MANAGED FUNDS ASSOCIATION

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VIA ELECTRONIC MAIL: regcomments@fincen.treas.gov

July 7, 2003

FinCEN
P.O. Box 39
Vienna, VA 22183

Attention: Section 352 CTA Regulations and
Section 352 Investment Adviser Rule Comments

Dear Sir or Madam:

Managed Funds Association ("MFA") appreciates the opportunity to comment on the above-referenced notices of proposed rulemaking, and accompanying releases (collectively, the "Proposed Rules"), published by the U.S. Department of Treasury, Division of Financial Crimes Enforcement Network ("Treasury"). This letter addresses both the proposed rule requiring Anti-Money Laundering Programs ("AML Programs") for Commodity Trading Advisors ("CTA") (68 Fed. Reg. 23,640) (the "Proposed Rule for CTAs") and the proposed rule requiring AML Programs for Investment Advisers ("IA") (68 Fed. Reg. 23,646) (the "Proposed Rule for IAs"), both published May 5, 2003.

MFA, located in Washington, DC, is the only U.S.-based membership organization dedicated to serving the needs of professionals worldwide that specialize in the alternative investment industry—managed futures funds, hedge funds, and funds of funds. MFA has approximately 700 members who manage a significant portion of the over $600 billion invested in these alternative investment vehicles globally. Many of our members are CTAs and IAs. Accordingly, MFA, its members and the investors who invest in our members' funds have a vital interest in the Proposed Rules.

MFA generally supports the application of Section 352 of the USA PATRIOT[1] Act of 2001 (the "Act") to CTAs and IAs, subject to our comments below. We believe that with clarification of certain provisions of the Proposed Rules, the application of Section 352 to CTAs and IAs will achieve the dual goals of providing additional safeguards against money laundering and reducing unnecessarily burdensome or duplicative regulatory requirements for financial institutions.

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[1] The full title of this act is the "United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001."

MFA Support of Efforts to Combat Terrorist Financing and Money Laundering.

As we have emphasized in prior correspondence to Treasury, MFA strongly supports Treasury's efforts to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. We are particularly pleased that Treasury, in the Proposed Rules and related rules, has adopted a risk-based approach to AML Program compliance. To promote compliance with the Act by the hedge fund industry, MFA published its "Preliminary Guidance for Hedge Funds and Hedge Fund Managers on Developing Anti-Money Laundering Programs" (March 2002) which may be amended from time to time (the "MFA Guidance"). We believe the MFA Guidance provides our members with important practical guidance on developing internal policies and procedures in order to comply with the expected AML Program requirements under the Act. The MFA Guidance provides detailed information on, among other things, how one might rely on the investor identification procedures, and other due diligence, conducted by third-party administrators on behalf of hedge funds and other alternative investment funds. Moreover, the MFA Guidance recognizes the critical role of carrying out an effective AML Program and how to determine the effectiveness of a third party's AML Programs. In February 2003, MFA published its "USA PATRTIOT Act Update" to provide industry participants a summary of recent regulatory developments that have taken place since the passage of the Act in October 2001. Once the regulations applicable to our membership base have been finalized by Treasury, MFA intends to publish an update of the MFA Guidance.

Since the passage of the Act, MFA has also had frequent discussions with the staffs of Treasury and of other affected agencies to discuss implementing regulations under the Act. Moreover, MFA has submitted various comment letters to proposed rulemakings by Treasury regarding the implementation of the Act.[2] Most recently, in November 2002, MFA submitted its comments to Treasury's proposed rule to subject unregistered investment companies ("UIC"), including hedge funds and commodity pools, to AML Program requirements.[3] We have attached a copy of this letter hereto and incorporate it herein by reference. In particular, as we explain below, we would like to draw Treasury's attention to the sections therein entitled, "Delegation of Anti-Money Laundering Compliance Responsibility to Third Parties" and "Additional Issues Related to Third-Party Delegation of AML Duties Under the Act."[4] It is not clear that the current Proposed Rules take into account issues raised in these sections. We strongly urge Treasury to take the comments from these sections into account as well as our comments below in finalizing its Proposed Rules as they relate to both IAs and CTAs.

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[2] See MFA comment letter, dated February 11, 2002 (Correspondent Accounts for Foreign Shell Banks); MFA comment letter, dated July 1, 2002 (Notice of Proposed Rulemaking on Anti-Money Laundering Due Diligence Programs for Certain Foreign Accounts (Section 312 of USA PATRIOT Act)); and MFA comment letter, dated November 25, 2002 (Section 352 Unregistered Investment Company Regulations). These letters are available on MFA's Web site at: ***www.mfainfo.org.***

[3] See MFA comment letter, dated November 25, 2002, regarding Treasury's proposed rule under Section 352 of the Act for AML Programs for unregistered investment companies published by Treasury on September 26, 2002 (67 Fed. Reg. 60,617).

[4] See MFA comment letter, dated November 25, 2002, at 3-8.

