INVESTMENT COMPANY INSTITUTE

CRAIG S. TYLE
GENERAL COUNSEL

May 29, 2002

Judith R. Starr, Chief Counsel
Office of the Chief Counsel
Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183

Re: Section 352 Mutual Fund Regulations

Dear Ms. Starr:

The Investment Company Institute[1] appreciates the opportunity to comment on the FinCEN's interim final rule relating to anti-money laundering programs for mutual funds (the "Interim Rule").[2] The Interim Rule prescribes minimum standards for anti-money laundering compliance programs to be established by mutual funds pursuant to Section 352 of the USA PATRIOT Act (the "Act").[3]

The Institute strongly supports effective rules to combat potential money laundering activity in the investment company industry and, in general, supports the Interim Rule as drafted. However, several statements in the Release raise issues that we would urge FinCEN to address. These include statements regarding omnibus accounts, AML compliance officers, delegation of compliance functions, reports on Form 8300, and the delegation of compliance examination authority to the Securities and Exchange Commission. The issues raised by each of these statements are described more fully below.

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 9,064 open-end investment companies ("mutual funds"), 485 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.050 trillion, accounting for approximately 95% of total industry assets, and over 88.6 million individual shareholders.

[2] Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21117 (Apr. 29, 2002) (the "Release").

[3] Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. Law No. 107-56 (October 26, 2001).

1401 H STREET, NW ▪ WASHINGTON, DC 20005-2148 ▪ 202/326-5815 ▪ FAX 202/326-5812 ▪ EMAIL: tyle@ici.org

1. Treatment of Omnibus and Similar Accounts

a. Omnibus Accounts

The Release notes that investors may purchase mutual fund shares either directly or through a variety of other distribution channels, including broker-dealers.[4] It further indicates that where intermediaries such as broker-dealers sell fund shares, those intermediaries usually hold an omnibus account with the fund. The Institute is pleased that the Release specifically recognizes that it is appropriate for fund AML programs to distinguish between omnibus accounts and other accounts by stating that:

> This rule does not require that a mutual fund obtain any additional information regarding individual transactions that are processed through another entity's omnibus account. Consequently, given Treasury's risk based approach to anti-money laundering programs for financial institutions generally, including mutual funds, it is not expected that mutual funds will scrutinize activity in omnibus accounts to the same extent as individual accounts.[5]

We are concerned, however, about the assertion in the Release that, while mutual funds will not be required to scrutinize the individual transactions within an omnibus account, they will need to "analyze the money laundering risks posed by particular omnibus accounts based upon a risk-based evaluation of relevant factors regarding the entity holding the omnibus account, including such factors as the type of entity, its location, type of regulation, *and of course, the viability of its anti-money laundering program.*"[6] The highlighted language is extremely problematic, particularly insofar as it might suggest that a mutual fund would have to assess the viability of the AML programs of each of the intermediaries that sell its shares. Such an obligation would present very serious practical issues and, moreover, is unnecessary to achieve the purposes of the Act.

Funds that are sold primarily through unaffiliated retail broker-dealers, for example, often have literally thousands of selling agreements. It may be possible for a fund to obtain certifications of AML compliance from each retail broker-dealer that sells its shares, but doing so clearly would be a time-consuming and expensive process, and would do no more to assure the fund that the broker-dealer has an effective AML program than a standard contractual clause to the effect that the broker-dealer is in compliance with all applicable laws. To require funds to go beyond certifications and undertake an actual *assessment* of retail broker-dealers' AML programs would be significantly more burdensome. For example, a mid-sized fund complex indicated to us that it has approximately 2,500 selling agreements in place. Assuming that it would take someone trained in this area an hour to assess the viability of an AML program, which could be a conservative estimate, it would take that person *more than a year,*

---

[4] Release, 67 Fed. Reg. at 21118.

[5] Release, 67 Fed. Reg. at 21120.

[6] *Id.*

doing nothing else, to assess the viability of each of that fund's 2,500 retail broker-dealers' AML programs.

