEC under the federal securities laws. As noted above, SEC rules are in place for investor and capital market protection, not for AML purposes. Further, regulators and law enforcement personnel who have access to SARs filed for AML purposes may not have access to information filed with the SEC related to securities law violations.

We also strongly support the proposed requirement that investment advisers file CTRs when engaging in cash transactions exceeding $10,000. A wide variety of U.S. financial institutions have been filing CTRs for decades and have developed effective, automated software to

[49] NPRM p. 12156
[50] NPRM p. 12145.
[51] 2024 Investment Adviser Risk Assessment, p. 17, 27.

minimize the reporting burden. Because investment advisers can take advantage of that existing CTR software and already track individual client transactions, meeting this reporting requirement should impose minimal cost, while providing law enforcement with valuable new AML information.

Similarly, we strongly support the proposed requirement that investment advisers comply with the recordkeeping and travel rules that already apply to banks and many RIAs and ERAs domiciled outside of the United States. Requiring U.S. investment advisers to provide the same transaction information as other financial institutions will help ensure law enforcement can track suspect transactions and better combat money laundering and terrorist finance.

Finally, we strongly support the proposed requirement that investment advisers comply with any "special measures" issued under Section 311 of the Patriot Act when the Treasury Secretary finds that a non-U.S. jurisdiction, financial institution, class of transactions, or type of account is "of primary money laundering concern."[52] Financial institutions have been complying with those special measures for more than 20 years, they have had a positive impact on efforts to combat money laundering,[53] and there is no reason to allow investment advisers to disregard them. The same reasoning applies to the proposed requirement that investment advisers comply with special measures issued under the more recent Combating Russian Money Laundering Act, which is designed to work with Section 311 to deter Russian illicit finance.[54]

Regulatory Impact Analysis

The benefits of the proposed rule significantly outweigh the costs involved to implement it. The estimated costs of compliance are insignificant compared to the size of the $130 trillion investment advisory market. As FinCEN acknowledges, the reported presence of at least some AML practices at approximately 75 percent of U.S. investment advisers today would also reduce implementation costs.[55]

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[52] 31 U.S.C. 5318A(a)(1).

[53] See, e.g., Fred Williams, "Behind the Scenes, US Officials Wield Patriot Act Power Against Corrupt Overseas Banks," MoneyLaundering.com, March 2, 2023, https://www.moneylaundering.com/news/behind-the-scenes-us-officials-wield-patriot-act-power-against-corrupt-overseas-banks/?type=free.

[54] See, e.g., FinCEN, "Imposition of Special Measure Prohibiting the Transmittal of Funds Involving Bitzlato," 88 Fed. Reg. 3919, January 23, 2023 (citing both Section 311 and the Combating Russian Money Laundering Act), https://www.federalregister.gov/documents/2023/01/23/2023-01189/imposition-of-special-measure-prohibiting-the-transmittal-of-funds-involving-bitzlato.

[55] NPRM p. 12145.

Other jurisdictions, such as the United Kingdom,[56] Ireland,[57] Australia[58] and New Zealand,[59] also require investment advisers to put in place AML safeguards. In the United Kingdom, investment advisers have had some form of AML obligations since 1994, without diminishing the competitiveness of its investment advisory industry.[60] When the U.K. regulator considered the costs to business as part of the post implementation review of its money laundering regulations in 2022, they noted that with some financial institutions (including investment advisers) being subject to such regulations for 30 years, it is difficult to even disentangle these compliance costs.[61] Businesses adjust, and the U.K.'s financial sector remains highly competitive and sought after as an international place of business 30 years later.

Similarly, U.S. banks have been complying with BSA requirements for many years, and the compliance costs associated with those requirements have not diminished the competitiveness of the U.S. banking industry. There is no reason to believe that the effect would be any different on the investment advisory industry.

By contributing to the integrity of the industry, the rule can only serve to improve competitiveness for those vast majority of businesses that are playing by the rules. There is clear reputational risk for investment advisers that are found to have facilitated the flow of illicit finance, whether knowingly or unknowingly. By helping prevent such illicit flows, the rule will help strengthen the reputation of the sector as a whole, and help prevent these instances that lead to negative outcomes for advisers.

The rule will help to detect and keep dirty money out of the U.S. financial sector, and help law enforcement seize ill-gotten gains that do evade detection and enter the system.

We appreciate your consideration of our views. If you have any questions, please contact Zorka Milin (zmilin@thefactcoalition.org).

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[56] See art. 10, The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (U.K.).
[57] See art. 24, 25, Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (Ireland).
[58] See art. 4, 6, Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Aus).
[59] See art. 5, 6, Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (NZ).
[60] See Regulation 4(1)(f), The Money Laundering Regulations (U.K.) 1993, https://www.legislation.gov.uk/uksi/1993/1933/crossheading/general/regulation/4/made. These obligations expanded to include, for example, customer due diligence with the U.K. enactment of the E.U. Third Money Laundering Directive. See: Tim Edmonds, 'Money Laundering Law,' House of Commons Law Briefing Paper Number 2592, Feb. 14, 2018, https://researchbriefings.files.parliament.uk/documents/SN02592/SN02592.pdf.
[61] "Post-implementation review of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017," HM Treasury, RPC-HMT-5199(1), June 24, 2022, p. 33, https://assets.publishing.service.gov.uk/media/62dfbbf1d3bf7f2d789b8d40/MLRs_post_implementation_review_final_postWR_EST_signed.docx.

Sincerely,

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PRIVATE INVESTMENTS, PUBLIC HARM

How the Opacity of the Massive U.S. Private Investment Industry Fuels Corruption and Threatens National Security

December 2021

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The findings and analysis in this report represent the views of its authors, and not necessarily those of any participating reviewer or organization.

Every effort has been made to verify the accuracy of the information contained in this report. All information was believed to be correct as of November 2021. Nevertheless, the authors cannot accept responsibility for the consequences of its use for other purposes or in other contexts.

ABOUT US

Financial Accountability and Corporate Transparency (FACT) Coalition

The Financial Accountability and Corporate Transparency (FACT) Coalition is a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promoting policies to combat the harmful impacts of corrupt financial practices.

Global Financial Integrity

Global Financial Integrity (GFI) is a Washington, D.C.-based think tank focused on illicit financial flows, corruption, illicit trade and money laundering. Through high-caliber analyses, fact-based advocacy to promote beneficial ownership and a cloud-based database to curtail trade fraud, GFI aims to address the harms inflicted by trade misinvoicing, transnational crime, tax evasion and kleptocracy. By working with partners to increase transparency in the global financial system and promote Trade Integrity, GFI seeks to create a safer and more equitable world.

Transparency International U.S. Office

Transparency International is a global movement with one vision: a world in which government, business, civil society and the daily lives of people are free of corruption. With more than 100 chapters worldwide and an international secretariat in Berlin, we are leading the fight against corruption to turn this vision into reality. The U.S. office focuses on stemming the harms caused by illicit finance, strengthening political integrity, and promoting a positive U.S. role in global anti-corruption initiatives. Through a combination of research, advocacy, and policy, we engage with stakeholders to increase public understanding of corruption and hold institutions and individuals accountable.

TABLE OF CONTENTS

ABBREVIATED KEY TERMS

AML/CFT	Anti-Money Laundering/Combatting the Financing of Terrorism
BSA	Bank Secrecy Act
CDD	Customer Due Diligence
CTA	Corporate Transparency Act
FATF	Financial Action Task Force
FinCEN	Financial Crimes Enforcement Network
KYC	Know Your Customer
SAR	Suspicious Activity Report
SEC	Securities and Exchange Commission
VCF	Venture Capital Firm

EXECUTIVE SUMMARY

A growing body of evidence suggests that this gap – the absence of requirements that investment funds and investment advisers establish anti-money laundering programs and conduct reviews to understand with whom they are doing business – is a significant vulnerability that negatively impacts U.S. national security and the lives of ordinary Americans.

The Pandora Papers exposé again reveals how financial secrecy in the United States has made the country a favored destination for the world's elite to hide illicit funds. The U.S. private investment industry, unfortunately, offers a perfect confluence of factors that make it an ideal place to hide and launder the proceeds of corrupt and criminal activity.

+ **It is large**. The U.S. market alone holds more than US$11 trillion dollars in assets.

+ **It is opaque**. Private funds, which target high-net worth investors, do not have the same reporting requirements as public equity and retail funds marketed for ordinary investors.

+ **It is complex**. In the United States, there are nearly 13,000 investment advisers with little to no anti-money laundering due diligence responsibilities.