Exclusions for Investment Advisers and CTAs Should be Parallel

Proposed Rule for IAs

In each of the Proposed Rules, Treasury has specifically requested comment on the respective definitions of CTAs and IAs. With respect to the Proposed Rule for IAs, Treasury has defined the term "investment adviser," for whom the Proposed Rules apply, to include two groups of advisers:

(1) Advisers registered with the Securities and Exchange Commission ("SEC") that have a principal office and place of business in the U.S. (the "U.S. advisers") and that report to the SEC that they have assets under management on form ADV; and
(2) U.S. advisers that are not registered with the SEC, but have $30 million or more of assets under management, and are relying on the registration exemption available under section 203(b)(3) of the Investment Advisers Act of 1940 (the "Advisers Act").[5]

The Proposed Rule for IAs excludes from its application the following types of IAs:

(1) Small, state registered firms with less than $30 million in assets under management that are not registered with the SEC;
(2) IAs that are registered with the SEC but do not manage client assets;[6] and
(3) Unregistered advisers required to have an AML Program under the BSA as a financial institution in another capacity and examined by a Federal functional regulator in that other capacity.

Treasury states in the Proposed Rule for IAs that, for a number of reasons, these categories of IAs "are unlikely to play a significant role in money laundering."[7]

Proposed Rule for CTAs

The Proposed Rule for CTAs would apply to any CTA[8] that is either registered or required to be registered with the CFTC and that directs client commodity futures or options

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[5] Section 203(b)(3) exempts from SEC-registration advisers who during the preceding 12 months have had fewer than 15 clients and who neither hold themselves out generally to the public as IAs nor act as IAs to any registered investment company or business development company.

[6] Under Section 203A of the Advisers Act, advisers with assets under management of less than $25 million are generally prohibited from registering with the SEC. Thus, all firms with assets under $25 million would be excluded from the Proposed Rule for IAs.

Under the Adviser Act, advisers with assets under management between $25-$30 million may choose whether to register with the SEC or with the states. Thus, firms with assets in this $25-$30 million range would only be subject to the Proposed Rule for IAs if they chose to register with the SEC.

[7] 68 Fed. Reg. at 23,648.

[8] Treasury has defined the term "Commodity Trading Advisor" generally as a person who, for compensation or profit, engages in the business of advising others, either directly or indirectly as to the value or advisability of trading futures contracts or commodity options, or who issues analyses or reports concerning trading futures or

accounts. As with the Proposed Rule for IAs, Treasury has also set forth certain exclusions from the AML Program for CTAs requirement:

(1) Any person who is not registered as a CTA under CFTC Rule 4.14(a);
(2) CTAs that provide commodity trading advice, but do not direct accounts; and
(3) Persons that choose to register with the CFTC as CTAs, even though they are not required to register, and who do not direct client accounts.

The Proposed Rule for CTAs does not contain an exclusion that is tied directly to the limited size of assets under management advised or directed by a CTA.

MFA's Recommendation

MFA believes that the exclusions under the Proposed Rule for CTAs should parallel the exclusions set forth under the Proposed Rule for IAs if those exclusions for IAs are to be adopted in the final rule. In the Proposed Rule for IAs, Treasury has essentially excluded all IAs that have less than $30 million in assets under management[9] from the requirement that they adopt an AML Program pursuant to Section 352 of the Act. In providing this exclusion for IAs, Treasury stated that "because these excluded firms … do not accept funds or hold financial assets directly, and have relatively few (or no) assets under management, these firms are unlikely to play a significant role in money laundering."[10] This exclusion for IAs appears to be based on the small amount of funds under management by the IA, rather than on its registration status with the SEC. The Proposed Rule for CTAs contains no similar exemption, even though the rationale for such an exemption is even stronger for CTAs than it is for IAs. CTAs are specifically prohibited from taking custody of clients' funds under the CEA and CFTC regulations. Moreover, if a CTA has only a relatively small amount of assets under management, then CTAs should similarly be granted an exclusion from the Proposed Rule for CTAs. For regulatory consistency, MFA believes that if Treasury is going to adopt the $30 million threshold for excluding certain IAs from AML Program requirements, it should also amend the Proposed Rule for CTAs to exclude all CTAs who direct or advise accounts of less than $30 million in assets under management.

Prescriptions for AML Programs Should be Clarified

Proposed Rule for CTAs

In the Proposed Rule for CTAs, under Section III.B.2(1) entitled, "The Four Required Elements of Each Anti-Money Laundering Program,"[11] MFA believes that Treasury has not correctly described the division of responsibility between the CTA in managing an account and the futures commission merchant ("FCM") in holding account assets. The Proposed Rule states that "CTAs face higher vulnerability to money laundering when clients place their assets with a

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commodity options. Such CTAs must register with the Commodity Futures Trading Commission ("CFTC") unless exempt from the provisions of Section 4m of the Commodity Exchange Act ("CEA").

[9] See footnote 6.

[10] See Proposed Rule for IAs, 68 Fed. Reg. at 23,648.

[11] See 68 Fed. Reg. at 23,642-44.

futures commission merchant and the funds are directed by the CTA."[12] As an example, Treasury suggests that a CTA's AML procedures "seek to identify unusual transactions whereby clients deposit checks drawn on (or wire transfers made from) accounts of third parties with no family or business relation to the client."[13] The statements that a CTA receives would not show the identity of the accountholder from which a check or wire originated. Since the CTA is not involved in the flow of assets in and out of an account, cannot hold client assets, and can direct them only to the extent authorized by its advisory agreement, it would not have access to these details. Accordingly, MFA believes that the final rule for CTAs should clearly provide that CTAs may exclude from the scope of their AML Programs those accounts that are maintained with an FCM that is subject to AML Program requirements under the Act.

