



**VIA E-Mail**

Policy Division  
Financial Crimes Enforcement Network  
United States Department of the Treasury  
**Docket No: FINCEN–2024–0006; RIN 1506–AB58**

**Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers**

Dear Sir or Madam:

The National Venture Capital Association (“NVCA”)<sup>1</sup> is pleased to comment on the Financial Crimes Enforcement Network’s (“FinCEN”) proposal (the “Proposed Rule”) to include certain investment advisers in the definition of “financial institution” under the Bank Secrecy Act (“BSA”). We note that among other things, the Proposed Rule would:

- prescribe minimum standards for anti-money laundering/countering the financing of terrorism (“AML/CFT”) programs to be established by covered investment advisers,
- require covered investment advisers to report suspicious activity to FinCEN pursuant to the BSA, and
- make several other related changes to FinCEN regulations.<sup>2</sup>

In our previous communications with government officials from FinCEN, the Department of Treasury (“Treasury”), the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Federal Reserve Board, NVCA has consistently supported regulatory efforts to reduce, detect, and deter incidents of money laundering and terrorist financing by requiring financial institutions to take precautions against their occurrence. We reiterate that support in this letter and appreciate the opportunity to comment on the Proposed Rule.

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<sup>1</sup> The National Venture Capital Association (NVCA) represents the U.S. venture capital and startup community, advocating for public policies that support America’s entrepreneurial system. Venture capitalists create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations, and others with the talent and expertise of the venture capital fund adviser in order to make high-risk, long-term equity investments in innovative young companies. Venture capital funds are generally partnerships that last ten to fifteen years, building investments far longer than any other asset class.

<sup>2</sup> Notice of Proposed Rulemaking: *Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers*, 89 Fed. Reg. 12108 (Feb. 15, 2024).

Briefly, NVCA's principal comments on the Proposed Rule are as follows:

- The Proposed Rule will create unnecessary compliance burdens and does not consider the downstream impact on funds and portfolio companies, especially among exempt reporting advisers ("ERAs") under the Investment Advisers Act, 1940 (the "Advisers Act").
- If the Proposed Rule applies to VC advisers, VC advisers should not be required to submit Suspicious Activity Reports ("SARs") for companies in which their funds invest. VC advisers should only be required to file SARs for their funds or other investment vehicles.

**Most importantly, the Proposed Rule is unsuitable and unnecessary for advisers to venture capital ("VC") funds and should therefore not apply to VC advisers.**<sup>3</sup> We are in strong opposition to the Proposed Rule applying to advisers to VC funds and urge FinCEN to re-propose the Proposed Rule to exclude VC advisers to avoid burdening VC advisers and funds that present low risk for facilitating money laundering.

Tailoring the Proposed Rule to meet its stated policy goals more clearly will, we believe, further our common objective of reducing, detecting, and deterring incidents of money laundering and terrorist financing. It is toward that common objective that we offer the following comments for FinCEN's consideration.

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<sup>3</sup> In this comment letter, unless the context clearly indicates otherwise, we refer to VC advisers to refer to both registered investment advisers as well as exempt reporting advisers.

## **1. THE PROPOSED RULE IS UNSUITABLE AND UNNECESSARY FOR VC ADVISERS.**

We entirely agree with the statement in the release accompanying the Proposed Rule (the “Proposing Release”) that some private funds “have characteristics that have traditionally been seen as less attractive to money launderers.” VC funds, in particular, are an inherently illiquid form of investing in operating companies, and VC funds are, for that reason among others, a seemingly illogical choice for money launderers. In support of this assertion, in section 1.a. below, we offer a brief description of VC funds and how they operate, with an emphasis on the features that make such funds unsuitable targets for money laundering.

We would also note that to the extent money laundering risk does attach to VC funds and their advisers, there already exist very substantive measures to address these risks. Investments in VC funds are largely mediated by financial institutions that are already subject to the BSA’s AML/CFT requirements, making the establishment of a further AML/CFT program at the VC adviser level needlessly duplicative and onerous.

Each of these submissions is developed further below.