The U.S. has adopted and implemented a series of rules to detect and prevent illicit funds from entering its financial system. The Bank Secrecy Act (BSA), passed in 1970, established an anti-money laundering (AML) framework. Subsequent legislative updates and regulations built out a risk-based approach to AML reporting in the U.S. across 25 types of financial institutions ranging from banks, broker-dealers, mutual funds, credit unions, casinos, pawn shops, and others. The expansion of the U.S. rules largely follow international standards. Two notable exceptions are 1) the lack of regulation of investment advisers – that is, individuals or firms in the compensated business of providing advice about investing in securities; and 2) unregistered investment companies such as hedge funds, private equity, venture capital funds, and real estate investment trusts, and family offices.

A growing body of evidence suggests that this gap – the absence of requirements that investment funds and investment advisers establish anti-money laundering programs and conduct reviews to understand with whom they are doing business – is a significant vulnerability that negatively impacts U.S. national security and the lives of ordinary Americans.

As detailed in this report, a few examples demonstrate the risks:

+ Russian and Chinese interests have sought access to sensitive U.S. technology and innovation through private investment vehicles.
+ A cryptocurrency scheme run through private equity was among the largest financial scams in history.
+ A lack of disclosure in private equity obscured the majority stake owned by a Russian oligarch in a U.S. voting management firm active in Maryland, calling into question election security.
+ A leaked FBI intelligence bulletin included examples of illicit financial schemes using pooled investment vehicles involving Mexican drug cartels, Russian organized crime, and U.S. sanctioned countries.

In 2002, 2003, and 2015, the U.S. Treasury Department proposed rules to close the gap and require the private investment industry to perform due diligence on potential investors. Unfortunately, the proposed rules were never finalized and the vulnerability in our financial system remains. **The FACT Coalition, Global Financial Integrity, and the Transparency International U.S. Office recommend that the U.S. Treasury Department update and finalize an AML rule covering both investment advisers and investment companies to address significant threats to America's financial system, national security, and citizens.** The rule should require (1) establishing a risk-based anti-money laundering and counter terrorist financing (AML/CFT) program; (2) identification of the real, "beneficial" owners of legal entities that open accounts; (3) assessments of those owners and their transactions to identify money laundering risk; (4) the filing of suspicious activity reports with the Financial Crimes Enforcement Network (FinCEN) when sufficient risk is identified; and (5) the ongoing monitoring of accounts with a higher risk profile.

A strong rule that would bolster national security and mitigate threats to America's financial system should cover the full range of unregistered investment companies and investment advisers, to avoid inadvertently creating loopholes ripe for exploitation. FinCEN should design the rule to institute affirmative anti-money laundering obligations for the following categories of advisers:

1. Advisers currently registered with the U.S. Securities and Exchange Commission (SEC);

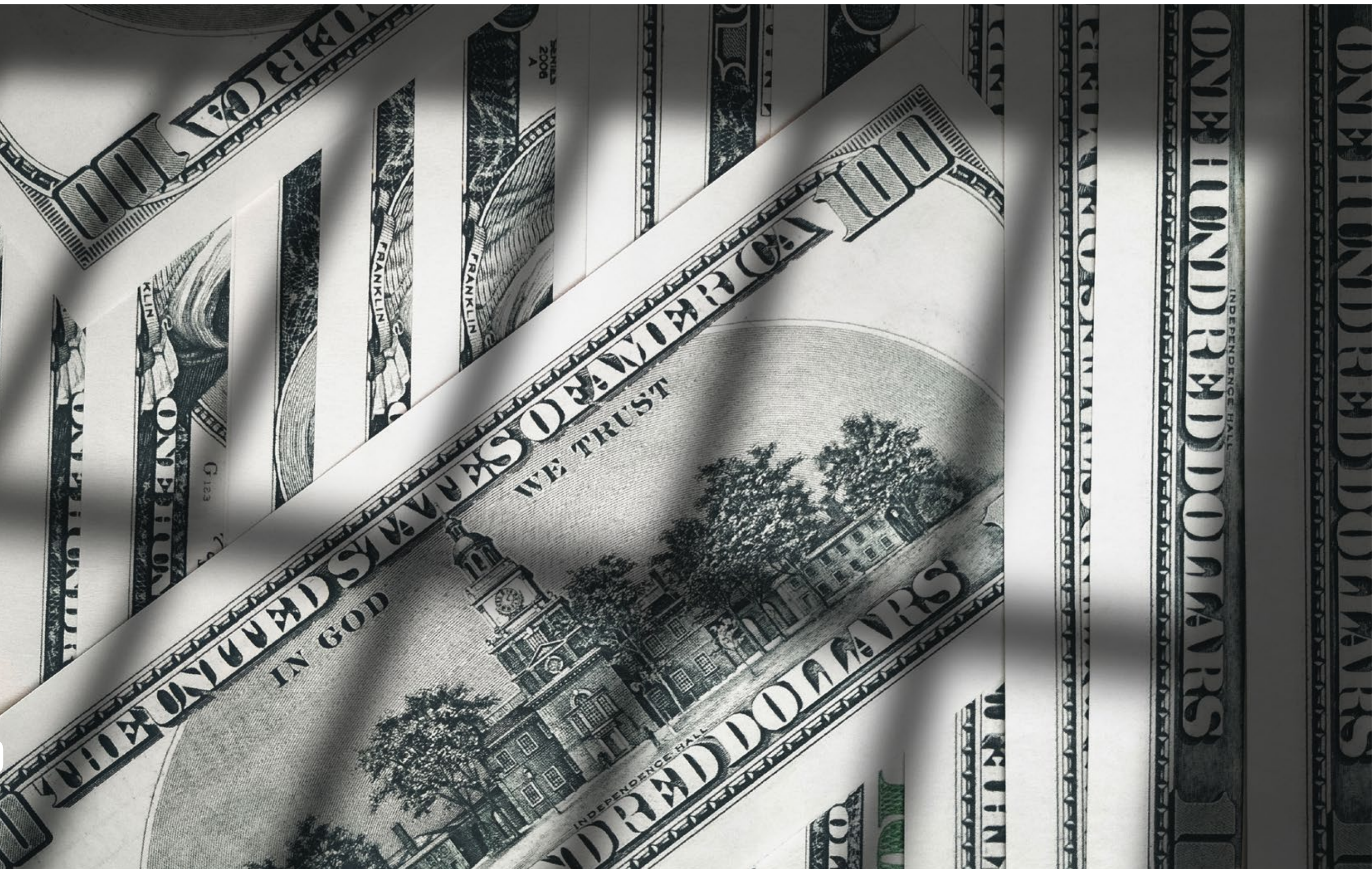
2. Advisers working solely with hedge funds, private equity, venture capital funds, rural business investment companies, family offices, or any other type of private fund; and

3. Advisers working as foreign private advisers.

The Biden administration has rightfully designated the fight against corruption as a national security priority and as a core pillar of the forthcoming Summit for Democracy. Committing to finalize a rule on unregistered investment companies and the full range of investment advisers would provide critical safeguards to close money laundering loopholes and protect the integrity of the U.S. and global financial systems.

INTRODUCTION

As the world's largest economy, the United States is a prime target for financial investment using legitimate and illegitimate resources alike. A recent paper by Global Financial Integrity found the following: The amount of illicit non-tax evading money generated and laundered annually in the U.S. is estimated at $300 billion. When money laundered from tax evasion, coupled with illicit funds that enter the U.S. financial system from outside the country are added, that figure could approach as much as $1 trillion.[1]



In recent years, significant attention has been generated on the use of anonymous companies, art, antiquities, and trade-based money laundering to facilitate illicit money in and out of the United States. The attention and advocacy around these issues culminated in the passage of the Corporate Transparency Act (CTA) in 2021. This landmark law requires the creation of a beneficial ownership directory and an AML/CFT rule for antiquities dealers alongside a requirement that the Treasury Department undertake studies into the risks of money laundering through art and trade-based money laundering. One area of risk that has been conspicuously absent in all of these efforts to strengthen the U.S. financial system against abuse are measures to create accountability within the U.S. private investment industry including hedge funds, private equity, venture capital firms, and family offices**.**

These vulnerabilities in the U.S. financial system from the private investment sector are far from hypothetical and encompass more than one-off examples. In July 2020, a leaked FBI intelligence bulletin revealed that the FBI believed with "high-confidence" that the US$11 trillion private investment fund industry was being used to launder money.[2] The assessment concluded that hedge funds, private equity funds, and other types of private placements of funds were being utilized to move illicit proceeds,[3] and referred back to a 2019 FBI report where it likewise concluded criminal actors were "very likely" to launder proceeds from fraud schemes through "fraudulent hedge funds and private equity firms."[4]

So why are criminal and corrupt actors turning to private investment vehicles to legitimize their illicit funds? Choosing how to obscure one's illicit funds involves a number of factors, including, but not limited to, the opacity of transactions and the size of the market. The private investment sector in the United States, unfortunately, offers a perfect confluence of favorable factors that make it an ideal place to hide and launder the proceeds of corrupt and criminal activity.