Proposed Rule for IAs

In the Proposed Rule for IAs, Treasury states that it is permissible for IAs to delegate the "implementation and operation of appropriate elements of its [AML Program]" to third party service providers.[14] We direct Treasury's attention to MFA's November 25th comment letter, attached hereto, and the section entitled, "Responsibility for Third Party's AML Program."[15] In that section, MFA refers to portions of the MFA Guidance that address the types of entities upon which it might be appropriate to rely for the performance of investor identification procedures. Furthermore, MFA provided detailed guidance on determining whether third-party administrators have adequate AML Programs in place. We still believe that the comments in our earlier letter regarding reliance upon third parties should be reflected in any final rules applicable to IAs and CTAs.

Federal Inspection Authority

Proposed Rule for CTAs

Under the Proposed Rule for CTAs, MFA supports Treasury's delegation of inspection authority to the CFTC. We believe that the CFTC's expertise, with the assistance of the National Futures Association ("NFA"), would be valuable in determining whether a CTA's AML Program was appropriate in light of a CTA's business risks. Both the CFTC and the NFA have the necessary resources to work with CTAs in developing effective AML Programs.

MFA Recommendation for Both Proposed Rules

In the Proposed Rules, on the issue of delegation of responsibilities to third-party service providers, Treasury states that both CTAs and IAs would remain "fully responsible for the effectiveness of its [AML Program], as well as for ensuring that federal examiners are able to

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[12] 68 Fed. Reg. at 23,643.
[13] *Id.* The CTA, who as an accounting matter can confirm inflows or outflows from an account, would not have enough information to question the source of checks or wires. A CTA's statements would not show the issuing institution for checks or wires or the destination institution or country of origin.
[14] 68 Fed. Reg. at 23,650.
[15] See MFA's comment letter, dated November 25, 2002, at 3.

obtain information and records relating to the program and to inspect the third party for purposes of the program."[16] MFA refers Treasury to its November 25th letter, attached hereto, and the section entitled "U.S. Federal Examination Authority."[17] Under the subsection, "Offshore Third Party Administrators", MFA addressed the difficulties involved in essentially requiring offshore fund administrators to open up their books and records to U.S. federal agents. MFA underscores its concerns about the feasibility of imposing extra-territorial jurisdiction of federal examiners over offshore administrators. We ask that Treasury reexamine its approach in the Proposed Rules consistent with our earlier comments.

Treasury Should Avoid Duplicative Regulation Over Financial Institutions

Treasury has also requested comment on the proposed provisions designed to avoid imposing overlapping or duplicative regulation of CTAs or IAs and other financial institutions that are also subject to AML Program requirements. In the Proposed Rule for CTAs, for instance, Treasury states, "to prevent overlap and redundancy, the proposed rule would permit CTAs covered by the rule to exclude from the anti-money laundering program any investment vehicle they advise that is subject to an anti-money laundering program requirement under BSA rules."[18] There is a similar provision in the Proposed Rule for IAs.[19] MFA believes that this exclusion should be clarified according to the general proposition we set forth below.

On the particular issue of "preventing overlap and redundancy" in requiring AML Programs for financial institutions, it is helpful to remember, as underscored in the legislative history of the Act and by Treasury, that this requirement is not one that is "one-size-fits all." Rather, each financial institution subject to the Act should have the flexibility to tailor its program to fit its business, using the risk-based approach endorsed by Treasury. Since the passage of the Act, Treasury has proposed various amendments to the definition of "financial institution" in other proposed rulemakings mandating the adoption of an AML Program.[20] If Treasury's various proposed rules are adopted as final rules, then the term "financial institution" could encompass entities such as hedge funds, commodity funds, CTAs, IAs, and others such as FCMs and registered broker-dealers. Many entities or individuals may fit into more than one of these categories. For example, many CTAs covered by the Proposed Rule are also CFTC-registered commodity pool operators ("CPOs"). The commodity funds operated by CPOs would be subject to the proposed rule for unregistered investment companies ("UIC"), published last September, if they meet the criteria set forth in the final rule.

The Proposed Rules acknowledge that many CTAs and IAs, respectively, direct accounts of pooled investment vehicles and other types of accounts. These entities, such as hedge funds, will also be covered by the Act under currently-proposed or adopted rulemakings by Treasury.

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[16] 68 Fed. Reg. at 23,643 (Proposed Rule for CTAs); 68 Fed. Reg. at 23,650 (Proposed Rule for IAs).
[17] MFA comment letter, dated November 25, 2002, at 6.
[18] 68 Fed. Reg. at 23,642.
[19] 68 Fed. Reg. at 23,648.
[20] See, e.g., Financial Crimes Network; Anti-Money Laundering Programs for Commodity Trading Advisors (68 Fed. Reg. 23,640) (May 5, 2003); Financial Crimes Network; Anti-Money Laundering Programs for Investment Advisers (68 Fed. Reg. 23,646) (May 5, 2003); Financial Crimes Network; Anti-Money Laundering Programs for Unregistered Investment Companies (67 Fed. Reg. 60,617) (September 26, 2002).