### **a. VC Funds are Inherently Illiquid and Have a Long-Term Focus, Making Them Unsuitable Targets for Money Laundering.**

We agree with the Proposing Release’s observation that,

“...there are a wide variety of private funds, and some have characteristics that have traditionally been seen as less attractive to money launderers. In particular, VC funds are illiquid investment vehicles where investors do not have redemption rights and will not see any investment returns for several years after the initial investment is made. For instance, venture capital funds may not permit any withdrawals due to the time it takes for the private companies in which those funds invest to go public or otherwise provide an exit strategy for these funds.”<sup>4</sup>

VC funds have a number of features that make them generally unsuitable for money laundering. Accordingly, to illustrate why VC funds are particularly weak avenues for money laundering, we provide brief description below of how such funds are organized and how they operate.<sup>5</sup>

The typical VC fund is organized as a limited partnership, or a limited liability company, in which the VC firm serves as the general partner (“GP”). The majority of the money in the fund comes

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<sup>4</sup> Proposing Release at 12114.

<sup>5</sup> The description below is taken from our letter to FinCEN of July 7, 2003 commenting on FinCEN’s then-proposed rules regarding the application of Section 352 of the USA PATRIOT Act to investment advisers, available at <https://www.fincen.gov/sites/default/files/shared/heesen.pdf>. The description of VC funds provided nearly 20 years ago continues to be accurate, illustrating that there appears to be no structural changes necessitating a new AML/CFT requirement for investment advisers.

from passive, limited partner investors (“LPs”) who agree to a commitment of capital for a period that generally exceeds seven years and often ranges up to twelve years.

The vast majority of VC funds are organized for the purpose of making equity investments in operating companies with the goal of capital gains from successful exit events, primarily public offerings, or the merger or sale of such operating companies. The typical fund portfolio includes between ten and fifty “portfolio companies.” Often, a representative of the fund GP sits on the board of each portfolio company, overseeing and supporting the management of the company for the purpose of enhancing the value of the fund’s investment. It is not unusual for this support to include assistance in recruiting key personnel, strategic business advice, CEO mentoring, assistance in building business relationships, and similar activities aimed at adding to the value of the portfolio company. While it is not the preferred use of the GP’s time, the GP may, in some cases, become involved in the day-to-day management of a portfolio company to address management continuity concerns or other critical matters. All activities of the GP are intended to enhance the long-term investment value of the fund.

VC firms offer potential investors a single “product,” specifically a long-term investment in a number of operating companies with returns based on the value of those investments when the companies are sold, merged or taken public. Firms may differentiate the product in terms of the strategy that a given fund will pursue. A fund may be biotechnology-focused or software-focused, for example. One fund may seek to invest in ten portfolio companies that have shown clear signs of commercial viability, and another to “seed” fifty early stage companies with an initial round of venture capital. In all cases, VC is inherently illiquid investing in operating companies.

The illiquidity and the long lock-up periods for VC investments make VC funds unwelcoming targets for money laundering. Many VC funds also have significant minimum subscription amounts for LPs, which makes the use of cash infeasible for most LPs. Further, VC funds do not permit the receipt of subscription amounts in the form of currency — subscription amounts are usually wired from banks or other financial institutions that are themselves subject to rigorous AML/CFT requirements, a point that we also discuss in greater detail below.

In the Proposing Release, FinCEN expressly acknowledges that private funds (including VC funds) are inherently illiquid and that restrictions on withdrawals at these funds “may deter criminals who need immediate access to illicit proceeds.”<sup>6</sup> Nevertheless, FinCEN proposes to require advisers to these funds to adopt and implement AML/CFT programs because such illiquidity and restrictions on withdrawal do not deter “wealthy corrupt foreign actors who seek stable returns, and have a medium- to long-term investment horizon, and do not need immediate access to capital.”<sup>7</sup> Absent evidence that this risk is more than hypothetical, it does not provide justification for requiring the adoption of extensive AML/CFT programs.

As we discuss further below, the Proposing Release provides no examples of such “wealthy corrupt foreign actors” investing in VC funds. Nor has any alert published by FinCEN, money laundering risk assessment produced by the Treasury, or any money laundering typology identified by the

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<sup>6</sup> Proposing Release at 12114-15.

<sup>7</sup> *Id.* at 12115.

Financial Action Task Force, identified examples of money laundering through VC funds (as opposed to unrelated issues such as technology theft).<sup>8</sup> To the extent that this Proposed Rule would cover VC funds, it is addressing a purely hypothetical risk that does not appear crafted to provide useful information to law enforcement.

