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Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183-1618

Re: NPRM - Section 352 Unregistered Investment Company Regulations

Dear Sir or Madam:

We are writing on behalf of our client, The Investment Funds Institute of Canada ("IFIC"). On behalf of IFIC, we are pleased to have this opportunity to comment on the rule that prescribes minimum anti-money laundering requirements for mutual funds and the more recently proposed rule that would extend similar requirements to many unregistered funds.

IFIC is the member association of the investment fund industry in Canada. Its membership includes 73 fund management companies sponsoring 1,920 mutual funds, 98 dealer firms selling mutual fund units, and 58 affiliates representing law, accounting and other professional firms. IFIC member funds manage $385.8 billion in assets (representing nearly 95 percent of the open-end mutual fund industry in Canada) in over 52 million unit-holder accounts.[1]

IFIC strongly supports effective rules in the United States and abroad that will help prevent, detect and prosecute international money laundering and the financing of terrorism. However, we are concerned with two aspects of the current and proposed framework: First, we are concerned that existing rules could be read to impose anti-money laundering requirements on certain Canadian funds that were not the intended object of those rules. Second, we are concerned that the recently proposed rule that would apply to unregistered investment companies, as initially proposed, would subject those same Canadian funds to unnecessary and burdensome anti-money laundering requirements.

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1 Figures representing membership and assets under management by IFIC members are current as of October 31, 2002.

I. Summary of Relevant U.S. Anti-Money Laundering Requirements

A. General

As you know, on October 26, 2001, President George W. Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001.[2] Title III of the USA Patriot Act amended multiple anti-money laundering provisions of the Bank Secrecy Act,[3] for the stated purpose of promoting the prevention, detection and prosecution of international money laundering and the financing of terrorism and effecting related measures. For example, Section 5318(h) of the Bank Secrecy Act was amended, effective April 24, 2002, to establish an anti-money laundering program ("AML Program") requirement for many U.S. financial institutions not already covered by the Bank Secrecy Act. As amended, Section 5318(h) requires every "financial institution" to establish an AML Program containing four elements: (i) minimum policies, procedures, and controls, (ii) a designated compliance officer, (iii) an ongoing employee training program, and (iv) an independent audit function. In addition, Section 5318(h)(2) authorizes the Secretary of the United States Department of the Treasury (the "Treasury"), in consultation with the appropriate U.S. federal functional regulator, such as the United States Securities and Exchange Commission (the "Commission"), to prescribe minimum standards for complying with the AML Program requirement and to exempt from that requirement any institution that is not otherwise regulated under the Bank Secrecy Act. The USA Patriot Act defines "financial institution" by reference to the Bank Secrecy Act, which defines "financial institution" to include an "investment company." An "investment company," however, is not defined in either Act.

B. Mutual Funds

On April 29, 2002, Financial Crimes Enforcement Network ("FinCEN"), Treasury, issued an interim final rule prescribing minimum standards for mutual fund AML Programs, which programs were required to be established by July 24, 2002.[4] In that rule, a "mutual fund" is defined to mean an "open-end company" as defined in Section 5(a)(1) of the Investment Company Act of 1940, as amended (the "Investment Company Act"). Pursuant to a separate interim final rule also issued on April 29, 2002, compliance with the AML Program requirement was deferred for

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2 Public Law 107-56 (the "USA Patriot Act").

3 Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, 84 Stat. 1305 (1970) (codified in subchapter II of chapter 53 of title 31, United States Code).

4 Anti-money Laundering Programs for Mutual Funds, 67 Fed. Reg. 21117 (2002) (to be codified at 31 C.F.R. pt. 103) (April 29, 2002) (the "Mutual Fund Interim Rule").

most other types of financial institutions, including investment companies other than "mutual funds."[5] Thus, the plain text of the Mutual Fund Interim Rule and the Financial Institutions Deferment Rule appears to provide that open-end companies (even those which are not required to register with the Commission) were required to establish AML Programs beginning July 24, 2002. Other types of investment companies and investment funds, including hedge funds and non-U.S. funds making limited offerings in the United States, were excluded from that requirement (at least temporarily).