As currently drafted, the Proposed Rules for IAs and CTAs permit such advisers to exclude from their AML Program investment vehicles which are themselves subject to the AML Program requirements under the Act. However, the Proposed Rules do not explicitly permit CTAs, IAs, or other impacted financial institutions, to exclude offshore funds located in FATF-Compliant Jurisdictions[21] from their AML Programs using the risk-based approach set forth in the MFA Guidance.[22] Thus, in order to avoid duplicative and unnecessary burdens on such inter-related financial institutions, MFA proposes that Treasury permit IAs and CTAs to rely upon the AML Programs of foreign financial institutions where, and to the extent that, such reliance is determined to be appropriate. The MFA Guidance provides fund managers with clear recommendations on how to determine whether reliance upon third parties with respect to AML procedures and responsibilities is appropriate.[23] The approach set forth in the MFA Guidance would be consistent with Treasury's risk-based approach to AML Program compliance and would help financial institutions avoid duplicative regulatory obligations through the adoption of clear channels of responsibilities among third parties with whom it conducts business.

Conclusion

Overall, MFA would like to commend Treasury for its efforts in bringing numerous financial institutions into compliance with the Act in a manner that seeks a risk-based approach. Accordingly, MFA is hopeful that Treasury will carefully consider our comments and those from other industry participants and take them into account in drafting final rules. Specifically, MFA also supports the comments submitted by NFA on the Proposed Rules for CTAs. MFA believes that the implementation of the Proposed Rules, and similar rules applicable to the managed funds industry, is very important and we strongly believe that a meeting between Treasury and representatives of affected parties would be helpful in finalizing various rulemakings under Section 352 of the Act.

If you have any particular questions about the issues MFA has raised in connection with the Proposed Rules, please contact me at 202.367.1140.
Sincerely,

/s/ John G. Gaine
John G. Gaine
President

Attachment

[21] The MFA Guidance defines "FATF Compliant Jurisdiction" as a jurisdiction that: (i) is a member in good standing of FATF; and (ii) has undergone two rounds of FATF mutual evaluations.
[22] See MFA comment letter, dated November 25, 2002, at 6 (urging Treasury to permit delegation of AML responsibilities to third parties located in FATF-Compliant Jurisdictions).
[23] The MFA Guidance covers the following topics in the section entitled, "Reliance Upon Investor Identification Procedures Performed by Third Parties": (1) relationships between hedge fund managers and third parties, (2) deciding to rely upon investor identification procedures performed by third parties, and (3) allocation of responsibilities between the parties.

MANAGED FUNDS ASSOCIATION

VIA ELECTRONIC MAIL: regcomments@fincen.treas.gov

November 25, 2002

FinCEN
P.O. Box 39
Vienna, VA 22183-1618

Attention: NPRM – Section 352 Unregistered Investment Company Regulations

Dear Sir or Madam:

Managed Funds Association ("MFA") appreciates the opportunity to comment on the notice of proposed rulemaking, and accompanying release,(the "Proposed Rule") by the U.S. Department of Treasury ("Treasury") Financial Crimes Enforcement Network ("FinCEN") pursuant to Section 352 of the USA PATRIOT Act (the "Act") published on September 26, 2002 (67 Fed. Reg. 60617). MFA, located in Washington, DC, is the only U.S.-based global membership organization dedicated to serving the needs of professionals worldwide that specialize in the alternative investment industry—hedge funds, funds of funds and privately and publicly managed futures funds. MFA has approximately 500 members who represent a significant portion of the over $600 billion invested in alternative investment vehicles around the world. Accordingly, MFA, its members and the investors who invest in our members' funds have a vital interest in the Proposed Rule.

MFA strongly supports and seeks to assist the U.S. government's efforts to combat money laundering and the financing of terrorist activities. We support the application of Section 352 to unregistered investment companies. We believe that with clarification of certain provisions of the Proposed Rule, as set forth below, the application of Section 352 to unregistered investment companies will provide additional safeguards against money laundering.

The Proposed Rule requires certain investment companies not registered with the Securities and Exchange Commission ("SEC") to establish anti-money laundering ("AML") programs as specified under section 352 of the Act. The unregistered investment companies ("UICs" or "funds") covered by the Proposed Rule include, among other entities, hedge funds and commodity pools. Under the Proposed Rule, these UICs must establish an anti-money laundering program that includes, at a minimum: (i) the development of internal policies, procedures, and controls; (ii) the designation of a compliance officer (an "AML Compliance

Officer"); (iii) an ongoing employee training program; and (iv) an independent audit function to test programs.

Introduction: Industry Practice

As in the banking and mutual fund industries, UIC managers often rely on third parties for the introduction of investors and the processing of fund investments and subscription documents. For example, investor intermediaries and nominees may introduce their investor clients to a hedge fund or may invest in hedge funds on their clients' behalf. Similarly, a "fund of funds" may make investments in a hedge fund on behalf of its investors. In addition, UICs typically rely on their fund administrators for the processing of subscription documents and compliance with anti-money laundering laws and regulations applicable in the fund's jurisdiction of organization.