One area of risk that has been conspicuously absent in all of these efforts to strengthen the U.S. financial system against abuse are measures to create accountability within the U.S. private investment industry including hedge funds, private equity, venture capital firms, and family offices.

First, the U.S. private investment market is opaque. While retail trading platforms have several public reporting requirements, private investments have almost none. U.S. securities laws require private equity firms to ensure that the clients they accept are "qualified purchasers" or "accredited investors," but do not require them to disclose – to the public or the government – the identity of those clients. While investment firms must ensure their clients have an ability to weather a loss and assume investment risk, they currently do not have to screen the clients' funds or business activities to avoid investing illicit funds. In addition, accredited investors can be either natural persons or legal entities[5], which can further add to the opacity of an investor's identity.

What does an investment adviser do?

An investment adviser is a firm or individual that offers guidance on, or otherwise manages, the investment decisions of their clients.

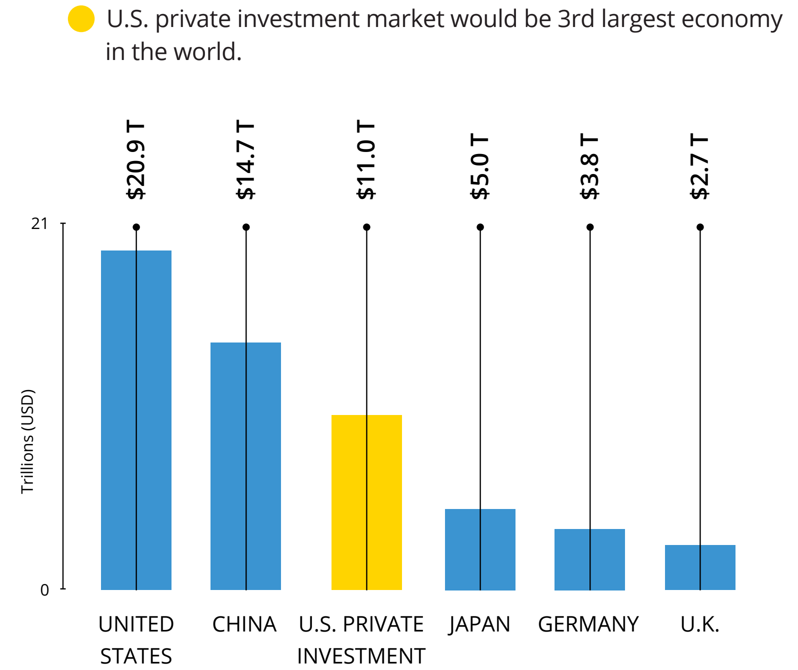
While an investment adviser may direct decisions about clients' portfolios with their consent, the adviser may or may not personally execute the purchase, sale, or trade on behalf of their client. They sometimes work through a third-party broker-dealer to get the job done.

It is other instances, in which the investment adviser operates independently outside the scope of anti-money laundering safeguards, that pose the most risk.

Furthermore, public investment funds almost always employ registered investment brokers to identify clients and execute trades on the clients' behalf. These brokers are required by law to know with whom they are doing business, as they have what is called "know your customer" (KYC) due diligence responsibilities.[6] That means that U.S. brokers have an obligation to check that any prospective client, either an individual or an entity, is not attempting to move dirty money into the U.S. financial system. In contrast, private investment vehicles do not always use registered brokers with AML obligations. While no U.S. business is allowed to directly engage with anyone on an official U.S. sanctions list, unlike some other financial service providers – banks for instance – private

GDPs FOR 2020

Private equity, hedge funds, and venture capital had approximately US$11 trillion in assets in 2020, and the private investment market is growing rapidly.



*Source: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=true

investment vehicles are not required to perform even a basic check to determine if an agent or entity requesting services is actually a front for a corrupt or criminal actor. Nor are they required to report suspicious activity to authorities, limiting law enforcement's ability to detect or prevent illicit transactions.

Second, the U.S. private investment sector is very large. Overall, the total equity market – public and private investments – in the United States is larger than the economy itself. With more than US$59 trillion in assets under management, the U.S. market is at least four times the size of the next largest market.[7] While private investment makes up only a portion of the total market, it is still a very large market by any metric. Private equity, hedge funds, and venture capital had approximately US$11 trillion in assets in 2020, and the private investment market is growing rapidly.[8] Investments in private equity have "grown more than sevenfold since 2002, twice as fast as global public equity."[9] Venture capital firms, a form of private equity, grew by 13 percent per year in that same period including in 2018, which ranked as the third biggest year for raising capital on record.[10] Experts project private equity will double its current portfolios to US$9 trillion by 2025, and hedge funds will grow to a little more than US$4 trillion.[11] The U.S. commercial banks, which do have KYC responsibilities, now hold approximately US$22.5 trillion in deposits.[12] The private investment market is quickly growing to an equivalent size.

Finally, while there are almost 5,000 commercial banks in the United States, all with KYC obligations, almost 13,000 hedge funds, private equity, venture capital firms, and family offices are operational without similar requirements.[13]

MONEY LAUNDERING IN A PRIVATE INVESTMENT TRANSACTION

Mr. Bad is a corrupt official who stole millions and is sanctioned by the U.S. government.

SCENARIO 1: U.S. BANK

Mr. Bad takes his stolen money to a U.S. bank. The bank does a “know your customer” check and turns him down.

SCENARIO 2: ANONYMOUS COMPANY

Mr. Bad creates an anonymous company and moves his stolen money into the company. The company goes to a U.S. bank. The bank does a “know your customer” check and turns him down.

SCENARIO 3: OFFSHORE

Mr. Bad registers his anonymous company offshore and tries to invest the money through a U.S. investment broker in public funds. The broker does a “know you customer” check and turns him down.

PRIVATE INVESTMENT TRANSACTION

Mr. Bad’s anonymous company uses the offshore account to invest with an investment adviser in private funds, who may only check to see if there are enough funds in the account. Then, they can legally say yes, let’s do business!

The Biden administration's expansive anti-corruption platform has created an environment ripe for action to close gaps in the U.S. AML framework**.** In its June 2021 national security study memorandum, the White House elevated anti-corruption as a core national security interest, calling corruption a threat to "United States national security, economic equity, global anti-poverty and development efforts, and democracy itself" and proposing, as a solution, U.S. policies around "effectively preventing and countering corruption and demonstrating the advantages of transparent and accountable governance."[14] A senior White House official explained, "we're looking to make significant systemic changes to the regulatory structure that governs illicit finance."[15] Safeguarding the U.S. investment market from abuse by corrupt regimes, U.S. adversaries, and criminals helps protect Americans and American national security interests while aiding U.S. partners in low- and middle-income countries to combat illicit financial flows that undermine good governance and rob them of much-needed resources.

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MAPPING THE PROBLEM

Assessing Demand for Financial Secrecy Instruments with Long-Term Horizons

The first mention of a money laundering operation often conjures up the mental image of a seedy, all-cash business on the edge of town. Yet methodologies to launder illicit financial flows are plentiful, and many have kept pace with a modern, globalized economy. The benefits to the criminal and corrupt are two-fold: they discover increasingly sophisticated ways to evade law enforcement by diversifying their holdings, while they simultaneously maximize returns on ill-gotten gains.

Established criminal networks like Italy's 'Ndrangheta mafia have shown the necessary patience to leverage financial markets for their fraudulent schemes. For instance, between 2015 and 2019, the powerful mafia organization reportedly attracted approximately US$1.6 billion in legitimate international investment – from hedge funds, family offices, pension funds, and other market participants, including one of Europe's largest private banks – by selling private bonds backed by front companies embedded in Italy's health sector.[16] The assets were reportedly sold through an instrument created by CFE, a Swiss investment bank, which claimed no knowledge of the criminal nature of the assets.[17]

Likewise, foreign corruption presents a threat to the integrity of U.S. investment channels**.** Many authoritarians have investment horizons that match their decades-long rule. As such, they engage in the equivalent of illicit estate planning: to consolidate power in-country, to keep their wealth out of reach of political opponents by moving it to rule-of-law jurisdictions, and ultimately, to pass on their wealth to their children.