C. Other Funds

On September 26, 2002, FinCEN published notice of a proposed rule that, if adopted, would extend AML Program requirements to some of those other types of investment funds.[6] This Unregistered Fund Rule generally would apply to so-called "unregistered investment companies," which are defined by the rule generally to include, among other entities, a fund that (i) would be an investment company under the Investment Company Act but for the exclusions provided for in Sections 3(c)(1) or 3(c)(7) of that Act, (ii) permits an owner to redeem his or her ownership interests within two years from purchase, (iii) has total assets of $1,000,000 or more and (iv) sells its ownership interests to one or more U.S. persons.[7]

D. Snowbird Funds

A Snowbird Fund is the popular term for a Canadian investment fund offering its shares to U.S. persons, without registration of that fund under the Investment Company Act, in reliance on Rule 7d-2 thereunder, and without registration of its shares under the Securities Act of 1933, as amended (the "Securities Act"), in reliance on Rule 237 thereunder. In essence, a Snowbird Fund is a Canadian investment fund whose shares are available for purchase through certain Canadian retirement accounts, by a Canadian resident or former resident from within the United States. In practice, most of these funds are open-end mutual funds, although the Rule generally accommodates any fund or other issuer whose securities are qualified for investment on a tax-deferred basis by a Canadian retirement account

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5 Anti-money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21110 (2002) (to be codified at 31 C.F.R. pt. 103) (April 29, 2002) (the "Financial Institutions Deferment Rule").

6 Anti-money Laundering Programs for Unregistered Investment Companies, 67 Fed. Reg. 60617 (2002) (to be codified at 31 C.F.R. pt. 103) (September 26, 2002) (the "Unregistered Fund Rule").

7 See paragraphs (a)(6)(i)(A)(1) and (a)(6)(i)(D). For purposes of paragraph (a)(6)(i)(D), the term "U.S. person" has the same meaning as provided in 17 CFR 230.902(k).

under Canadian law, and thus may also include closed-end funds and certain other types of Canadian investment funds.

As stated in the release adopting Rule 7d-2, the Rule was designed to enable participants in Canadian retirement accounts for which the participant selects or controls the underlying securities held (which accounts are analogous to self-directed retirement accounts in the United States, like IRAs) to manage their investments in those accounts.[8] Prior to adoption of the Rule, Canadian investment funds that permitted participants in self-directed Canadian retirement accounts to adjust their holdings in the funds from within the United States ran a significant risk of being deemed to be engaged in a public offering in the United States. Engaging in a public offering, of course, triggers registration obligations under the Securities Act and the Investment Company Act, which obligations prove problematic for Canadian investment funds. As a consequence, participants in Canadian retirement accounts who were temporarily or permanently in the United States were effectively precluded from making changes to their accounts as their investment goals or economic needs changed over time. Rule 7d-2 addresses this problem by allowing Canadian investment funds to permit participants to make adjustments to their investments in those funds, subject to certain conditions, without requiring the funds or their shares to be registered in the United States.[9]

Rule 7d-2 provides, in pertinent part, that for purposes of Section 7(d) of the Investment Company Act, the term public offering does not include the offer to a Participant, or the sale to his or her Canadian Retirement Account, of Eligible Securities issued by a Qualified Company, subject to certain conditions.[10] Section 7(d) provides,

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8 See Investment Company Act Release No. 24491 (June 07, 2000) ("Snowbird Release").