These third parties often have direct contact and maintain the primary relationship with the investor and are consequently in the best position to "know the customer". As a result, a UIC may, directly or indirectly, rely upon the investor identification and verification procedures performed by such third parties.[24] Given the complexity and importance of appropriately allocating investor identification and verification responsibilities to such a third party, the AML Compliance Officer would be aided by sound regulatory guidance in making the decision to rely upon a particular third party to perform investor due diligence. MFA seeks to offer FinCEN suggestions to help formulate such guidance.

MFA Support of Efforts to Combat Terrorist Financing and Money Laundering.

MFA strongly supports the Treasury's efforts to combat money laundering and the financing of terrorist activities. Since the passage of the Act, MFA has had frequent discussions with officials from Treasury and other affected agencies to discuss the implementing regulations. One of the central points in these discussions has been recognition of the importance of the ability of UICs to rely on the AML compliance programs of intermediaries, including third-party administrators. Accordingly, in March 2002, MFA published its "Preliminary Guidance for Hedge Funds and Hedge Fund Managers on Developing Anti-Money Laundering Programs" which may be amended from time to time (the "MFA Guidance"). The MFA Guidance provides our members with the necessary tools to develop internal policies and procedures for their own AML programs, which we believe are consistent with the Proposed Rule. The MFA Guidance provides detailed information on how to rely on third-party administrators who conduct "Know

[24] The AML rules of many jurisdictions in which offshore fund administrators operate provide for "travel rules" on which such offshore administrators can rely upon for the majority of the capital transactions (subscriptions, redemptions and transfers) of the funds administered by offshore firms. The so called "travel rules" essentially provide that if the subscriber is remitting its subscription monies from an account in its name with a qualifying financial institution in an FATF-compliant jurisdiction, and absent any suspicious circumstances, the offshore administrator can rely on the identification procedures and verification conducted by that qualifying financial institution when the subscriber opened its account with that institution, and do not have to further identify the subscriber. There are also other certain exceptions, for instance where investors are themselves qualifying financial institutions, or where the investor is introduced by a qualifying financial institution and those parties make certain representations about the institution. MFA's anti-money laundering guidance, discussed herein, is premised upon the ability to rely upon such rules.

Your Customer" ("KYC") checks and other due diligence on behalf of hedge funds and other alternative investment funds. Moreover, the MFA Guidance recognizes the critical role of carrying out an effective AML program and how to determine the effectiveness of a third party's AML programs. MFA is now taking the opportunity, among other things, to suggest ways that some of the practical advice set forth in the MFA Guidance could be incorporated by FinCEN in the final rule or its preamble to any adopting release impacting UICs under the Act.

Delegation of Anti-Money Laundering Compliance Responsibility to Third Parties

The Proposed Rule acknowledges that UICs conduct their operations through contractual third-party service providers, such as fund administrators or investment advisers, and accept investments through intermediaries (such as fund-of-funds and bank nominee companies). The Proposed Rule further acknowledges that UICs can delegate the implementation and operation of elements of the mandatory anti-money laundering compliance program (the "AML Program") to such third parties. The legislative history and the language of Section 352(c) of the Act itself suggest that in adopting AML programs, "one size does not fit all." Section 352(c) of the Act specifically states that "… the Secretary shall prescribe regulations that consider the extent to which the requirements imposed under this section are commensurate with the size, location, and activities of the financial institutions to which such regulations apply." Different practices both within and among members of the financial service industry, both within the U.S. and offshore, must be recognized and taken into account in developing an AML program.

Third-parties both in the U.S. and offshore, would be unlikely to accept delegation of the implementation and operation of a fund's *entire* AML Program. It is more likely that the responsibilities and duties under a fund's AML Program will be split among several third parties. This will involve careful negotiation of the AML Program and contractual delegation in the agreements with such third-parties so that the responsibilities of each entity engaging in AML procedures are clearly allocated and documented.

Under the Proposed Rule, if UICs wish to delegate responsibility for aspects of the AML Program to a third-party, then, among other requirements:

1. They will remain fully responsible for the effectiveness of that party's AML Program; and

2. They must ensure that "federal examiners are able to obtain information and records relating to the anti-money laundering program and to inspect the third party for the purposes of the program".

We will address each item separately below. MFA believes that FinCEN needs to elaborate further, in any adopting release, on how these requirements can be satisfied.