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For both the criminal and the corrupt, money laundering is not just about short-term gains.

The dictatorial demand for long-term investments moves money through a multitude of financial vehicles. For instance, look to real estate. Teodoro Obiang – president of oil-rich Equatorial Guinea and one of the world's longest serving dictators – has depleted the country's coffers and made Equatorial Guinea one of Africa's lowest per-capita income countries.[18] He has reportedly used the stolen wealth to cement his financial and political dominance, make extravagant purchases abroad (including a US$2.6 million mansion a few miles from the U.S. Capitol), and tee up rule for his sons.[19] According to a settlement with the Department of Justice, Teodorin Obiang, one of two sons and the current vice president, reportedly used shell companies as conduits for embezzled money to buy real estate in Malibu, California, Michael Jackson memorabilia, and a US$35 million Gulfstream jet. [20,21]

Trusts offer another investment vehicle. Ferdinand Marcos ruled the Philippines as president for 21 years, and during that time, was believed to have stolen US$10 billion while in office.[22] Yet, during this 20-year period, his official annual salary never rose above US$13,500.[23] Though many of the Marcos family accounts were frozen after his government finally fell in the 1980s, hundreds of millions of dollars remained unrecovered. Two decades later, a whistleblower stated that "lawyers for KPMG (then known as Fides, a subsidiary of Credit Suisse) moved the $400 million in Marcos funds to a Liechtenstein trust, Limag Management und Verwaltungs AG" where, left to accrue interest in the intervening years, its value was estimated to have doubled.[24] KPMG has denied the whistleblower's accusations. The availability, secrecy, and long investment horizon of a trust provide parallels to the operation of many U.S. private investment funds.

Other powerful figures in jurisdictions plagued by corruption likewise turn to long-term investments, including by recruiting family offices and other gatekeepers to manage their wealth. Jahangir Hajiyev, former chair of the biggest bank in Azerbaijan, earned a salary of US$70,650 in 2008. [25] Yet Jahangir and his wife Zamira – who, according to Bloomberg, "earned no significant income herself" – spent millions of dollars in the UK purchasing a US$14.3 million townhouse in London and a Gulfstream jet for US$42.5 million.[26] Zamira, in a week alone, reportedly spent nearly a million dollars at the Harrods department store in London.[27] According to a National Crime Agency investigation, the couple was allegedly able to hide and spend all this money through the assistance of a network of gatekeepers including the global trust administration firm Trident Trust, which has operations in the U.S., and a multi-family office Werner Capital, based in London, that helped set up entities to hold the couple's various assets.[28] It's unclear what questions either firm asked the couple about the source of their wealth when taking them on as clients.[29]

Perhaps surprisingly, even these traditionally long-term horizon investments are not safe from short-term exploitation for the purposes of financial secrecy. There is no better example than the 1MDB scandal, a global case of corruption in which private equity played a prominent role in the theft of billions from the country's development fund by the former Prime Minister of Malaysia.[30] A 2016 U.S. Department of Justice civil forfeiture complaint regarding the 1MDB scandal claimed that hundreds of millions of dollars from the development fund meant for a bond offering were layered through private investment funds and then pocketed by the perpetrators of the fraud. In one such example, over the course of one week in May 2013, an arm of the development bank, 1MDB Global, purportedly transferred a total of US$1.59 billion from its Swiss bank account to accounts belonging to three different overseas investment funds in the British Virgin Islands and in Curaçao.[31] The funds were passed back and forth through multiple accounts held in the names of different legal entities but all with the same beneficial owner. In a related case, it was determined that the crisscross movement of funds had no legitimate commercial purpose and was designed to "obscure the nature, source, location, ownership and/or control of the funds."[32] Clearly, private investment funds are ripe for exploitation, including as short-term and long-term investment vehicles used to disguise and conceal the origin of illicit funds.

The 1MDB case, in particular, illustrates an additional point: the lack of AML programs and disclosure requirements in the U.S. private investment industry heighten risks among advisers and companies located in the United States as well as among advisers located outside the U.S. seeking to access U.S. markets. Non-U.S. advisers are bound to view the U.S. financial sector as an attractive avenue to hide illicit funds, given the lack of AML controls and opacity of the U.S. private investment industry. Increasing the risk to the U.S. financial system is the low level of AML enforcement activity outside of the United States, whether due to limited resources, a weak regulatory climate, or a lack of political will to tackle money laundering. These non-U.S. deficiencies can be exploited to create added opacity around the identity of non-U.S. individuals and entities seeking to exploit the U.S. financial system.

For both the criminal and the corrupt, money laundering is not just about short-term gains. As the above examples from across the globe illustrate, criminals and kleptocrats are, in fact, interested in financial instruments with a longer horizon, an acceptable return on investment, and the ability to diversify their holdings and conceal their money-laundering tactics. For those with the means, the long horizon, high yield, and opacity of multi-year investments like those offered by hedge funds, private equity, and venture capital firms make them attractive conduits for money laundering.

UNDERSTANDING THE CURRENT FRAMEWORK

The U.S. anti-money laundering regime – enshrined in Bank Secrecy Act (BSA) regulations – has built out a risk-based approach to AML reporting across 25 types of financial institutions including banks, mutual funds, credit unions, casinos, pawn shops, and others.[33] The list includes broker-dealers who, like investment advisers, can execute trades in securities on behalf of clients.

FinCEN's CDD rule was an important step toward meeting international standards, but it failed to include a strong definition of beneficial owner, and it failed to encompass all of the entities specified in FATF's definition of "financial institution," such as private investment funds.

Unlike broker-dealers, however, investment advisers are not currently required to maintain anti-money laundering/combating the financing of terrorism (AML/CFT) programs under the BSA. Nor are several types of "investment companies," which are explicitly exempted from that requirement.[34] While FinCEN has made multiple attempts to create anti-money laundering obligations for investment advisers and certain investment companies, the U.S. has failed to finish the work and so remains an outlier as the United Kingdom and other countries with similar financial systems in the European Union have applied their anti-money laundering requirements to the private investment sector.

This section examines U.S. efforts at strengthening customer due diligence (CDD) requirements for financial institutions, previous attempts at creating AML/CFT requirements for investment advisers and investment companies, and current regulatory practice among U.S. allies.

Current U.S. Customer Due Diligence Obligations for Financial Institutions Exclude Private Investment Companies and Investment Advisers

The BSA has been regularly amended over the course of its 50-year history to meet modern challenges. The Financial Action Task Force (FATF), the international standard-setting organization for anti-money laundering and combating terrorist financing, described the U.S. framework in its most recent evaluation in 2016 as "well-developed," coordinated across government agencies, and rooted

in a sophisticated understanding of money laundering and terror financing risks.[35]

Yet the same 2016 FATF evaluation highlighted a major U.S. deficit. The deficit was that, in the United States, law enforcement and other essential parties had no way of learning the identity of the true, “beneficial” owner of legal entities formed in the 50 U.S. states. In January 2021, Congress took an important step towards curing that deficit by enacting the Corporate Transparency Act, which will, when implemented, require corporations, limited liability companies, and other similar entities to report their beneficial owners to a secure database at FinCEN.

A related problem was that, although as of 2001 the BSA required financial institutions to establish AML programs, BSA regulations did not initially spell out requirements for financial institutions – as part of their obligation to know their customers – to identify the beneficial owners of legal entities like shell corporations and trusts that opened accounts with them. That regulatory gap left the legal door open for financial institutions to administer accounts for entities with hidden owners.

In 2016, the Treasury Department finalized new regulations requiring certain financial institutions – banks, credit unions, mutual funds, brokers-dealers in securities, futures commission merchants, and introducing brokers in commodities – to conduct customer due diligence reviews and collect beneficial ownership data for account holders that were legal entities.[36] FinCEN’s CDD rule was an important step toward meeting international standards, but it failed to include a strong definition of beneficial owner, and it failed to encompass all of the entities specified in FATF’s definition of “financial institution,” such as private investment funds.[37, 38]

Historical Efforts to Create AML/CFT Obligations for Investment Companies and Advisers

Over the past twenty years, the U.S. government has initiated at least three efforts to bring the private investment industry further under the purview of BSA regulations. In 2001, following the 9/11 terrorist attack, Congress enacted new anti-money laundering laws that, among other provisions, required all financial institutions subject to the Bank Secrecy Act to establish anti-money laundering programs.[39]

A few months later in 2002, however, the Treasury Department granted "temporary exemptions" for several categories of financial institutions, including "investment companies."[40] That same year, FinCEN required certain investment companies registered with the SEC, including mutual funds, to establish AML programs,[41] but did not otherwise alter the "temporary exemption."