9 Rule 237 under the Securities Act provides the Securities Act exemption for Snowbird Fund securities. It exempts from registration the offer of a foreign issuer's securities to a participant and the sale of those securities to his or her Canadian retirement account. See id. In conjunction with the adoption or Rule 237 under the Securities Act and Rule 7(d)(2) under the Investment Company Act, the Commission issued an order exempting any Canadian broker-dealer that is a member of a Canadian self regulatory organization from the requirements of Section 15(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") to the extent that the broker-dealer "effects transactions in securities with or for, or induces or attempts to induce the purchase and sale of any security by, Participants for their Canadian Retirement Accounts," subject to a number of conditions. In the Matter of the Investment Dealers Association of Canada, Exchange Act Release No. 42906 (June 7, 2000) ("IDA Order")

10 (emphasis added). The Rule defines "Participant" to mean "a natural person who is a resident of the United States, or is temporarily present in the United States, and who contributes to, or is or will be entitled to receive the income and assets from, a Canadian Retirement Account," and a "Canadian Retirement Account" to mean "a trust or other

> No investment company, unless organized or otherwise created under the laws of the United States . . . shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any security of which the company is the issuer." (emphasis added)

Thus, by excluding a Snowbird Fund from the definition of public offering in Section 7(d), Rule 7d-2 effectively removes the registration requirement for a Snowbird Fund that otherwise could arise under that Section. Because Section 7(d) speaks in terms of an investment company, a Canadian investment fund that relies exclusively on Rule 7d-2 to avoid registration under the Investment Company Act (in contrast to a fund that, for example, might independently satisfy the terms of Section 3(c)(1)), arguably may concede the point that it is an investment company for purposes of the Investment Company Act, or at least for purpose of Section 7(d) thereof.

As a consequence, the typical Snowbird Fund may be regarded as somewhat unique under the Investment Company Act. Unlike most other types of funds that are not required to register under the Investment Company Act because they qualify for an exclusion from the Section 3(a) definition of "investment company" in the Act, such as that provided by Section 3(c)(1), a Snowbird Fund may be more aptly described as an entity that is an investment company within the meaning of Section 3(a) but which is not required to register under the Act. Although Snowbird Funds make their shares available in the United States to investors almost exclusively in reliance on Rule 7d-2, it is conceivable that, in certain limited circumstances, a Snowbird Fund would permit a U.S. person to invest on a retail basis in that Fund. In that case, the Snowbird Fund also may be relying on the Section 3(c)(1) exclusion.

II. Snowbird Funds and the Mutual Fund Interim Rule

A. Overview

It is not clear whether existing anti-money laundering requirements under the USA Patriot Act are meant to apply to Snowbird Funds, although a technical reading of the Mutual Fund Interim Rule suggests that they may apply. As noted above, the Mutual Fund Interim Rule defines the term "mutual fund" to mean an "open-end

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arrangement, including, but not limited to, a 'Registered Retirement Savings Plan' or 'Registered Retirement Income Fund'" that is administered under Canadian law, managed by the Participant, operated for the purpose of providing retirement benefits to that Participant, established in Canada, and administered and qualified for tax-deferred treatment under Canadian law. "Eligible Securities" and "Qualified Company" are also defined by the Rule.

company" as defined in Section 5(a)(1) of the Investment Company Act. Section 5(a)(1) defines "open-end company" to mean any "management company" that is offering for sale or has outstanding any redeemable security of which the management company is the issuer, and Section 4(3) of the Investment Company Act defines a "management company" to mean an investment company other than a "face-amount certificate company" or "unit investment trust." Section 2(a)(32) of the Investment Company Act, in turn, defines "redeemable security" to mean "any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof."[11]

Consequently, the typical Snowbird Fund, which stands ready to redeem its shares upon proper demand by a shareholder (i.e., a Canadian retirement account participant), and which is unlikely to fit within the Investment Company Act definitions of face-amount certificate company or unit investment trust, would seem to fall within the definition of "mutual fund" for purposes of the Mutual Fund Interim Rule.[12] For the reasons described below, however, we believe that Snowbird Funds should be excluded from the AML Program requirements provided by the Mutual Fund Interim Rule (and any future related rules or regulations).

Moreover to the extent that a Snowbird Fund which permits one or several unsolicited U.S. investors to purchase shares on a retail basis could be viewed as meeting the definition of "unregistered investment company" in the Unregistered Fund Rule, we believe that Snowbird Funds should be excluded from the AML Program requirements in that Rule (and any future related rules or regulations).