1. **Responsibility for Third Party's AML Program.** With respect to the first point above, the Proposed Rule implies that if AML Program duties are delegated to third parties, and such third parties failed to meet the requirements of Section 352, then the fund would be held to

a strict liability standard for noncompliance with the Act. MFA believes that UICs should be able to satisfy the requirements of the Act if they, for example, conduct the primary steps that we have laid out in the MFA Guidance. For instance, FinCEN should find acceptable the case where a fund establishes a policy providing that it will generally rely upon the investor identification (or KYC) and verification procedures performed by third parties, with respect to the fund's investors, such as one of the following (or an entity, all of the beneficial owners of which are):

- A U.S.-regulated financial institution where the investor is a customer of that institution and the investor's investment funds are wired from its account at that U.S.-regulated financial institution, or an affiliate under common control of such U.S. financial institution;
- An investor intermediary, nominee, fund of funds or asset aggregator that is itself a U.S.-regulated financial institution or exempt from registration pursuant to Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 and subject to FinCEN anti-money laundering obligations;
- A tax exempt organization described in Section 501(c)(3) of the Internal Revenue Code;
- A public company whose shares are listed on a recognized exchange in a FATF-compliant jurisdiction, or a subsidiary or pension fund of such a public company;
- A private pension fund which is subject to the Employee Retirement Security Act; or
- A foreign financial or investment institution organized in a FATF-compliant jurisdiction, or that is a subsidiary, affiliate or under common control with such institution. To the extent that the hedge fund manager believes that the investor identification and verification procedures performed by a foreign financial institution, although reliable, may not include procedures that the hedge fund manager is required to perform, e.g., verification of whether an investor is a "Listed Investor" whose name appears on Treasury's list in the Office of Foreign Assets Control ("OFAC"), the hedge fund manager should either expressly request that the foreign financial institution confirm that it has performed the necessary additional procedures or otherwise provide for the performance of such procedures prior to accepting an investor through that financial institution.

In addition, FinCEN could, in any adopting releases, set forth the following options laid out in the MFA Guidance for cases where third-party administrators do not meet the above-stated criteria (and absent any suspicious circumstances):

- Requiring the third party to provide the hedge fund manager with a copy of its anti-money laundering and investor due diligence policies, procedures and controls and to promptly notify the hedge fund manager of any amendment thereto.

- Requiring the third party to certify and covenant that it complies and will continue to comply with its anti-money laundering and investor due diligence policies, procedures and controls.

- Requiring meaningful written representations and covenants of the third party as to investors verified by the third party, e.g., a covenant that it will ensure that no such investors are prohibited Listed Investors, such as those prohibited by OFAC.

- Requiring the third party to provide access, upon request, to copies of documents reviewed by the third party in performing investor due diligence.

- Requiring the third party to submit to an independent review or audit of its anti-money laundering policies, procedures and controls and its compliance with them as they relate to the funds managed by the hedge fund manager and to provide the results of such a review to the UIC.

- In the case of an intermediary or nominee, obtaining evidence of or representations as to its authority to make the contemplated investment.

The MFA Guidance also provides sample agreement language to assist our members in allocating AML duties among the unregistered investment company, the third-party administrator and investor representatives. For instance, in the MFA Guidance's Sample Provisions for Fund Administrators, we suggest that fund administrators essentially make the following representations and covenants with respect to its own AML program:

- The administrator has adopted and implemented anti-money laundering policies, procedures and controls that comply and will continue to comply in all respects with the requirements of applicable anti-money laundering laws and regulations in its home country jurisdiction.

- The administrator has provided the hedge fund manager with a copy of its anti-money laundering policies, procedures and controls, and will promptly provide the hedge fund manager with any material amendment thereto. Alternatively, the hedge fund manager may wish to incorporate the administrator's anti-money laundering policies, procedures and controls into its agreement with the administrator so that the administrator's anti-money laundering policies, procedures and controls could only be amended with the consent of the hedge fund manager.

- The administrator strictly adheres to, and will at all times during its relationship with the hedge fund manager strictly adhere to, its anti-money laundering policies, procedures and controls.

- The administrator agrees to submit, at its own expense, to an independent audit to assess its compliance with and the effectiveness of its anti-money laundering policies, procedures and controls.

These suggestions in the MFA Guidance illustrate that MFA has encouraged our members to comply with AML procedures. We believe FinCEN should consider this advice in promulgating future regulations, or adopting releases, in requiring UICs to comply with the Act.

2. U.S. Federal Examination Authority. The Proposed Rule also requires that federal examiners be able to inspect a third party delegatee's records for the purposes of the UIC's AML Program. Federal inspection authority is not specifically delegated in the Proposed Rule, and the default inspection authority for Treasury lies with the Internal Revenue Service ("IRS").[25] We believe that FinCEN should specifically delegate this authority to an appropriate government agency in the Proposed Rule, as discussed below.

a. Offshore Third Party Administrators. With respect to third-party administrators, one concern is the requirement in the Proposed Rule that funds will have to ensure that third-party delegatees will provide information and records to, and make themselves available to inspection by U.S. federal examiners. By "information and records" relating to the AML Program, we assume this could include underlying shareholder records as these would form part of the records and information relating to the implementation of the AML Program. As drafted under the Proposed Rule, U.S. federal examiners would be able to access confidential shareholder information of offshore funds. Administrators and investment managers located in non-U.S. jurisdictions will become subject to U.S. jurisdiction and inspection by U.S. federal examiners. The scope of this requirement is unclear. This extra-territorial jurisdictional reach by U.S. federal examiners is obviously of great concern, particularly to offshore fund administrators and to non-U.S. investors in offshore funds, and we believe it will have a detrimental effect on the hedge fund industry. FinCEN should explain how it proposes that U.S. federal examiners will enforce these provisions and obtain access to the information which will be, for the large part, maintained offshore. MFA encourages FinCEN to take a les intrusive approach such as that set forth in the MFA Guidance.