Perhaps more importantly, an AML viability assessment for an intermediary that is itself required to have an AML program under Section 352 of the Act would not seem to strengthen AML compliance or further the policies underlying the Act in any meaningful way. Presumably, a failure by such an intermediary to have a viable program would be a violation of Section 352 of the Act and one or more related rules. Funds should be entitled to rely upon this fact and assume that these intermediaries have viable AML programs in place. We urge FinCEN to clarify that mutual funds therefore are not required to assess the viability of such intermediaries' AML programs.

b. Intermediated Accounts

In addition to the omnibus accounts discussed above and described in the Release, there are other, similar arrangements that the Institute believes warrant similar treatment under fund AML programs. These arrangements, which we refer to as "intermediated accounts," include all accounts for which an intermediary required to have an AML program under Section 352 of the Act is involved in opening the account and maintains an ongoing client relationship with the shareholder. As with the omnibus accounts described in the Release, the intermediary in these arrangements will have "all of the relevant information about the customer." Unlike omnibus accounts, however, the mutual fund (or its transfer agent) also may have limited information about the customer (*e.g.*, a name, address, social security number and/or account number), and may have transaction information relating to the account.

We believe it would be entirely consistent with the overarching goal of ensuring that there are no gaps in AML responsibilities for mutual funds to take a risk-based approach to intermediated accounts that is similar to the approach for omnibus accounts discussed above. In these circumstances, as with the omnibus accounts described above, the intermediary has an independent obligation to have an effective AML compliance program with respect to its customers. The fund, in developing its AML program, should be able to take that fact into consideration. For example, a fund's AML program could recognize that the intermediary is required to satisfy Section 326 of the Act (and any applicable rules adopted thereunder) with respect to the identification and verification of the shareholder, and thus that any identifying information provided to the fund already would have been verified for those purposes.[7] In addition, it could take into account the intermediary's obligation to monitor for and report suspicious activity.[8] We request that FinCEN indicate its concurrence with these views in the release adopting the Interim Rule in its final form.

---

[7] The rules implementing Section 326 of the Act have not yet been proposed. We would strongly recommend that these rules, when proposed, specifically address this point.

[8] We understand that FinCEN is considering proposing an SAR rule specifically applicable to investment companies. Once the fund SAR rule becomes effective, an intermediary and a fund might have separate, but complementary, SAR obligations. We would strongly recommend that any fund SAR rule clarify these respective obligations.

c. **Other Accounts**

In recognizing a distinction between omnibus and individual accounts, the Release implies that the *type* of account can be a relevant consideration in determining what level of scrutiny is appropriate as part of a risk-based AML program. The Institute agrees with this premise. In fact, in some circumstances, the type of account may be a more important consideration than any of the factors FinCEN describes in the Release with respect to omnibus account holders (*i.e.*, the type of entity, its location, its type of regulation, and the viability of its AML program). For example, a mutual fund might reasonably conclude that an account for a Fortune 500 company's retirement plan would not have to be scrutinized to the same extent as an individual account, since that retirement plan account presents little, if any, money laundering risk. That conclusion might be warranted regardless of whether the company is a financial institution that is required to have a viable AML program in place, or an operating company that has no AML responsibilities. We suggest that FinCEN confirm that a variety of factors could impact the money laundering risk that a particular mutual fund account presents, and that it is consistent with Treasury's risk-based approach to AML compliance for mutual fund AML programs to take all of these factors into account.

2. **AML Compliance Officers**

The Interim Rule requires each mutual fund to designate an individual (or committee) with the responsibility for overseeing its AML program.[9] In discussing this provision, the Release states that "[a]lthough in many cases the implementation and operation of the compliance program will be conducted by entities (and their employees) other than the mutual fund, the person responsible for the supervision of the overall program should be a fund officer."[10]

Compliance officers in mutual fund complexes often are not fund officers, but instead are officers of the funds' investment adviser, transfer agent, or principal underwriter. The Institute believes that it should not matter whether the AML compliance officer is a fund officer, as long as that person is "competent and knowledgeable regarding BSA requirements and money laundering issues and risks, and empowered with full responsibility and authority to develop and enforce appropriate policies and procedures throughout the fund complex."[11] It is the substance of this standard, not the individual's title, that will determine whether he or she would be an effective AML compliance officer. We therefore recommend that FinCEN clarify that the AML compliance officer designated by a mutual fund is not required to be a fund officer, as long as the above-cited standard is met.

3. **Delegation of AML Compliance Functions**

The Release states that mutual funds are permitted to delegate AML compliance functions to service providers, such as transfer agents. It further indicates that, in order to do so, funds must obtain written consent from the delegate ensuring the ability of federal

---

[9] §103.130(c)(3) of the Interim Rule.