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11 A "face-amount certificate company" is defined in Section 4(1) of the Investment Company Act to mean "an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding. A "unit investment trust" is defined in Section 4(2) of the Investment Company Act to mean "an investment company which (A) is organized under a trust indenture, contract or custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents and undivided interest in a unit of specified securities; but does not include a voting trust."

12 This definition of mutual fund provided by the Mutual Fund Interim Rule is similar to the meaning typically assigned in Canada. For example, the Ontario Securities Act, R.S.O. 1990, c. S. 5 - Interpretation - Definitions 1.(1), defines "mutual fund" to include "an issuer of securities that entitle the holder to receive on demand, or within a specific period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in a part of the net assets, including a separate fund or trust account, of the issuer of the securities."

B. No Substantial Money Laundering Risk

Because Snowbird Funds do not present the same degree of risks for international money laundering and terrorist financing that U.S. registered open-end investment companies may present, we believe that it is appropriate for the Treasury to exempt or exclude, as applicable, Snowbird Funds from coverage under the Mutual Fund Interim Rule (and any future related rules or regulations), pursuant to its authority under Section 5318(h)(2) of the Bank Secrecy Act.[13]

Snowbird Funds are offered under circumstances that are unlikely to raise significant money laundering concerns. As noted above, they are offered in the United States solely to participants in certain Canadian retirement plans that are administered under Canadian law and that qualify for tax deferred treatment under Canadian law.[14] Like participant-directed 401(k) plans and IRAs in the United States, these Canadian plans encourage retirement savings by permitting individuals to invest savings on a tax-deferred basis, subject to contribution limitations and withdrawal restrictions designed to encourage long-term investment in the plans. Similar to U.S. law applicable to participant-directed 401(k) plans and IRAs, Canadian law imposes significant adverse tax consequences on exceeding annual contribution limitations in or taking early withdrawals from Canadian retirement accounts. Thus, in contrast to retail U.S. registered open-end funds, which regularly experience high volumes of subscriptions and redemptions and thus may present opportunities for the layering and integration stages of money laundering, investments in Snowbird Funds by participants in Canadian Retirement Accounts typically are not characterized by these same patterns of activities.[15] Consequently, they do not present the same magnitude of anti-money laundering concerns. Furthermore, in the improbable circumstances that a Snowbird Fund is used as part

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13 As amended by the USA Patriot Act, Section 5318(h)(2) of the Bank Secrecy Act provides that "[t]he Secretary of the Treasury, after consultation with the appropriate Federal functional regulator . . . may exempt from the application of those standards any financial institution that is not subject to the provisions of the rules contained in part 103 of title 31, of the Code of Federal Regulations. . . ."

14 Contributions to Canadian retirement accounts and income on those accounts are not subject to income taxation in Canada until proceeds are withdrawn. Those accounts typically are structured as a trust and must be registered with the Canadian Minister of National Revenue and maintained with a qualified Canadian financial institution, such as a trust company, an insurance company, or a bank.

15 Layering involves the distancing of illegal proceeds from their criminal source through a series of complex financial transactions. Integration occurs once illegal proceeds have been converted to proceeds which appear to have been derived from a legitimate source. See Notice accompanying Mutual Fund Interim Rule at 2118.

of a money laundering scheme, the unusual pattern of contributions and withdrawals would raise a red flag that is likely to be detected quickly.

C. USA Patriot Act Does Not Address Snowbird Funds

Neither Snowbird funds specifically nor Canadian investment funds more generally are mentioned in the USA Patriot Act. Nor are we aware of any legislative history suggesting that the United States Congress was seeking specifically to target such funds in adopting the legislation. Accordingly, we believe that any steps taken by FinCEN or the Secretary of the Treasury to exclude Snowbird Funds from coverage under the Act would be consistent with the Act, and would not, in any way, compromise the important purpose of Title III of the USA Patriot Act to promote the prevention, detection and prosecution of international money laundering and the financing of terrorism.