To the extent that inspection authority under the Act would require giving the U.S. government access to account-specific information maintained by an offshore administrator, we believe this is unrealistic and serves no reasonable purpose. Third-party administrators located outside the U.S. will not likely agree to divulge confidential, account-specific information to U.S. authorities unless compelled to do so by their local government. Indeed, such an agreement would generally violate applicable contract provisions and local law. Instead, the focus of this requirement should be to insure that the UIC has acted reasonably in delegating its AML Program responsibilities to the third-party administrator (whether in the U.S. or offshore). As mentioned above, MFA Guidance offers members of the alternative investment industry specific guidelines for relying on a third party's compliance with AML rules. We believe that upon examination, a UIC should be found to be in compliance with its AML obligations if it has obtained certificates confirming that it has taken the following steps:

1. Delegated AML responsibilities to a third party that is located in a FATF-compliant jurisdiction, or a subsidiary, affiliate or under common control with such third party;

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[25] 31 CFR 103.56(b)(8).

2. Obtained a certification that the third party has complied with the AML requirements of its own jurisdiction;

3. Reviewed and retained a copy of the third party's AML Program; and

4. Audited the third party administrator's AML Program and procedures and has documented such audit. It should be clear in the final rule, however, that such third party administrator is not required to turn over account-specific information to U.S. federal examiners (particularly with regard to non-U.S. investors).

b. Commodity Pool Operators. One other final point concerning federal inspection authority relates to funds operated by commodity pool operators ("CPOs"). The National Futures Association ("NFA") has already agreed to perform that function for registered CPOs. As drafted, the IRS would be the default agency for inspection of records under the Act. However, we believe that the NFA, or the Commodity Futures Trading Commission, should be the proper inspection authority for CPOs to determine their compliance with the Act.

Additional Issues Related to Third-Party Delegation of AML Duties Under the Act

We would also like to address other concerns with respect to third party delegation, with particular emphasis on the offshore administrator community, vís a vís: (1) confidentiality laws and policies, and (2) offshore financial centers.

1. Confidentiality Laws. Most of the jurisdictions in which offshore administrators provide services to funds have strict confidentiality laws which require offshore administrators and the relevant funds to maintain any shareholder records as confidential, save for the ability to disclose information in certain circumstances, including pursuant to: (a) the shareholder's consent, (b) a request by a regulatory authority having jurisdiction over the fund or the administrator (e.g., by the Cayman Islands Monetary Authority ("CIMA"), the Central Bank of Ireland ("CBI"), the Bermuda Monetary Authority ("BMA"), etc.); or (c) a court order issued by a competent court in the relevant jurisdiction. If U.S. federal examiners find cause for concern to go beyond the certificates of compliance relied upon by UICs (as suggested above), then any requests by such examiners for detailed shareholder information should be made through the appropriate regulatory authorities in the applicable jurisdiction. For instance, the U.S. federal examiners would have to make the request for records inspection through CIMA, CBI or the BMA, and not directly upon the offshore administrators, showing cause for why they believe U.S. anti-money laundering laws may have been violated.

2. Offshore Financial Centers. It should also be noted that offshore financial centers are not necessarily lax with respect to anti-money laundering requirements. Footnote 31 in the Proposed Rule makes reference to the Working Group Report and states "that a significant number of hedge funds are established in offshore financial centers that are tax havens and may be engaged in illegal tax avoidance and similar unlawful activities." Although a number of hedge funds may be established in offshore financial centers, many of these offshore financial centers,

including Bermuda and the Cayman Islands, have sophisticated and rigorous anti-money laundering rules applicable to investors in such vehicles. Third-party administrators located in these jurisdictions have already implemented anti-money laundering systems and procedures that are significantly more advanced than those employed by most U.S. investment companies.

Overall, we believe that the final rule should more clearly define the parties to whom the AML Program of a fund can be delegated, and the responsibilities of each such delegatee. MFA believes that any investor identification and verification aspect of the AML Program can be delegated to the fund's offshore administrator. The AML Compliance Officer should be responsible for communicating information to federal examiners about the fund's AML Program and its implementation, but not detailed shareholder information which is subject to confidentiality laws. In this way, if federal examiners wished to make inspections, they would be able to inspect the offices of the UIC that is subject to the Act by meeting with the AML Compliance Officer.

Notice Requirement

The release accompanying the Proposed Rule states that, because many UICs are not necessarily registered with or identifiable by FinCEN or other financial regulators, the only way for FinCEN to assure such companies are in compliance with the Act is to require that they file a short notice identifying themselves and providing basic information about their company.

1. Who Should File. MFA believes that the notice requirement should be limited to entities that have outside investors and not include each subsidiary of an investment fund or vehicle. For example, in a typical "master-feeder" structure, various "feeder funds" are created to accept investments from outside investors. Each "feeder fund" then contributes its assets to a common "master fund," which may itself form various subsidiaries through the actual investments are made. MFA believes that it is appropriate to require the "feeder funds," which accept money from outside investors, to submit the required notice to the U.S. government. It would be confusing and unnecessary, however, to require a notice filing by the master fund and each of its various subsidiaries, even though each of these entities is technically an "unregistered investment company."