The BSA's primary purpose is to enable law enforcement to prevent and investigate money laundering and other financial crimes. This purpose is highlighted by the Anti-Money Laundering Act of 2020 ("AMLA"), which significantly strengthened and modernized the BSA. Among other things, AMLA emphasizes the importance of the BSA's provision of critical information to law enforcement agencies, confirming its ongoing relevance as a tool in combating illicit financial activities.<sup>9</sup> Indeed, AMLA specifically notes as one of its purposes, "coordination and information sharing among the agencies tasked with administering anti-money laundering and countering the financing of terrorism requirements, the agencies that examine financial institutions for compliance with those requirements, Federal law enforcement agencies, national security agencies, the intelligence community, and financial institutions."<sup>10</sup> Here, neither the Proposing Release nor the broader record provides any reason to believe that information regarding investments in VC funds would be of any importance to law enforcement agencies in their AML efforts. Rather, a significant amount of unnecessary and irrelevant information could hinder such efforts. AMLA also noted that that AML/CFT policies, procedures, and controls of financial institutions must be risk-based.<sup>11</sup> Nothing in the Proposing Release or the broader record supports the idea that VC funds and their investors pose significant AML/CFT risks.

Further, even in the unlikely event that bad actors with no liquidity needs and long-term investing horizons were investing in VC funds in appreciable numbers, their investments would go through other financial institutions such as banks and broker-dealers that are already subject to AML/CFT requirements. There is no additional benefit to the Treasury or to law enforcement to imposing these obligations on intermediaries who would be able to share no additional information with any law enforcement investigation. For these reasons, among others, we urge FinCEN to rescind and re-propose a rule in which VC advisers are not included in the BSA's definition of "financial institution."

**b. For VC Advisers, the Proposing Release Does Not Adequately Identify the Harm It Seeks to Address.**

The Proposing Release would require private fund advisers (including VC advisers) to adopt and implement AML/CFT programs in order to deter "wealthy corrupt foreign actors who seek stable

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<sup>8</sup> Note that while the Treasury's 2024 Investment Adviser Risk Assessment (published on the same day that FinCEN published the Proposing Release) discusses certain activities involving technology theft concerns at VC funds, the Risk Assessment largely reiterates the same examples provided in the Proposing Release – examples that do not relate to money laundering through VC funds. *See* Department of the Treasury, *2024 Investment Adviser Risk Assessment*, at 21-22, available at <https://home.treasury.gov/system/files/136/US-Sectoral-Illicit-Finance-Risk-Assessment-Investment-Advisers.pdf>.

<sup>9</sup> *See generally*, Anti-Money Laundering Act of 2020, Pub. L. No. 116-283, 134 Stat. 3388.

<sup>10</sup> AMLA, Section 6002(1), 31 U.S.C. § 5311.

<sup>11</sup> *Id.* at Section 6002(4).

returns, and have a medium- to long-term investment horizon, and do not need immediate access to capital.”<sup>12</sup> Yet the Proposing Release provides few, if any examples, of where such investments have occurred, and provides little detail on how real this risk is. The Proposing Release appears to cite only one example of such investment by a wealthy corrupt foreign actor — namely, the fact that “investment funds affiliated with Low Taek Jho (Low) laundered approximately \$150 million diverted from 1Malaysia Development Berhad’s (“1MDB”) 2012 bond issuance into the U.S. financial system.”<sup>13</sup>

It would, however, be reductive to view the 1MDB case as illustrating the need for investment advisers to adopt and implement AML/CFT programs. Rather, as a survey of the complaint in the matter<sup>14</sup> filed by the Department of Justice shows, this case involved the failure by multiple banks to adequately conduct diligence and follow the required processes for suspicious transactions. As the complaint and other sources show, the movement of funds stolen from 1MDB was made possible only by repeated compliance failures at banks and other institutions in multiple jurisdictions, including failures to file SARs and failures to monitor politically-exposed persons.<sup>15</sup> Instead of supporting the addition of an extra new regulatory layer — *i.e.* the proposed AML/CFT program for investment advisers — the 1MDB case appears to revolve almost entirely around process failures at other BSA-covered financial institutions.<sup>16</sup>

The Proposing Release provides only one other example of an investment from wealthy corrupt foreign actors — a billion-dollar international scheme to launder funds obtained through embezzlement, fraud, and bribery from Venezuelan state-owned oil company Petroleos De Venezuela S.A. through an investment advisory firm located in the U.S.<sup>17</sup> However, as the Proposing Release goes on to expressly acknowledge, the adviser in this case “was complicit in the fraudulent scheme,”<sup>18</sup> so that it is very unlikely that the additional AML/CFT program would have served to check the wrongdoing.