Moreover, we observe that in several notices published after the Mutual Fund Interim Rule, FinCEN appears to have embraced a narrower construction of the term mutual fund that would exclude Snowbird Funds from coverage under the Rule. For example, in the July 23, 2002 notice accompanying the proposed rule that would extend customer identification requirements to mutual funds pursuant to Section 326 of the USA Patriot Act, FinCEN stated that for purposes of Section 326, "the scope of the proposed rule is limited to those entities that are required to register with the Commission as investment companies and that fall within the category of 'open-end company' in section 5(a)(1) of the Investment Company Act."[16] Also in that notice, FinCEN observed that "[t]hese entities are commonly referred to as 'mutual funds.'" In an accompanying footnote, FinCEN stated further that the Mutual Fund Interim Rule required mutual funds to adopt AML Programs pursuant to Section 352 of the USA Patriot Act. FinCEN again embraced this narrower construction of the term in the September 26, 2002 notice accompanying the Unregistered Fund Rule, in which it stated, "[i]n April 2002, FinCEN issued an interim final rule requiring investment companies that are 'mutual funds' (i.e., registered open-end management investment companies as described in the 1940 Act)" to implement AML Programs.[17]

This more recent construction of the term mutual fund, which limits the term to U.S. registered open-end funds, also comports with common usage in the United States, and suggests that the definition provided by the Mutual Fund Interim Rule is

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16 Customer Identification Programs for Mutual Funds, 67 Fed. Reg. 48318 (2002) (to be codified at 31 C.F.R. pt. 103) (July 23, 2002) (emphasis added).

17 67 FR 60617 (emphasis added).

broader than may have been intended.[18] In any event, we encourage the Treasury to embrace formally this more recent construction.

D. Deference to Canadian Anti-Money Laundering Law is Appropriate

While we believe that Snowbird Funds do not present a substantial risk of facilitating international money laundering or terrorist financing activities, we acknowledge the possibility, however remote, that a person might attempt to use Snowbird Funds, to a limited extent, for such illicit purposes. To the extent that Snowbird Funds raise such concerns, however, we believe that several factors support the determination that deference to Canadian law is appropriate. First, Canada has an extensive and expanding anti-money laundering regime that seeks the same objectives as Title III of the USA Patriot Act. Second, subjecting Canadian investment funds to the new U.S. requirements would substantially increase burdens and inefficiencies for those funds and their shareholders. Third, because Canadian investment funds are established and conduct most of their activities in Canada, Canada has a stronger nexus to those funds than the United States, whose only nexus is likely to be through a handful of investors; and the spirit of the USA Patriot Act would be best served by deference to the country with the stronger, more direct regulatory interest. Accordingly, in our view, subjecting Canadian investment funds with such limited U.S. activities to the U.S. anti-money laundering regime is unnecessary and potentially sends the wrong policy message to those funds.

1. Canada has an Effective Anti-Money Laundering Regime

Money laundering has been recognized as a criminal offense under the Canadian Criminal Code since 1988.[19] Under the Canadian Criminal Code, Canadian law

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18 We also observe that the discussion of the U.S. mutual fund industry in the notice accompanying the Mutual Fund Interim Rule seems to contemplate extending the AML Program requirement only to open-end companies that are registered under the Investment Company Act. In that notice, FinCEN states that "[c]urrently, almost 3,000 active mutual funds are registered with the Commission," and that "[m]utual funds usually offer their shares to the public through a principal underwriter." See 67 FR 21117, 21118. Moreover, the discussion of the mutual fund industry does not address the structural differences between U.S. and Canadian mutual funds, which we would expect if the rule is intended to include Canadian funds. For example, the notice state that "[a] mutual fund is governed by a board of directors or trustees, which is responsible for overseeing the management of the fund's business affairs." This simply does not describe the vast majority of Canadian mutual funds, which are organized in Canada as mutual fund trusts.

19 See General Discussion in FINTRAC, Guideline 1: Backgrounder ("Guideline 1") (May 2002).

enforcement is authorized to search, seize and restrain property believed to constitute criminal proceeds.