On September 26, 2002, FinCEN for the first time proposed a rule that would require unregistered investment companies, including hedge funds, private equity, commodity pools, and real estate investment trusts, to establish AML/CFT programs.[42] The following year, on May 5, 2003, FinCEN proposed another rule that would require "investment advisers" registered with the SEC to establish AML/CFT programs and also delegate FinCEN's authority to conduct compliance examinations of those entities to the SEC.[43] Exactly how the 2003 proposed regulation of registered "investment advisers" related to the 2002 proposed regulation of unregistered "investment companies" was not explicitly addressed. After years of inaction finalizing either rule, however, on November 4, 2008, FinCEN withdrew both.[44]

In 2015, toward the end of the Obama administration, FinCEN once again proposed a rulemaking for registered investment advisers.

According to the draft rule, the proposed changes would bring both registered investment advisers and some unregistered investment companies under the purview of the BSA.[45] In its proposal, FinCEN stated that "money laundering involves three stages, known as placement, layering, and integration, and an investment adviser's operations are vulnerable at each stage."[46] The 2015 rule proposed requiring a certain class of registered investment advisers – meaning those with more than US$100 million in assets under management and not subject to several exemptions – to establish AML programs, begin submitting Suspicious Activity Reports (SARs) to law enforcement, and establish certain recordkeeping and reporting practices.[47]

Why should investment advisers conduct CDD if other financial institutions are already reporting?

BSA-covered financial institutions like banks are required to conduct CDD for their direct clients, including investment advisers opening bank accounts. But they are not required to go farther and conduct CDD reviews of their client's clients. Instead, BSA-covered institutions like banks are allowed to rely on their direct clients, including investment advisers, to conduct reviews of their own clientele. That arrangement breaks down, however, when investment advisers have no affirmative legal obligation to conduct CDD reviews of their clients and no idea who is the true owner of a legal entity client.

FinCEN also proposed once again delegating its examination authority to the SEC.[48] FinCEN's 2015 proposed rule outlined AML/CFT requirements for investment advisers that were similar to those already applicable to broker-dealers and mutual funds.[49] FinCEN warned 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."[50]**
Despite support from civil society and financial industry associations, [51] the 2015 rule apparently lost "inertia among federal bureaucracies" and was never finalized.[52]

The European Union and UK Impose AML Requirements on Investment Funds

The failure to impose affirmative AML obligations on the private investment industry relegates the United States to a place in line behind many of its allies. For example, six years ago in 2015, the European Union passed the 4th Anti-Money Laundering Directive (4th AMLD),[53] which includes investment firms within its definition of "financial institution" and therefore renders investment advisers subject to the same CDD standards as banks and other reporting entities. In 2017, the UK passed provisions based on the 4th AMLD and imposed AML obligations on investment advisers as well as "enabler" professions such as real estate agents and incorporation agents.[54] Making similar changes in the United States would bring the U.S. in alignment with its allies and with international AML standards it has long pledged to meet.

CASE STUDIES

This section presents 11 case studies illustrating how the absence of U.S. AML obligations on investment companies and investment advisers has increased U.S. vulnerability to criminal activity, corruption, and national security threats.

The evidence base establishing money laundering through private funds, including hedge funds, private equity, venture capital funds, and family office investment activities is substantial. Throughout the course of our research, we identified multiple mechanisms through which money laundering risk was introduced. The cases presented in this report broadly represent three trends:

+ **First,** cases in which investment advisers or investment companies fail to heed red flags in operating with specific clients;

+ **Second,** cases in which the opacity resulting from a lack of government disclosure requirements for private investment funds increased the difficulty of banks and other institutions to conduct their own AML and due diligence processes; and

+ **Third,** cases demonstrating the highest level of wrongdoing, in which threat actors and criminals deliberately exploited the opacity of private investment funds to dodge detection by law enforcement.

A rule requiring investment advisers and investment companies to adopt risk-based anti-money laundering programs, including "know your customer" due diligence obligations, would clearly help mitigate the first two trends. Investment advisers and companies would be newly required to evaluate potential clients and the source of their funds, assess AML/CFT risks accordingly, and report suspicious activity to law enforcement. Those efforts would help clean up what is now an unregulated sector vulnerable to wrongdoing and thereby assist other financial institutions working to safeguard the U.S. financial system.

In the third category of cases marked by explicit wrongdoing, an AML/CFT rule for investment advisers and investment companies would help deter bad actors from misusing the investment sector, compel investment managers to screen clients more carefully and conduct more transaction monitoring to uncover misconduct, and provide another mechanism for regulators and law enforcement to conduct oversight, spot wrongdoing, and shut down hidden channels for illicit funds. Involving regulators would also introduce additional enforcement tools including cease and desist orders, suspensions and debarments, and a wide range of civil and administrative penalties for institutions and individuals.

CASE 01

Chinese state-owned venture capital firms pour huge sums into sensitive U.S. technology sector

As the epicenter of America's tech innovation, Silicon Valley has attracted a wide array of venture capital firms (VCFs) with ties to a Chinese government fund or other Chinese state-owned entities. A 2018 report from the Department of Defense found that Chinese venture capital investments granted the Chinese government "access (to) the crown jewels of U.S. innovation."[55] A Reuters report claims that Danhua Capital, a VCF based just outside Stanford University in California, invested in rising star startups that specialized in drones, cybersecurity, and artificial intelligence and had holdings in "some of the most sensitive technology sectors."[56] It also found that Danhua Capital – apparently unknown to many within the U.S. government – had been established and financed with the assistance of the Chinese government through Zhongguancun Development Group, a Chinese state-owned enterprise funded by the municipal government of Beijing.[57] Some analysts have concluded that Zhongguancun views Danhua as a vehicle for technology transfer, since its website apparently states, "Zhongguancun capital goes out and foreign advanced technology and human capital is brought in."[58]

Danhua Capital's investments have included the data management and security company Cohesity, which had contracts with both the U.S. Air Force and the U.S. Department of Energy.[59] Its holdings have also included drone startup Flirtey, which helped the U.S. Department of Transportation on projects to safely integrate drones into U.S. air space.[60]

Danhua Capital is not a lone example. Reports indicate that more than 20 Silicon Valley venture capital firms have close ties to a Chinese government fund or another state-owned entity within China.[61] Other VCFs that have been tied to Chinese backing and that were identified as active investors in Silicon Valley include Westlake Ventures, Oriza Ventures, and SAIC Capital.

Westlake Ventures is backed by the Hangzhou city government and, according to Reuters, has invested in at least 10 other venture capital funds based out of Silicon Valley, including Amino Capital which has a portfolio of US$540 billion.[62] Oriza Ventures reportedly belongs to the investment arm of the Suzhou municipal government and invested in startups working on artificial intelligence and self-driving car technology.[63] SAIC Capital is the venture capital arm of SAIC Motor, a Chinese state-owned automotive design and manufacturing company headquartered in Shanghai, that invested in autonomous driving, mapping, and AI startups. In addition, 500 Startups, a well-known startup accelerator, raised part of its main fund from the Hangzhou government. The relationship between the Chinese state and these venture capital firms, which are not currently obligated to disclose who their investors are, highlights unique economic and national security challenges for the United States.

Did you know?
Most VCFs invest through layers of funds, otherwise known as funds of funds. This practice can obscure both the identity of the investors and the source of the investment funds.