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<sup>12</sup> Proposing Release at 12115.

<sup>13</sup> *Id.*

<sup>14</sup> *U.S. v. One Drawing Entitled “Self-Portrait” by Jean Michel Basquiat* (filed July 1, 2020) available at [file:///C:/Users/n019322/Downloads/download\\_drawing\\_basquiat\\_complaint%20\(5\).pdf](file:///C:/Users/n019322/Downloads/download_drawing_basquiat_complaint%20(5).pdf).

<sup>15</sup> Aidila Razak, *US banks didn’t act on ‘suspicious’ Jho Low, 1MDB-linked transfers until too late, leak shows*, (Sep. 21, 2020) available at <https://www.malaysiakini.com/news/543389>; Yueqi Yang, Jennifer Surane, and Yalman Onaran, *Bank Shares Dip with \$2 Trillion of Suspect Flows Under Scrutiny*, (Sep. 20, 2020), available at <https://www.bloomberg.com/news/articles/2020-09-20/banks-moved-2-trillion-defying-money-laundering-orders-icij>.

<sup>16</sup> The 1MDB case suffers from a further infirmity if it is used to support the introduction of an AML/CFT program for investment advisers. The stolen funds were believed to have flowed from Low’s investment vehicle, Jynwel Capital, to U.S. based registered investment advisers. However, as the Proposing Release notes, Jynwel Capital itself appears to have been misrepresented as an investment adviser to a private equity fund. (*See* Proposing Release at 12115, n.71.) Where the funds are procured through a misrepresentation by the adviser or its affiliate, an additional AML/CFT program at the level of the adviser provides no additional safeguard.

<sup>17</sup> Proposing Release at 12115.

<sup>18</sup> *Id.*

The examples cited in the Proposing Release accordingly seem to provide no support for requiring the implementation of AML/CFT programs for private fund advisers. One of the examples involves multiple failures by financial institutions other than advisers. The other involves an adviser complicit in fraud. Neither example illustrates the need for advisers to have AML/CFT programs. Perhaps most importantly, neither example concerns an investment in venture capital. Neither example concerns a VC fund, no VC adviser is alleged to have failed to conduct diligence, and no VC investment is alleged to have emanated from wealthy corrupt foreign actors seeking to place laundered funds. We do not view either example cited in FinCEN's Proposing Release as illustrating the need for the adoption of AML/CFT programs by VC advisers.

The Proposing Release also provides two examples of suspicious investor conduct specifically in the VC context. One such example is that in 2016, the Chinese government explicitly endorsed the use of overseas VC funds to invest in "seed-based and start-up technology," demonstrating the link between the funds and government priorities.<sup>19</sup> The second is that several U.S. VC funds appear to have significant ties to Russian oligarch investors that invested in firms developing emerging technologies with national security applications.<sup>20</sup>

While both these examples pertain directly to venture capital, neither relates to money laundering. Further, to the extent FinCEN has concerns regarding technology access, those concerns are appropriately addressed via export controls and investment screening. The use of AML/CFT rules to address technology access would stretch the BSA well beyond its intended purpose, would be largely duplicative of these other regulatory regimes, and would require VC advisers to make judgments that they are not equipped to make.

**c. Existing AML/CFT Requirements for Other Financial Institutions Make the Proposed Rule Needlessly Duplicative.**

Investments in private funds are already subject to multiple AML-related checks and compliance procedures. Most subscription amounts from would-be LPs or investors originate from jurisdictions that are generally subject to extensive AML/CFT and customer identification program ("CIP") controls conducted by the bank or other financial institution in the jurisdiction from which the funds originate. These extensive AML/CFT and CIP controls are also applied to funds transmitted to LPs as a result of redemptions or transfers. AML/CFT and CIP processes are also performed by the U.S. bank or broker-dealer receiving the funds on behalf of the VC fund, its GP or its adviser.

The VC fund investment landscape therefore already appears to include significant AML/CFT and CIP controls. Adding another layer of costly and seemingly redundant AML/CFT controls to these functioning and well-established processes would add confusion and administrative burdens on family offices or similarly situated firms with limited resources.

The Proposing Release puts forward five reasons for why it believes advisers should be required to adopt and implement their own AML/CFT programs. These are:

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<sup>19</sup> *Id.* at 12116.