Since then, additional legislative actions have strengthened the Canadian anti-money laundering regime. Examples include amendments to the Canadian Customs Act and the Canadian Excise Act. Early components of this anti-money laundering regime included certain record keeping and client identification requirements that applied to financial entities such as banks, credit unions, trust and loan companies, life insurance companies, securities dealers, casinos, any person engaged in a business, profession or activity that received cash for payment or transfer to a third party.[20] Although there were no mandatory reporting requirements, those entities were encouraged to submit reports voluntarily to appropriate law enforcement agencies.

More recently, in early October 2001, Canada passed the United Nations Suppression of Terrorism ("UNST") Regulations, which make it a criminal offense for anyone in Canada (and any Canadian outside Canada) to provide funds to or collect funds from any individual or entity on a government maintained list of suspected terrorists. In addition, the UNST Regulations provide the following: (i) anyone in Canada (and any Canadian outside Canada) is prohibited from dealing in any way with property (including effecting a related financial service or transaction) if they know it is owned or controlled by an individual or entity on that list; (ii) anyone in Canada (and any Canadian outside Canada) is required to disclose to the Royal Canadian Mounted Police and the Canadian Security Intelligence Service the existence of any property in their possession or control that that they believe is owned or controlled by or on behalf of any individual or entity on the list; and (iii) Canadian financial institutions (defined to include banks, credit unions, trust and loan companies, insurance companies and entities that deal with securities) are required to determine, on a continuing basis, whether they are in possession or control of property owned or controlled by anyone on the list, and to submit a report, on a monthly basis, to their principal supervisory or regulatory body concerning the possession or control of any such property.[21]

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20 Id.

21 In addition, the Canadian Anti-Terrorism Act, Bill C-36 - Anti-Terrorism Act, which received Royal Assent on December 18, 2001 and came into force on December 24, 2001, created additional measures to detect, deter, prosecute and disable terrorist groups. It amended the Criminal Code to make criminal any of the following acts: (i) knowingly to collect or provide funds, either directly or indirectly, to carry out terrorist activities, (ii) knowingly to participate in, contribute to or facilitate the activities of a terrorist group, (iii) to instruct anyone to carry out a terrorist activity on behalf of a terrorist group, and (iv) knowingly to harbor or conceal a terrorist.

An enhanced Canadian anti-money laundering regime was introduced in June 2000, when the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (the "Canadian AML Act") received Royal Assent.[22] Consistent with the USA Patriot Act, the principal purposes of the Canadian AML Act are to implement specific measures (i) to help detect and deter international money laundering and the financing of terrorist activities and to facilitate investigations and prosecutions of the related offenses; (ii) to respond to the threat posed by organized crime by providing law enforcement officials with the information they need to deprive criminals of the proceeds of their illicit activities, while protecting individual privacy, and (iii) to help fulfill Canada's international commitments to fight multinational crime. In line with these purposes, the Canadian AML Act requires the following specific measures, among others: (i) the creation of an independent government agency to oversee the anti-money laundering regime; (ii) the imposition of certain minimum record keeping and reporting requirements for covered entities; and (iii) the imposition of cross-border currency and monetary reporting.[23] The Canadian AML Act requires covered entities to implement a compliance program to comply with their reporting, record-keeping and client identification requirements. The compliance program is required to include, as far as practicable, (i) the development and application of compliance policies and procedures, (ii) the appointment of a compliance officer, (iii) an ongoing training program for its employees and agents, if any; and (iv) the periodic review of the program to test its effectiveness.

The Canadian AML Act established the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") as an independent government agency responsible for overseeing the implementation of these measures, providing guidance in respect of these measures, collecting and analyzing required reports, and inspecting covered entities for compliance with these measures.[24]

As part of its overall compliance program, a covered entity is required to establish processes to do the following things, among others: (i) report to FINTRAC transactions that are known or reasonably suspected to be related to the commission of a money laundering offense or a terrorist offense financing activity; (ii) report terrorist property in the possession or control of the covered entity; (iii) take

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22 Proceeds of Crime (Money Laundering) and Terrorist Financing Act (2000, C-17, s.1; 2001, C.41, s.48) (originally named the Proceeds of Crime (Money Laundering) Act).