CASE 02

Russian attempts to steal sensitive technology may be advanced by a lack of CDD requirements for VCFs

The FBI has put the venture capital sector on alert to Russian investments that may be aimed at the covert transfer of sensitive technology. In a 2014 public op-ed, the FBI Boston office warned venture capital and other investment sectors of its belief that "the true motives of the Russian partners, who are often funded by their government, is to gain access to classified, sensitive and emerging technology from the companies."[64] In certain instances, the FBI claimed a connection between the investment funds and a Russian-government financed science park in Moscow that reportedly shared stolen U.S. military technology with Russian military and defense contractors.[65]

One firm suspected of covert technology transfer objectives is Rusnano USA. Russia's government-owned venture capital firm Rusnano established Rusnano USA in Menlo Park, California. The firm's investment strategy reportedly centers on nanotechnology acquisitions. According to a former intelligence officer, Rusnano USA was thought to be involved not only in the "acquisition of technology, but also inserting people into venture capital groups, in developing those relationships in Silicon Valley that allowed them to get their tentacles into everything."[66] Another U.S. intelligence officer observed, "The Russians treated [Rusnano USA] as an intelligence platform, from which they launched operations."[67]

Another example is Bright Capital Fund, a Russian venture capital firm in Moscow that made investments in several U.S. firms that specialized in technology with military applications. Bright Capital Fund was established in 2010, by Mikhail Abyzov, a Russian billionaire and former minister for open government affairs. Abyzov was purportedly the previous "sole shareholder of Promtechnologii, a weapons company that makes sniper rifles used by Russian-backed rebels in the Donbass of Ukraine and in Syria."[68] The year Bright Capital Fund was founded, the firm invested US$15 million in Alion Energy, a U.S.-based company that manufactured robots for assembling solar power plants.[69] Alion Energy also apparently had contracts with the U.S. Naval Research Laboratory. The next year, Bright Capital invested US$75 million in Alta Devices, a company that develops solar panels used in drones, enabling unmanned aircraft to remain in flight for longer periods.[70] In 2016, Bright Capital invested in Augmented Pixels, a Palo Alto-based software startup that develops automatic navigation algorithms for unmanned aerial vehicles.[71] Repeated venture capital investments in technology with defense applications by a firm a with alleged ties to a U.S. adversary raises important questions about the vulnerability of the U.S. technology sector to espionage, technology theft, and other abuses introduced through the U.S. private investment industry.

CASES FROM THE 2020 FBI MEMO

The FBI intelligence memo leaked in 2020 marked a deepening recognition by the Bureau of the U.S. national security threats posed by the opacity and ease of misuse of private equity and hedge fund investments. Whereas the FBI previously analyzed private investment vehicles as a mechanism used to finance activities by foreign adversaries, its 2020 report also focused on how the private investment sector had become a conduit for money laundering, transnational organized crime, and sanctions evasion. Three cases cited in the FBI report demonstrate the national security risks.[72]

CASE 03

Mexican drug cartels alleged to have used hedge funds to launder $1 million a week

According to the FBI, Mexican drug cartels operating in Los Angeles and Orange counties recruited and paid people to open hedge fund accounts at private banking institutions. Each week, the cartel is believed to have laundered an average of US$1million through the hedge fund accounts and then withdrew the money to purchase gold, a commodity commonly used by organized crime and drug cartels to move money across international lines.[73] The FBI report has not been independently verified.

CASE 04

Firm with alleged ties to Russian organized crime used private equity firm to launder US$100 million

According to the FBI, a private equity firm based in New York at one point received more than US$100 million in wire transfers from an identified company that is based in Russia and that allegedly has ties with Russian organized crime.

CASE 05

Hedge funds offered up as means to facilitate trade-based money laundering schemes and evade U.S. sanctions

The FBI reported that, in 2019, an individual representing a hedge fund with operations in New York and London proposed a scheme to use shell corporations and hedge funds in Luxembourg and Guernsey to evade regulatory requirements when transacting with sanctioned companies. According to the FBI, based on human intelligence, the intent of the scheme was to help the companies export prohibited items from sanctioned countries into the United States.

Over a six-year period, 2006 to 2012, the pair allegedly funneled US$100 million in illicit funds through financial institutions and anonymous shell companies located in Cyprus.

CASE 06

Illicit Russian and Ukrainian proceeds from high stakes gambling operations were purportedly invested through hedge funds

Anatoly Golubchik and Vadim Trincher – U.S.-based operatives for a massive Russian-American organized criminal enterprise – purportedly moved millions of dollars in illicit gambling proceeds through anonymous companies, real estate, and hedge fund investments.[74] The operation ran under the protection of Alimzhan Tokhtakhunov, the equivalent of a Mafia "godfather" in Russia's criminal world.[75] The pair, later convicted for racketeering, set up one of the largest sportsbooks in history, primarily to cater to millionaire and billionaire clients, including oligarchs based in Russia and Ukraine.[76] The enterprise also apparently built out an extensive network of illegal high-stakes poker games and online gambling in Los Angeles and New York that drew in U.S.-based Wall Street traders, professional athletes, and Hollywood stars.[77] The proceeds were then reportedly funneled to organized crime abroad.[78]

Over a six-year period, 2006 to 2012, the pair allegedly funneled US$100 million in illicit funds through financial institutions and anonymous shell companies located in Cyprus.

According to the Department of Justice, approximately half of the money, US$50 million, was then transferred to the United States. Once here, the money was further moved through investments in hedge funds and real estate or through additional shell companies.[79] JP Morgan branch manager Ronald Uy pled guilty to assisting Trincher and his associates structure financial transactions to obscure the illegal origin of the funds.[80]

ByteGrid had been hired by Maryland to handle the "statewide voter registration, candidacy, the election-management system, the online ballot-delivery system and the website for unofficial election-night results."

CASE 07

Russian oligarch held stake in U.S. voting management firm through private equity

In 2018, Maryland Governor Larry Hogan, alongside state Senator Thomas V. Mike Miller Jr. and House Speaker Michael E. Busch, sought the assistance of the U.S. Department of Homeland Security after learning that ByteGrid LLC, a firm with a contract to manage Maryland's voting system, was backed by investments from a Russian oligarch with apparent close ties to the Russian government.

ByteGrid had been hired by Maryland to handle the "statewide voter registration, candidacy, the election-management system, the online ballot-delivery system and the website for unofficial election-night results."[81] However, the state's elected officials had been unaware until warned by the FBI[82] that ByteGrid was financed by a private equity firm, AltPoint Capital Partners, whose fund manager and largest investor was a Russian oligarch named Vladimir Potanin.[83]

Potanin, one of Russia's wealthiest individuals, reportedly made his money after the fall of the Soviet Union through a series of privatization deals in the commodities markets.[84] Potanin also reportedly has close ties to Russian President Vladimir Putin.[85]

The lack of disclosure of the Russian oligarch behind ByteGrid and AltPoint Capital raises national security concerns, highlighting how a hostile foreign interest could use private equity to potentially gain a measure of secret control over a firm administering important aspects of U.S. election infrastructure. The Department of Homeland Security issued the following statement at the time: "While we have no reason to believe Maryland state systems have been compromised, this serves as an opportunity to remind all critical infrastructure owners and operators to remain aware of key information regarding their contractors and subcontractors, including ownership, management, funding sources, and other activities."[86]

CASE 08

OneCoin scheme laundered fraudulent cryptocurrency windfalls through private equity

An international pyramid fraud scheme known as "OneCoin" used private equity funds to conceal, move, and launder substantial proceeds. According to the U.S. Justice Department, Mark Scott, a New York resident, corporate lawyer, and former partner at Locke Lord LLP law firm, worked with OneCoin designer Ruja Ignatova to launder US$400 million in illicit proceeds through fraudulent investment funds that he expressly set up for that purpose.[87, 88]

Scott established the fake private investment funds in the British Virgin Islands and dubbed them the "Fenero Funds." He then moved the US$400 million into the funds disguised as transfers from "wealthy European families."[89] Scott further obscured the origin of the money by moving it through several Fenero Fund bank accounts in the Cayman Islands and Ireland, before finally transferring money back to the architect of the OneCoin scheme, Ignatova, and related entities. [90] She disappeared with the money in 2017.