<sup>20</sup> *Id.*

- First, the lack of comprehensive AML/CFT regulations directly and categorically applicable to investment advisers mean that advisers are generally not required to understand their customers’ ultimate sources of wealth or identify and report potentially illicit activity to law enforcement.<sup>21</sup>
- Second, where AML/CFT obligations apply to investment adviser activities, the regulated entities (such as banks, broker-dealers, and fund administrators providing services to advisers and the private funds that they advise) do not necessarily have a direct relationship with the customer or, in the private fund context, underlying investor in the private fund.<sup>22</sup>
- Third, the existing Federal securities laws are not designed to comprehensively detect illicit proceeds or other illicit activity that is “integrating” into the U.S. financial system through a registered investment adviser (“RIA”) or ERA.<sup>23</sup>
- Fourth, RIAs and ERAs routinely rely on third parties for administrative and compliance activities, and these entities are subject to varying levels of AML/CFT regulation.<sup>24</sup>
- Fifth, particularly for private funds, it is routine for investors to invest through layers of legal entities that may be registered or organized outside of the U.S., making it challenging to collect information regarding illicit finance risk under existing frameworks.<sup>25</sup>

We disagree that these five reasons provide adequate justification for requiring advisers to adopt and implement AML/CFT programs. First, it is unclear that adding a layer of AML/CFT oversight at the adviser level would enhance visibility into investor funds. AML/CFT oversight by the bank or other financial institution from which investor funds originate is more likely to be effective in this regard. The Proposing Release notes that because advisers are not “financial institutions” under the BSA, they have wide discretion as to the information they request from their customers and private fund investors.<sup>26</sup> This is true, but it ignores the fact that investments flowing into VC funds are subject to rigorous AML/CFT checks by banks and broker-dealers, as are LP funds custodied by RIAs, and that the AML/CFT regime for banks is relatively standardized and relatively uniform.

Second, it is unclear why a “direct relationship” with the customer would give an adviser any greater visibility into an LP’s sources of funds than the oversight that the LP’s bank exercises. The Proposing Release does not specify what advantage this “direct” relationship gives, and why it outweighs, for example, the significantly greater institutional resources, surveillance

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<sup>21</sup> *Id.* at 12111-12.

<sup>22</sup> *Id.* at 12113.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 12114.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 12112.

infrastructure, and international coordination that banks may rely on to observe and investigate AML/CFT concerns. The Proposing Release observes that “[w]hile investment advisers often do not take possession of financial assets, **they nonetheless may have the most direct relationship with the customers they advise and thus be best positioned to obtain the necessary documentation and information** from and about the customers concerning their assets that the investment adviser is deploying in public or private financial markets.”<sup>27</sup> **This is not accurate.** Investors in VC funds are, in fact, direct customers of the banks which custody their funds, and the banks are therefore in a much better position to collect this information. Indeed, VC advisers are arguably in a worse position to understand the risk of an investor because they only see the investor at a single point in time and do not have access to the continuous transactional information that allows a bank to assess the risk of an individual customer.

In light of this reality, the Proposing Release does not explain why a direct relationship as to asset management for LPs necessarily best positions a VC adviser to obtain documentation and information from such LPs. Nor does the Proposing Release explain why VC advisers, as opposed to banks, are better placed to identify patterns of money laundering transactions. Large international banks act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g. interest-bearing accounts in a variety of currencies), international wire transfers, check clearing, payable-through accounts and foreign exchange services.<sup>28</sup> The significantly wider range of participation by banks across a range of transactions positions banks far better than advisers to observe and report on money laundering activities. As the Proposing Release’s reference to the 1MDB case shows, the use of an investment adviser may often only form a single fragment of a much larger money laundering scheme. There is therefore no reason to believe that advisers are better placed than banks to evaluate a complex money laundering scheme.

Third, while we agree that advisers are not currently required to have AML/CFT programs, we disagree that existing Federal laws are not designed to comprehensively detect illicit proceeds or other illicit activity that is “integrating” into the U.S. financial system through an RIA or ERA. Broker-dealers are specifically covered by the BSA. As we have previously outlined, funds entering the U.S. financial system through an RIA or an ERA are processed by banks and broker-dealers and are subjected to multiple mandatory AML/CFT and CIP checks and controls by banks and broker-dealers. While it is true that money laundering is not a significant focus of the Federal securities laws, this does not imply that the Federal laws are generally ineffective in detecting illicit proceeds or other illicit activity that is “integrating” into the U.S. financial system through an RIA or ERA. As the Treasury’s Assistant Secretary for Terrorist Financing and Financial Crimes, Elizabeth Rosenberg, recently noted, the U.S. has historically had “one of the most effective

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<sup>27</sup> *Id.* at 12113 (emphasis added).