23 See Guideline 1.

24 In addition to these substantial recent measures under the Canadian AML Act, Canada has a long history of combating international money laundering. For example, Canada has been a member of the Financial Action Task Force on Money Laundering ("FATF"), since it was established by the G-7 countries in 1989.

additional steps to safeguard international electronic funds transfers; (iv) report most cash transactions exceeding C$10,000; (v) maintain additional records concerning financial transactions; and (vi) take measures to identify an individual with which the entity conducts a cash transaction in excess of C$10,000, an individual who requests and electronic funds transfer in excess of C$10,000 or conducts a foreign exchange transaction in excess of C$3,000, any new corporate or entity account, and any settlor or co-trustee of a trust. Thus, consistent with the U.S. approach currently being implemented under the USA Patriot Act, specified Canadian entities are required to have established an anti-money laundering program which includes customer identification and suspicious activity reporting components, and which is reasonably designed to deter, detect, and report money-laundering activities.

Consistent with the U.S. approach, the Canadian AML Act carries stiff penalties for non-compliance: (i) failing to report a suspicious transaction or to make a terrorist property report could lead to a fine of C$2,000,000 and imprisonment of up to five years, or both; (ii) failing to report specified cash transactions could lead to a fine of C$500,000 for a first offense and C$1,000,000 for each subsequent offense; and (iii) failure to retain required records or to implement a compliance regime could lead to a fine of C$500,000 or imprisonment of up to five years, or both.

Although the Canadian AML Act does not apply directly to Canadian investment funds, it effectively regulates transactions in fund shares by regulating securities dealers, mutual fund dealers, fund managers, portfolio managers, and investment counselors. Our understanding is that transactions in Canadian investment fund shares necessarily are conducted through these covered entities, and thus that the funds are effectively covered. While we do not assert that the Canadian anti-money laundering requirements are entirely coextensive with those already adopted or soon to be adopted in the United States under the USA Patriot Act, we believe that they are substantially similar to these U.S. requirements.

2. Overlapping Requirements Would be Burdensome

Even if one were able to identify specific instances in which the U.S. AML Program requirements (as currently existing or as may evolve in the near future) may deter, detect or prosecute money laundering or other illicit activities in a more effective manner than those provided by current Canadian law, we believe that it is appropriate for the Treasury and other Federal functional regulators to defer to Canadian regulators and Canadian law on this issue. Historically and in the aftermath of the 911 Terrorist attacks, Canada has stood firmly with the United States as one of its strongest allies on the issue of combating international money laundering and the financing of terrorism and, and through its actions in establishing a strong anti-money laundering regime, has demonstrated a level of commitment to combating such activities at least equivalent to that of the United States. Subjecting Canadian entities that already face strong anti-money laundering requirements in

their home country to these new U.S. requirements, without a demonstrated need, would unnecessarily increase the costs of doing business in the United States and introduce market inefficiencies through added compliance costs. In addition to incurring costs for largely duplicative measures, Snowbird Funds would be expected to comply with measures that are not well tailored to their circumstances. For example, the Mutual Fund Interim Rule provides that a mutual fund must have its AML Program approved by its board of directors or trustees. In Canada, unlike the United States, a mutual fund may not have a board of directors or trustees that provides independent oversight of the management and operations of the fund.[25]

3. USA Patriot Act Calls for Cooperation Among Regulators

Moreover, subjecting Canadian entities, which already operate within a comprehensive anti-money laundering regime, to these new U.S. requirements would send an inappropriate message to Canada and other strong U.S. allies, namely, that the United States is not looking for partners in its campaign against international money laundering and terrorist financing, but instead is looking to impose its will unilaterally, without regard to local costs or other considerations. Sending such a message would contravene principles of sound foreign policy and the spirit of Section 352 of the USA Patriot Act, which contemplates a flexible approach to pursuing the purposes of the Act.[26] In the notice accompanying the Mutual Fund Interim Rule, for example, FinCEN expressly acknowledged,

> The legislative history of the Act explains that the requirement to have an anti-money laundering program is not a one-size-fits-all requirement. The general nature of the requirement reflects Congress' intent that each financial institution should have the flexibility to tailor its program to fit its business, taking into account factors such as size, location, activities, and risks or vulnerabilities to money laundering. This flexibility is designed to ensure that all firms subject to the stature, from the largest to the very small firms, have in place policies and procedures appropriate to monitor for anti-money laundering compliance.[27]

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25 See e.g., Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers, Concept Proposal of the Canadian Securities Administrators (March 1, 2002).