[10] Release, 67 Fed. Reg. at 21120.

[11] *Id.*

examiners to obtain information and records relating to the AML program and to inspect the delegate for purposes of the AML program.[12]

In many instances, a third party to which a mutual fund delegates AML compliance functions will already be required by law or regulation to allow federal authorities to examine its books and records and inspect it for AML compliance purposes. We recommend that FinCEN clarify that it is not necessary to obtain written consent from such a delegate. For example, if a mutual fund delegates its AML compliance to its transfer agent, and the transfer agent is a bank, that bank is itself a financial institution under the Act required to have an AML program in place. Federal authorities have, by law, the right to inspect the bank's books and records and examine its AML program. Requiring the fund to obtain written consent to such inspection and examination in these circumstances would therefore be unnecessary. We request that FinCEN concur with this view.

4. **Reporting on Form 8300**

The Release indicates that "the only BSA regulatory requirement currently applicable to mutual funds is the obligation to report on Form 8300 the receipt of cash or certain non-cash instruments totaling more than $10,000 in one transaction or two or more related transactions."[13] This statement creates ambiguity as to the precise application of the Form 8300 reporting requirement in the mutual fund context. Mutual funds typically have no employees; their operations are conducted by various affiliated and/or unaffiliated service providers. Payments for purchases of fund shares generally are received and processed by the fund's transfer agent. We recommend that FinCEN confirm our understanding that, where a fund's transfer agent receives payments for fund shares, and the transfer agent either (1) is a bank, broker-dealer, or other financial institution subject to the BSA regulations, or (2) is acting as an agent of a bank, broker-dealer (*e.g.*, the fund's principal underwriter), or other financial institution subject to the BSA regulations, there is no requirement for the transfer agent (or the fund or its principal underwriter) to file reports on Form 8300. Rather, in these circumstances, the transfer agent would be required to comply with the reporting requirements applicable to banks, broker-dealers, or other financial institutions under the BSA regulations, including, as appropriate, requirements to file currency transaction reports ("CTRs") and suspicious activity reports ("SARs"). Indeed, Section 6050I(c)(1)(B) of the Internal Revenue Code ("IRC") and the regulations promulgated under Section 6050I provide an express exception from the Form 8300 reporting requirements for certain financial institutions, including banks and broker-dealers, because they are subject to the currency reporting requirements for financial institutions under the BSA regulations.

In addition, as noted above, we understand that Treasury intends to propose a suspicious activity reporting requirement for funds in the near future. We fully expect that any transactions in fund shares involving cash equivalents (*i.e.*, money orders, traveler's checks, cashier's checks, and bank drafts with a face amount of $10,000 or less), that otherwise would be

---

[12] Release, 67 Fed. Reg. at 21119.

[13] *Id.* (citation omitted).

reportable on Form 8300, also would be reportable suspicious transactions.[14] Requiring duplicative reporting to FinCEN and the Internal Revenue Service on two different forms would be burdensome and would serve no valid law enforcement or public policy purpose.[15] Thus, to the extent that Treasury adopts SAR requirements for funds, it may make sense also to subject funds (and/or their transfer agents) to the CTR requirements for financial institutions under the BSA regulations, instead of the reporting requirements for nonfinancial trades or businesses under the regulations implementing IRC Section 6050I and BSA Section 5331, thereby completely obviating the need to file Form 8300 to report transactions in fund shares. Alternatively, Treasury should take action to provide that, if and when any fund SAR requirement is implemented, there will no longer be a need to file Form 8300 to report fund share transactions involving cash equivalents.[16] In this regard, IRC Section 6050I(c)(1)(A) specifically recognizes the potential for duplicative reporting, and authorizes the Treasury Secretary to make exceptions from the Section 6050I reporting requirements "if the Secretary determines that reporting under [Section 6050I] would duplicate the reporting to the Treasury under title 31, United States Code."[17]

5. **Compliance Enforcement**

The Release notes that as part of this rulemaking, FinCEN has delegated examination authority to the Securities and Exchange Commission ("SEC"). The Institute supports this delegation of authority, since the SEC is the functional regulator for mutual funds. We note that the SEC's Office of Compliance Inspections and Examinations has general examination authority over not only mutual funds but also their relevant service providers (such as principal underwriters and transfer agents), and thus is well positioned to perform this role in an effective and efficient manner.