<sup>28</sup> See, for example, *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation – The FATF Recommendations* (Updated Nov. 2023) at 125, available at <https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf>.

AML/CFT regimes in the world.”<sup>29</sup> There is no reason why the Federal securities laws should be evaluated in terms of their effectiveness on AML/CFT, particularly given that AML/CFT has historically been a central concern of Federal banking laws, rather than of the Federal securities laws.

Fourth, although it is true that RIAs and ERAs may rely on third parties for certain administrative and compliance activities, AML/CFT regulation levels do not vary widely among such third parties, particularly where such third parties are banks or broker-dealers. Banks and other financial institutions, rather than advisers, have been the subject of most international coordination efforts on AML/CFT. For example, several recommendations of the Financial Action Task Force (“FATF”) focus specifically on the role of banks and money transmitters in combating money laundering.<sup>30</sup> Accordingly, given the centrality of banks in facilitating financial flows to VC funds, the relative uniformity in AML/CFT implementation across banks should address FinCEN’s concerns regarding any potential “arbitraging” of varying AML/CFT regulations across financial institutions.

Fifth, while we agree that investors may sometimes invest through layers of legal entities that may be registered or organized outside of the U.S., it is unclear why an AML/CFT program run by an investment adviser would be better placed to review these various layers than regulated banks or other fund-transmitting financial institutions in the jurisdictions where these various foreign entities are organized.

There is little, if any, data to suggest that there are significant AML/CFT failures at VC funds, and the Proposing Release provides practically no examples of such failures. Nor are we aware of any data to suggest that if such widespread AML/CFT failures at VC funds did exist, they would be effectively counteracted by the creation of an additional AML/CFT regime at the level of the VC adviser. Any analysis of the flow of funds into VC and other private investment vehicles must first evaluate the indispensable role of banks and broker-dealers in facilitating these flows, and any such evaluation would reveal the extensive, effective, and relatively uniform AML/CFT checks and controls that banks across a range of jurisdictions implement.

In light of (1) the relatively low risk of money laundering at VC funds; (2) the lack of any significant data to suggest any heightened risk of money laundering around VC funds; and (3) the extensive existing AML/CFT and CIP controls present at the banks and broker-dealers that facilitate investment flows into VC funds, we would request FinCEN to re-evaluate the application of the Proposed Rule to VC advisers, and to carve VC advisers out of the application of the Proposed Rule. If, as the Proposing Release suggests, FinCEN’s concerns are around the theft or misappropriation of sensitive technology and intellectual property through VC investments, an AML/CFT program is an inappropriate and ineffective remedy for such harms.

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<sup>29</sup> See Remarks by Assistant Secretary for Terrorist Financing and Financial Crimes Elizabeth Rosenberg at the Association of Certified Anti-Money Laundering Specialists Assembly Conference, (Oct. 2, 2023), available at <https://home.treasury.gov/news/press-releases/jy1778>.

<sup>30</sup> See, for example, FATF Recommendation 13 on Correspondent Banking.

**2. THE PROPOSED RULE WILL CREATE UNNECESSARY COMPLIANCE BURDENS AND DOES NOT CONSIDER THE DOWNSTREAM IMPACT ON FUNDS AND PORTFOLIO COMPANIES, ESPECIALLY AMONG ERAS.**

If the Proposed Rule is adopted, VC advisers would face significant financial and other burdens on their funds – with no additional insight or benefit. VC advisers have limited capacity and resources, and these constraints are often especially pronounced among many ERAs. These additional compliance burdens, if implemented, would divert time and attention away from creating and investing in companies. As mentioned earlier, VC support to entrepreneurs goes far beyond writing checks – this Proposed Rule would take time away from VCs in their work building and scaling the very businesses that are increasing U.S. global competitiveness.

Including ERAs in the Proposed Rule would likely place a number of ERAs at a significant disadvantage. In the Proposed Rule, FinCEN acknowledges that it cannot accurately estimate the degree to which ERAs currently implement AML/CFT requirements. This failure to arrive at an accurate estimate will inevitably affect FinCEN’s ability to accurately estimate the costs of complying with the Proposed Rule for many RIAs as well.