Well-compensated for his money laundering services, Scott was paid more than US$50 million. He used the funds to buy luxury cars, watches, a yacht, and several multi-million coastal homes in Massachusetts.[91] In 2019, he was convicted of conspiracy to commit money laundering and bank fraud.[92]

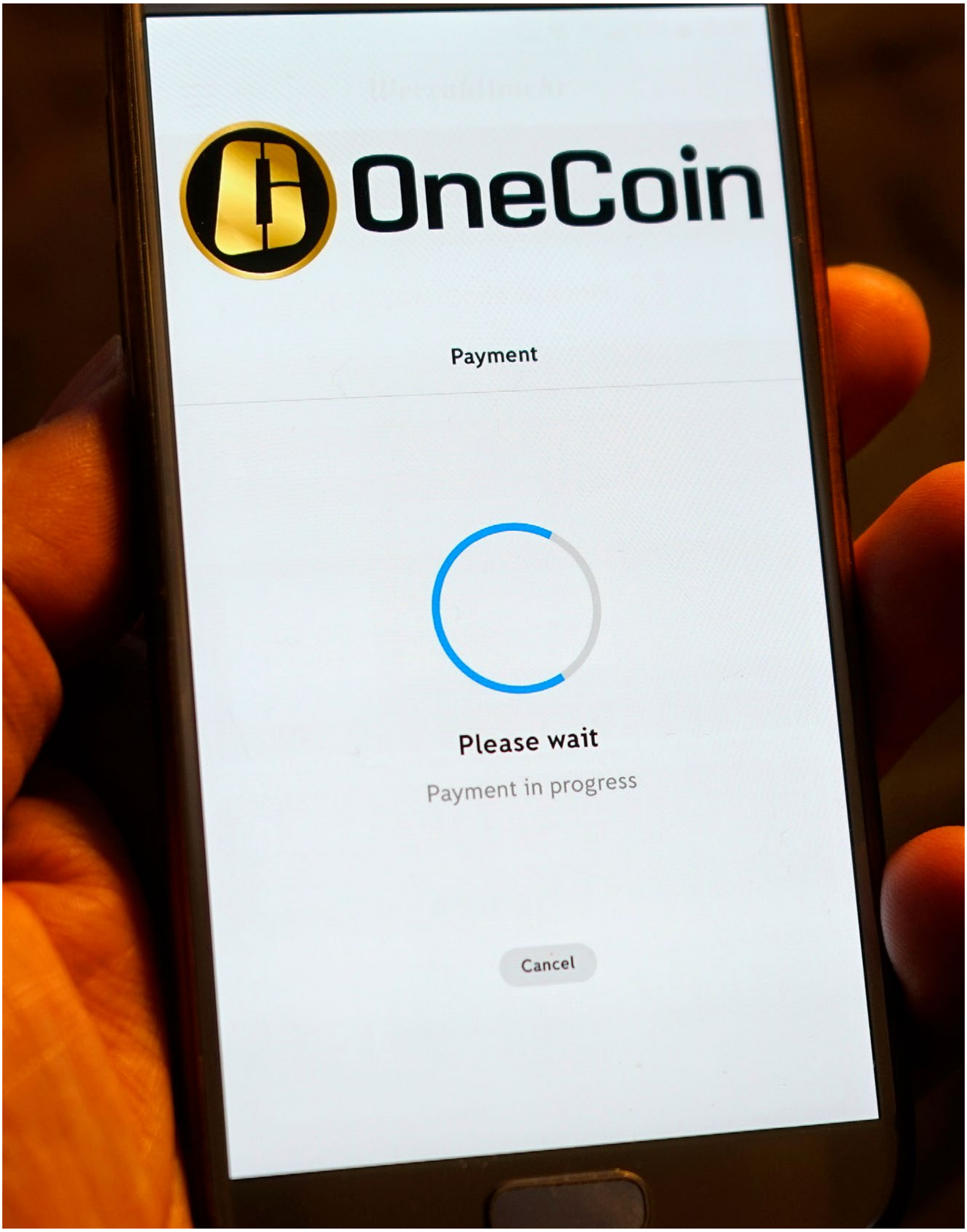
This case demonstrates that fraudsters are willing and able to use private investment funds to hide and launder hundreds of millions of dollars in criminal proceeds. While Scott lied to banks, including those in the United States, about the origin of the funds so as to evade detection, additional AML safeguards and scrutiny in the private investment sector could have raised questions about his credentials and provided additional oversight and opportunities to freeze the proceeds and stop the fraud.

This case demonstrates that fraudsters are willing and able to use private investment funds to hide and launder hundreds of millions of dollars in criminal proceeds.

OneCoin Scheme

The OneCoin scheme is a cryptocurrency Ponzi arrangement that *Forbes* and others have described as one of the "biggest (financial) scams in history." OneCoin operated as a multi-level marketing network through which members obtained commissions for recruiting others to purchase cryptocurrency packages.

OneCoin allegedly took money from more than three million victims worldwide, including victims living in the United States. The scheme is estimated to have stolen US$4 billion from its victims and may still be operational. The mastermind behind the scheme is convicted fraudster and Bulgarian national, Ruja Ignatova, who has been on the run from law enforcement since 2017.


OneCoin
Payment
Please wait
Payment in progress
Cancel

CASE 09

Real estate investment company purportedly laundered millions of dollars in drug proceeds

This case study examines private equity investments in the U.S. real estate market used to launder criminal proceeds. Sefira Capital LLC, a boutique investment company in Florida, invested more than US$100 million in high-end commercial and residential real estate projects across the United States.[93] According to a Department of Justice civil forfeiture complaint, from 2016 to 2019, Sefira and its subsidiaries received millions of dollars in criminal proceeds from "investors" who were actually drug trafficking organizations laundering funds through the Black Market Peso Exchange (see text box). [94]

As part of 2018-2019 undercover investigations on the Black Market Peso exchange, the Drug Enforcement Administration (DEA) had transferred narcotics proceeds worth millions of dollars to Sefira subsidiaries at the instruction of money-laundering brokers. [95]

Sefira allegedly accepted the funds without asking questions about the true owners of the investment accounts or the source of their funds.[96] Likewise, Sefira apparently ignored discrepancies between the supposed investment amount and the actual amount Sefira received, and between the purported identities of the investors and the entities sending the investments to Sefira.[97] After U.S. authorities brought a civil forfeiture action against the firm, Sefira ultimately settled the case for more than US$50 million with the Department of Justice. [98]

This case demonstrates that some private equity firms accept substantial sums of cash with few or no questions asked. If private equity firms were instead legally required to establish AML programs, screen clients, monitor account activity, and report suspicious transactions to law enforcement, the sector could better safeguard its operations and the U.S. financial system against dirty money.

BLACK MARKET PESO EXCHANGE

The Black Market Peso Exchange is a trade-based money laundering scheme that allows drug trafficking organizations to launder and transfer the value of their profits from the United States to their own country – all the while concealing the source and nature of the funds. While this scheme includes "peso" in the name after its notorious use by Colombian cartels, a wide array of threat actors use this methodology to launder drug proceeds into various currencies.

1. CARTEL

Cartel gives the dollars to a U.S. office of a currency exchange company

2. CURRENCY EXCHANGE CO.

The Latin American office of the currency exchange company gives the cartel pesos but now has dollars and no pesos

3. IMPORT/EXPORT COMPANIES

The currency exchange company gives dollars for pesos to legitimate Latin American import/export companies that need dollars to trade in the U.S.

CASE 10

Swiss firm allegedly used opaque investment accounts to shield U.S. account holders from IRS scrutiny

This case study involves a foreign investment firm that was investigated by the U.S. Department of Justice for helping U.S. clients cheat on their taxes. Finacor is a small privately-held asset management firm based in Basel, Switzerland and licensed as a broker-dealer. Finacor's cross-border asset management business model allegedly enabled U.S. clients to open and maintain "undeclared accounts in Switzerland and conceal the assets and income they held in these accounts."[99] The accounts were "undeclared," because Finacor apparently did not report them to the IRS.

Finacor offered its clients two types of accounts: asset management accounts and fiduciary accounts (see text box).[100] Finacor managed client assets for both types of accounts, while holding the funds and assets at custodial banks in Switzerland. Finacor originally used UBS to hold the majority of its client assets, but had to change banks after UBS notified Finacor in 2008 that it would no longer service the accounts of U.S. citizens without an IRS Form W-9, which serves a request for a taxpayer identification number (TIN). Finacor moved its U.S. client asset management accounts to another Swiss bank, after which it again transferred the undeclared U.S. citizen accounts to a custodian bank, in accounts opened in the name of Finacor itself. The firm then provided its clients with so-called "fiduciary account services." By transferring the client funds to accounts opened in the firm's own name, Finacor kept the client names off the bank's records and did not trigger CDD reviews of the clients by the bank. Instead, Finacor itself became solely responsible for carrying out CDD reviews for its clients.

Finacor's other services provided additional forms of secrecy to account holders, raising additional concerns about U.S. taxpayers' ability to shield assets from the IRS. Those services purportedly included: a) holding account-related mail at Finacor, so that mail concerning undeclared accounts would not be sent to the United States; b) sending checks to the U.S. in amounts less than US$10,000 to circumvent currency transaction reporting; c) using code words for money transfers to obscure the repatriation of undeclared assets and income back into the United States; and d) divesting U.S. securities from the undeclared U.S. accounts so that Finacor was not legally required to disclose U.S. client names under the terms of an agreement with the IRS.[101]

After the U.S. Department of Justice confronted Finacor with its misconduct, the firm reached a nonprosecution agreement with the Department and agreed to close its U.S. client accounts, turn over the account information, pay a fine, and cooperate with any prosecution or civil action taken against its clients. It also agreed to provide information on other banks working with secretive accounts.[102]

Asset management accounts

In asset management accounts, client assets are held in the names of the clients at the custodian bank. Therefore, the custodian bank is required to know the identity of the client and carry out full CDD in line with AML/CFT obligations.