With this in mind, we proposed a narrowly crafted carveout from the National Association of Securities Dealers ("NASD") AML program rule, NASD Rule 3011, when that rule was proposed.[18] The carveout would have provided a conditional exemption to any NASD

---

[14] The regulations implementing IRC Section 6050I and BSA Section 5331 require persons subject to the Form 8300 reporting requirements to treat cash equivalents as cash in circumstances where the recipient knows that the cash equivalents are being used in an attempt to avoid cash reporting requirements. 26 CFR Section 1.6050I-1(c)(1)(ii)(B)(2); 31 CFR Section 103.30(c)(1)(ii)(B).

[15] This is the rationale underlying the above-mentioned exception provided in IRC Section 6050I(c)(1)(B) and the related regulations.

[16] Treasury would need to amend the regulations implementing IRC Section 6050I and Section 5331 of the BSA to exempt mutual funds (and/or their transfer agents) from having to file Forms 8300 for cash equivalents. This would be consistent with the reporting requirements for banks and broker-dealers, which are not required to report transactions in cash equivalents on CTRs.

[17] The same potential for duplicative reporting arises where a fund's transfer agent is a nonbank subsidiary of a bank holding company, because such a transfer agent is subject to SAR requirements under Federal Reserve Board Regulation Y (12 CFR Section 225.4(f)). In these circumstances, it should not be necessary for the transfer agent to file both a Form 8300 and a SAR with respect to fund share transactions involving cash equivalents. Thus, irrespective of whether or when Treasury adopts SAR requirements for funds, we recommend that Treasury amend the regulations implementing IRC Section 6050I and BSA Section 5331 to exempt these fund transfer agents from having to file Forms 8300 for cash equivalents.

[18] *See* SEC Release No. 34-45457 (February 19, 2002), 67 Fed. Reg. 8565 (February 25, 2002) (proposing release) and SEC Release No. 34-45798 (April 22, 2002), 67 Fed. Reg. 20854 (April 26, 2002) (adopting release).

member with respect to its activities as a principal underwriter of mutual fund securities, based on the likelihood that the funds' required AML program would cover any relevant activities of the principal underwriter.[19] The exemption would apply where the NASD member underwrites funds that have established an anti-money laundering program meeting the requirements of Section 352 of the Act (and any rule applicable to funds adopted thereunder).[20] The NASD chose not to incorporate such an exemption in the final rule, but indicated that once Treasury's mutual fund AML program rule is in effect and the study relating to the application of the BSA to investment companies called for under Section 356 of the Act is concluded, the NASD may address whether any adjustment to NASD Rule 3011 would be appropriate.[21]

We continue to believe that such an exemption would avoid unnecessary regulatory duplication and eliminate the illogical, bifurcated AML compliance examination regime that Rule 3011 otherwise creates for fund complexes. We urge FinCEN to consider whether the same result could be accomplished by amending the Interim Rule to cover a broker-dealer's mutual fund underwriting activities or through some other means. At a minimum, Treasury should address this and other issues related to fund principal underwriters in its report under Section 356 of the Act. In the meantime, we are hopeful that the SEC and the NASD will coordinate their AML compliance examination efforts, keeping in mind the unique circumstances of fund underwriters.

* * *

Thank you for considering our comments on the Interim Rule. If you have any questions or need additional information, please contact me at (202) 326-5815, Frances Stadler at (202) 326-5822 or Bob Grohowski at (202) 371-5430.

Sincerely,

Craig S. Tyle
General Counsel

Attachment

cc: Paul F. Roye
Director, Division of Investment Management
Securities and Exchange Commission

---

[19] *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan Katz, Secretary, Securities and Exchange Commission, dated March 18, 2002. A copy of this letter is attached.

[20] Under our proposal, if a broker-dealer underwrites funds and also engages in other activities such as offering brokerage services to clients, it would be subject to Rule 3011 with respect to those other activities.

[21] Letter from Patrice M. Gliniecki, Vice President and Acting General Counsel, NASD Regulation, Inc., to Katherine England, Assistant Director, Division of Market Regulation, Securities and Exchange Commission, dated April 17, 2002, at 3. This letter, which responds to comments received on proposed NASD Rule 3011, is available at http://www.nasdr.com/money.asp.