**a. The Proposing Release Fails to Provide Adequate Reasons or Data to Justify the Expansion of the Proposed Rule to ERAs.**

FinCEN’s 2015 proposal to require investment advisers to adopt and implement AML/CFT programs was restricted only to RIAs.<sup>31</sup> By contrast, the requirements of the Proposed Rule would apply to both RIAs and ERAs. The Proposing Release fails to provide any meaningful justification for this significant expansion in the Proposed Rule’s coverage. Instead, the Proposing Release points only to a review by the Treasury of the illicit finance risk in the investment adviser industry.<sup>32</sup> This review included the Treasury’s analysis of SARs filed between 2013 and 2021 that were associated with RIAs and ERAs.<sup>33</sup> The Proposing Release states that Treasury’s analysis found that 15.4 percent of RIAs and ERAs were associated with or referenced in at least one SAR (*i.e.*, they were identified either as a subject or in the narrative section of the SAR) during this time.<sup>34</sup> Further, according to the Proposing Release, the number of SAR filings associated with an RIA or ERA increased by approximately 400 percent between 2013 and 2021—which the Proposing Release states was a disproportionately higher increase than the overall increase in SAR filings.<sup>35</sup>

The Proposing Release’s discussion of the Treasury review raises more questions than it answers. What percentage of the SARs associated with RIAs and ERAs related to ERAs, as opposed to

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<sup>31</sup> Notice of Proposed Rulemaking: *Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers*, 80 Fed. Reg. 52680 (Aug. 1, 2015).

<sup>32</sup> Proposing Release at 12114.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

RIAs? Is this percentage significant? How many of these SARs related to money laundering at or through ERAs? Were there any findings that suggested that ERAs, by virtue of their exempt status, were somehow more vulnerable to illicit finance risks?

The Proposing Release provides no answer to these and other questions regarding the data on which FinCEN relies. Beyond the single Treasury review that it references, and a handful of examples, the Proposing Release provides no evidence of any heightened money laundering risk that might justify expanding the coverage of the Proposed Rule to ERAs.

“When an agency changes its existing position, it . . . must at least display awareness that it is changing position and show that there are good reasons for the new policy.”<sup>36</sup> Here, however, the Proposing Release fails to put forward any adequate reason for the expansion in the scope of the Proposed Rule beyond citing a Treasury review that does not, in fact, furnish any reason to think that ERAs are especially vulnerable to illicit financing risks.

### **3. IN ITS CURRENT FORM, THE PROPOSED RULE’S REQUIREMENT THAT ADVISERS FILE SUSPICIOUS ACTIVITY REPORTS (SARS) IS EXCESSIVELY BROAD.**

If, against our recommendations, FinCEN decides to adopt the Proposed Rule so that it applies to VC advisers, FinCEN should reconsider the Proposed Rule’s SAR filing requirements as they are currently proposed to apply to VC advisers. The Proposed Rule would require investment advisers to report suspicious activity by filing SARs for any suspicious transaction that “involves or aggregates funds or other assets of at least \$5,000 [when] the investment adviser knows, suspects, or has reason to suspect that the transaction” generally involves funds derived from or intended to facilitate illegal activity or that has no business or lawful purpose.<sup>37</sup> We submit that this proposed SAR filing requirement is excessively broad in at least two respects, which we discuss in greater detail below.

First, the Proposed Rule provides no limits on the entities for which an investment adviser is required to file SARs. We submit that a VC adviser should only be required to file SARs for activities and transactions occurring at the level of the adviser itself. No SAR filing requirements should apply to advisers for activities or transactions occurring at the level of a portfolio company in which the adviser’s fund is invested.

Second, the Proposed Rule appears to require SARs to be filed for a very wide range of suspicious activities — including potential activities which do not amount to violations of law. This is overbroad, and risks placing VC advisers in the impossible position of having to determine which activities, though entirely legal, may nevertheless merit the filing of a SAR. To avoid such ambiguities, we would suggest that FinCEN require SAR filings only where the adviser knows, suspects, or has reason to suspect that the activity or transaction in question involves a violation of law.

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<sup>36</sup> *Encino Motorcars LLC v. Navarro*, 579 U.S. 211, 221 (2016), citing *FCC v. Fox Television Stations, Inc.*, 556 U. S. 502, 515 (2009).

<sup>37</sup> Proposed § 1032.320(a)(2).