Fiduciary accounts

In fiduciary accounts, client assets are held in the name of the asset management business, in this case Finacor. Therefore, the only CDD review conducted by the bank was of Finacor. It did not and was not required to conduct any CDD reviews of Finacor's clients.

The risk of abuse of the U.S. investment market warrants expanding the AML reporting definition of investment advisers to include advisers to venture capital firms, family offices, and other market actors who are in a position to accept large amounts of suspect funds.

CASE 11

Financial advisers accused of providing undercover agent with advice on how to move illicit funds outside the U.S. using investment vehicles

The final case illustrates how the opacity of private investments can lead to additional risks in other industries by facilitating investments in those sectors, including the insurance industry. Stefan Seuss and Thomas Meyer, financial advisers based in Florida, were accused, in a joint FBI and IRS sting, of advising an undercover agent on how to move illicit funds abroad using offshore accounts and investment vehicles.[103]

Seuss, an international wealth consultant, ran a business – Seuss and Partners LLC – based in Miami that, per a grand jury indictment, allegedly helped clients in the United States and elsewhere set up offshore companies and foreign bank accounts to conceal investments and any profits. Meyer was a Seuss associate specializing in life insurance. According to the indictment, when acting as a consultant for Florida-based Global Life Solutions LLC, Meyer collaborated with Seuss to reinvest money that had been moved offshore into investments in the insurance sector. As the federal indictment explained, Meyer and Seuss allegedly offered "[c]lients a variety of financial services and investment opportunities that included, among other things, ... insurance settlement annuities."[104]

In a series of meetings and telephone conversations between 2007 and 2008, Seuss and Meyer met with an undercover federal agent who posed as a businessman who "illegally duplicated, distributed and sold CDs, DVDs and computer software to other businesses and individuals in New York and other parts of the United States" in violation of U.S. copyright infringement laws.[105] Seuss and Meyer were accused of actively advising the federal undercover agent on ways "to conceal and disguise the nature, location, source, ownership, and control of the funds ... believed to be the proceeds of illegal activity" and use those funds to purchase an investment vehicle. [106]

FINDING THE SOLUTION

A change in U.S. policy would curb the risks highlighted by these case studies. FinCEN should bring the United States on par with its international allies and into better compliance with FATF recommendations by applying AML requirements to investment advisers and unregistered investment companies operating in the United States. This change would bring investment advisers into alignment with their counterparts in the U.S. financial system by requiring these advisers to stand up basic risk-based AML programs, file Suspicious Activity Reports (SARs) with FinCEN, and maintain accurate records.

FinCEN should go a step further to add investment advisers and unregistered investment companies to its shortlist of financial institutions required to conduct full CDD reviews for legal entities.[107] As our examples show, many criminal and threat actors run money through accounts owned by legal entities, adding a layer of opacity to these transactions. Requiring investment advisers and unregistered investment companies to follow "know your customer" rules would ensure that they screen prospective clients, identify entities' beneficial owners, and monitor account activity. Investment advisers and unregistered investment companies should likewise be required to apply enhanced due diligence standards including checks on the source of the funds and wealth – just like banks and security firms do – before opening accounts for certain high-risk foreign financial institutions or wealthy individuals with private banking accounts. Taking these precautions would help weed out the most egregious money-laundering abuses within U.S. markets.

Additionally, the risk of abuse of the U.S. investment market warrants expanding the AML reporting definition of investment advisers to include advisers to venture capital firms, family offices, and other market actors who are in a position to accept large amounts of suspect funds.

The evidence of abuse is only increasing, as is the size of the U.S. private investment market. It will only become easier over time for increasing amounts of illicit funds to taint legitimate U.S. investments.

As doors close on other financial secrecy vehicles – namely, anonymous U.S. shell companies, which are now subject to reporting under the Corporate Transparency Act – criminals will likely increase demand for opaque private investment funds.

An AML Rule for Investment Advisers and Investment Companies is Urgently Needed and Can be Created Without Any New Action from Congress

The Biden administration can act independently, through the Treasury Department, to bring investment advisers and unregistered investment companies under AML obligations, without any new action from Congress. Under the Bank Secrecy Act and its subsequent amendments, the Treasury Secretary has the authority to add entities to the list of "financial institutions" so long as the Treasury Secretary "determines that they engage in any activity similar to, related to, or substituted for, any of the listed businesses."[108] Likewise, Treasury can require such institutions to keep records and file reports that provide a "high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism."[109] At the same time, "investment companies" are already a covered category under the BSA, and certain investment companies like mutual funds already comply with AML requirements; all the Biden administration needs to do is revoke the 2002 temporary exemption, now nearly 20 years old, to bring the full scope of investment companies under BSA regulations.

As discussed previously, FinCEN has made several prior efforts to add investment advisers to its list of financial institutions and create AML program requirements for unregistered investment companies, but never finished the proposed rules. The difference now is that the evidence justifying action is much stronger than before. As the FBI intelligence bulletin notes, the current system is "not adequately designed to monitor and detect threat actors' use of private investment funds to launder money." [110] The evidence of abuse is only increasing, as is the size of the U.S. private investment market. It will only become easier over time for increasing amounts of illicit funds to taint legitimate U.S. investments.

Likewise, as doors close on other financial secrecy vehicles – namely, anonymous U.S. shell companies, which are now subject to reporting under the Corporate Transparency Act – criminals will likely increase demand for opaque private investment funds. And that demand will increasingly target U.S. markets, as other countries toughen AML/CFT controls on investment advisers and investment companies operating within their borders.

Further, the Corporate Transparency Act, while inclusive of many businesses, exempts many investment advisers and pooled investment vehicles from reporting their true, “beneficial” owners to the forthcoming FinCEN database. While those exemptions are subject to review by the Government Accountability Office and Treasury Department, FinCEN action to impose AML/CFT program requirements and CDD obligations on investment advisers and investment companies could help shore up the sector and reduce the attractiveness of private investment funds as a vehicle to move illicit finance.[111]

Finally, the political moment is right. The Biden administration can reclaim American leadership in the international anti-corruption space, in part, by reviewing domestic policies that fuel foreign corruption, especially in the lead up to the Summit for Democracy. The White House has started by featuring in its international agenda deliverables like the efforts to robustly implement the Corporate Transparency Act and to introduce greater transparency in the ownership of U.S. real estate.[112] Tackling money laundering through investment firms would likewise make an important contribution to reducing the inadvertent U.S. role in facilitating wealth drain from low- and middle-income countries. Given its importance and the advanced stages of previous policymaking, analysts have identified shoring up the U.S. private investment industry as one of the most essential reforms in the campaign to strengthen global democracy and minimize the U.S. role in promoting corruption.[113]

Recommendations

+ FinCEN should issue new rules that include investment advisers among BSA-covered financial institutions and revoke the temporary exemption given to unregistered investment companies. The new rules should require both investment advisers and unregistered investment companies to establish AML/CFT programs and affirmatively engage in customer due diligence reviews of prospective investors.

+ Importantly, the rules should cover the full range of advisers in order to avoid loopholes that allow for exploitation by bad actors. Covered investment advisers should include:

  1. Advisers currently registered with the U.S. Securities and Exchange Commission;

  2. Advisers working solely with private equity, hedge funds, venture capital funds, rural business investment companies, family offices, or any other type of private fund; and

  3. Advisers working as Foreign Private Advisers.

+ In particular, the new “know your customer” requirements should mandate (1) the identification of the beneficial owners of legal entities that open accounts, including single transaction clients; (2) evaluating all account holders and beneficial owners for money laundering risk; (3) ongoing monitoring of all accounts, with enhanced scrutiny of those with higher risk profiles; and (4) the filing of Suspicious Activity Reports with FinCEN.

CONCLUSION

The cases presented in this report show how opaque private investment vehicles can be misused by U.S. adversaries as well as criminals and other wrongdoers. The case studies demonstrate the need to bring greater transparency to the funds flowing through this multi-trillion dollar industry. Greater transparency will make it harder for actors looking to evade government scrutiny to enlist the private investment sector for help to stay in the shadows.

Moving forward to establish affirmative AML/CFT obligations for investment advisers and investment companies would ensure that hedge funds, private equity funds, venture capitalists and other investment firms finally follow the same anti-money laundering safeguards that other financial institutions follow to protect Americans and maintain the integrity of the U.S. financial system.

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