2. Public Access to Filings. We are concerned about the confidentiality that will be provided for these notice filings. It is clear that as a result of these rules, Treasury will obtain a comprehensive list of hedge funds for the first time. For a number of reasons, we believe that, if such notice is required, it should be protected from public access under the Freedom of Information Act. If the notice can be obtained by the public, we would be concerned about privacy as well as other issues.

3. Registered Commodity Pool Operators. MFA would also like to address the issue of notice filings by funds operated by registered CPOs. We believe that such funds should be exempt from the notice filing requirement and that the NFA be used as the source for information about those pools. The NFA, in its comment letter submitted to FinCEN, addresses this issue in greater detail and MFA concurs with their analysis.

4. Assets Under Management. Assets under management of UICs may vary materially from time to time. As a result, rather than state the specific amount of assets under management, we recommend that the assets be reported on the notice filing within a certain range. Thus, MFA would like to suggest that the form be amended to provide boxes for us to check off assets within a certain range (for example: $100M-500M, over $500M, etc.).

Independent Testing of the AML Program

The Proposed Rules provide that a periodic audit of the fund's AML Program must be conducted, and that the audit can be carried out either by employees of the relevant fund, or by employees of affiliates of the fund or unaffiliated service providers, provided that the individuals are not involved in the operation or oversight of the AML Program. The tests have to be conducted by persons knowledgeable with the Bank Secrecy Act's requirements, and can not be conducted by the fund's AML Compliance Officer.

It is unclear from this as to who will be the most appropriate person to conduct the audit. Clearly, the audit should not be conducted by the administrator which is performing the investor identification and verification procedures for the fund. Non-U.S. based auditors to offshore funds are also not going to be familiar with Bank Secrecy Act ("BSA") requirements. Further, most investment managers are not going to have sufficient employees well versed in the BSA's requirements and will also most likely be providing the fund's AML Compliance Officer (who as noted above cannot conduct the audit under the Proposed Rules). Accordingly, MFA suggests that FinCEN adopt essentially the same language from MFA's Guidance on the independent audit requirement in any adopting releases. The independent audit function should involve:

- Evaluation by the fund manager's legal and compliance director or officer or by external auditors (accounting firms, financial investigation firms or other similarly competent professionals) or counsel of compliance with applicable anti-money laundering laws and regulations and the fund manager's own anti-money laundering program; and

- Reporting of the results of such evaluation to the appropriate oversight body of the fund manager.

- Appropriate follow-up to ensure that any deficiencies detected in the course of the audit of its anti-money laundering program are addressed and rectified.

The UICs AML Program should also provide for appropriate follow-up to ensure that any deficiencies detected in the course of the audit of its anti-money laundering program are addressed and rectified.

Ongoing Training

The Proposed Rule requires that UICs also provide for ongoing AML training for appropriate persons. MFA recommends that FinCEN, in any adopting releases, follow the suggestions in the MFA Guidance stating that AML training programs, among other things:

- Review applicable anti-money laundering laws and regulations and recent trends in money laundering, including the ways in which such laws and trends relate to hedge funds; and

- Address elements of the hedge fund's own anti-money laundering program, particularly its investor identification procedures and policies regarding detection of suspicious activity.

In addition, the manager of the fund should be required to develop and maintain policies, procedures and controls reasonably designed to ensure that all appropriate personnel attend the anti-money laundering training programs as required.

FinCEN should also require that records of all anti-money laundering training sessions conducted, including the dates and locations of the training sessions and the names and departments of attendees, should be retained for at least five years, or for such longer period as deemed appropriate.

Commodity Pool Operators

Many UICs covered by the Proposed Rule are operated by CPOs registered under the Commodity Exchange Act. CPOs are specifically listed as "financial institutions" under Section 352 of the Act. Moreover, a CPO may only accept customers and customer funds into the commodity pools operated by the CPO. Thus any anti-money laundering program adopted by a CPO would necessarily be with respect to its commodity pools. It will be important for Treasury, or FinCEN, in drafting any further rules under Section 352, to take into account the broad coverage of the Proposed Rule and the fact that the obligations of CPOs cannot be separated from obligations of the pools that they operate. This would be necessary to avoid unnecessary burdens on CPOs, including, perhaps, duplicative application of AML Program requirements with respect to the same customer investing in the same fund.

General Comment Regarding Definition of "Unregistered Investment Company"

Another comment to the Proposed Rule concerns the application of the term "unregistered investment company." It is unclear from the Proposed Rule whether the inclusion of "unregistered investment companies" within the definition of "financial institution" would apply only to Section 352 or also apply to all other Act and Bank Secrecy Act provisions that use the term "financial institution". We believe that section 103.132(a) should be revised to replace the word "section" with the word "Subpart" to clarify that the new definition applies only to Section 352.

Section 326 of the Patriot Act

Finally, FinCEN in its commentary on the Proposed Rule noted that UICs may become subject to more detailed requirements regarding investor identification and verification under rules to be issued under Section 326 of the Act. We look forward to participating in any such rulemaking.

If you have any particular questions about the issues MFA has raised in connection with the Proposed Rule, please contact me at 202.367.1140.

Sincerely,

John G. Gaine
President