**a. The Proposed Rule Should Not Require VC Advisers to file SARs for Activities at the Portfolio Company Level.**

In its current form, the Proposed Rule provides no demarcation as to the range of entities for whose activities and transactions VC advisers are required to file SARs. Proposed § 1032.320(a)(1) contains the general statement of the obligation to file reports of suspicious transactions. The obligation would extend to transactions conducted or attempted by, at, or through an investment adviser. To clarify that the Proposed Rule imposes a reporting requirement that is uniform with those for other financial institutions, § 1032.320(a)(1) incorporates language from the SAR rules applicable to other financial institutions, such as banks, broker-dealers in securities, mutual funds, casinos, and money services businesses.<sup>38</sup>

Unlike banks or broker-dealers, however, VC advisers are often involved in transactions or activities at multiple levels. Advisers may engage in transactions for themselves, for the funds they advise, and with, or for the portfolio companies in which their funds invest, and even, occasionally, with affiliates of these portfolio companies. As we have noted above, a VC fund may often invest in anywhere between ten and fifty companies, and VC advisers may offer advice to portfolio companies on matters ranging from recruiting key personnel, CEO mentoring, assistance in building business relationships and similar activities aimed at adding to the value of the portfolio company.

Yet this wide array of transactions does not necessarily mean that a VC adviser has significant visibility or control with respect to any investment. The typical VC fund has only very limited visibility into its investments, and it is likely to have few, if any, governance rights at the portfolio company level. This limited visibility and control at the portfolio company level means that VC advisers are unlikely to be able to file SARs for activities at the portfolio company level or at any level beyond the adviser itself and the fund or funds that it advises. Requiring VC advisers to file SARs for portfolio companies would also upset the delicate balance between VC funds and advisers, on the one hand, and portfolio companies on the other, with VC advisers being forced to demand ever greater visibility into the workings of portfolio companies in order to comply with SAR filing requirements. If VC advisers are included within the ambit of the Proposed Rule, it would be optimal to require them to file SARs only at the level where such advisers have both visibility and day-to-day control – *i.e.*, at the level of the adviser itself, and the VC funds it advises.

**b. The Proposed Rule Should Only Require VC Advisers to File SARs for Suspicious Activities That Could Constitute Violations of Law.**

In its current form, the Proposed Rule appears to require advisers to file SARs for a very wide range of activities — some of which may be entirely legal. For example, the Proposing Release notes that “[r]equiring ERAs, particularly venture capital advisers, to submit SARs may help CFIUS agencies identify transactions where investors affiliated with foreign governments are attempting to use an investment to acquire technology or know-how with national security implications.”<sup>39</sup>

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<sup>38</sup> Proposing Release at 12131.

<sup>39</sup> *Id.* at 12149.

Trying to transform the SAR process into a CFIUS-assisting tool would force VC advisers to become attuned not to potential violations of law but to U.S. government national security concerns about which VC advisers generally lack relevant information. A CFIUS filing, or a determination that a CFIUS filing is needed, generally is not indicative of violations of law. The U.S. maintains robust export control laws geared to prevent foreign parties from gaining access to sensitive U.S. technology or data, and the CFIUS process aims to determine whether, **even where foreign access is legal**, it should be prohibited or conditioned because of national security concerns. These determinations generally are made by CFIUS and by transacting parties' outside legal counsel with national security expertise.

In contrast, the purpose of the SAR filing process is to highlight for law enforcement agencies potential violations of law, not to make judgments about national security. FinCEN should not force VC advisers to make these national security judgments (which VC advisers are ill-equipped to make) or to incur the significant expense of hiring outside legal counsel to make these judgments. The SAR process should be maintained as a tool to assess potential violations of law.

We therefore urge FinCEN to clarify that under the Proposed Rule, a VC adviser is only required to file SARs with respect to transactions or activities that the adviser knows, suspects, or has reason to suspect involves a violation of law.

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In conclusion, NVCA is in strong opposition to the application of this rule to VC advisors - the Proposed Rule, if applied in its current form, will likely have a significant and adverse impact on the venture capital ecosystem, particularly on VC advisers and the innovative startups they fund and advise. We urge FinCEN to re-propose the Proposed Rule to avoid burdening VC advisers and funds that present low risk for facilitating money laundering.

We appreciate the opportunity to provide comments and FinCEN's consideration of our feedback. We would be pleased to provide any additional information that would be helpful.

Sincerely,

A handwritten signature in cursive script that reads "Bobby Franklin".

Bobby Franklin  
President and CEO  
National Venture Capital Association (NVCA)