26 Section 352(c) of the USA Patriot Act provides, for example, that the Secretary of the Treasury "shall prescribe regulations that consider the extent to which the requirements imposed under [section 352] are commensurate with the size, location, and activities of the financial institutions to which such regulations apply."

27 67 FR 21119, citing USA Patriot Act of 2001: Consideration of H.R. 3162 Before the Senate (October 25, 2001) (statement of Sen. Sarbanes); Financial Anti-Terrorism Act of 2001: Consideration Under Suspension of Rules of H.R. 3004 Before the House of

These principles of prudent risk assessment and implementation flexibility are what led the Treasury to defer imposing AML Program requirements on unit investment trusts and other types of investment companies other than open-end funds. In the notice accompanying the Mutual Fund Interim Rule, the Treasury explained that in determining whether to extend AML Program requirements to those entities in the future, it would consider the extent to which such entities pose a money laundering risk that is not more appropriately covered by some other entity, such as its distributor.[28] We believe that it is appropriate for the Treasury to apply these same principles of prudent risk assessment and implementation flexibility in responding to the potential concerns presented by Snowbird Funds. By doing so, we believe that Treasury would be justified in reaching the determination that, at least with respect to Snowbird Funds and even more generally to all Canadian investment funds, deference to Canadian regulators is both reasonable and appropriate for purposes of effecting the objectives of the USA Patriot Act.

4. U.S. Public Interest Could be Harmed

While we do not contend that the Treasury would be acting outside its jurisdictional authority by imposing U.S. AML Program requirements on Snowbird funds (given their U.S. contacts), we believe that doing so exceeds that which is necessary or appropriate under the circumstance. Canada has its own comprehensive anti-money laundering regime. Extending U.S. AML Program requirements to Snowbird Funds would impose significant compliance costs, without conferring a material benefit on the U.S. public or the international community. By increasing compliance costs for those funds, participants in Canadian retirement accounts are likely to be harmed either through increased fees (as costs are passed on to shareholders in those funds) or decreased choices (as Canadian investment funds are forced out of this market). In either event, the important public interest of encouraging retirement savings by U.S. persons would be impaired.[29]

E. Requested Action

For the above reasons, we respectfully request that 31 CFR 103.130(a) be revised to insert the word "registered" immediately before "open-end company."

Representatives (October 17, 2001) (statement of Rep. Kelly) (provisions of the Financial Anti-Terrorism Act of 2001 were incorporated as Title III of the Act).

28 See 67 FR 21117, 21118.

29 Federal functional regulators have expressly recognized this important public policy interest. In the IDA Order, for example, the Commission stated, "We believe it is clearly in the public interest to encourage individuals to save for retirement."

III. Snowbird Funds and the Unregistered Investment Company Proposal

A. Background

As noted above in Section I.D. of this memorandum, although Snowbird Funds make their shares available in the U.S. to investors almost exclusively in reliance on Rule 7d-2, it is conceivable that, in certain limited circumstances, a Snowbird Fund or other Canadian investment fund would permit a U.S. person to invest on a retail basis in that fund. If, in addition to selling its units to a U.S. person, the fund is regarded as relying on Section 3(c)(1) to avoid the registration requirements under the Investment Company Act, the fund permits redemptions within two years from purchase, and the fund has $1,000,000 or more in total assets, then the fund might be regarded as subject to the Unregistered Fund Rule (assuming it is adopted as proposed). In that case, the fund would be required to comply with AML Program requirements substantially similar to those required by the Mutual Fund Interim Rule for mutual funds.

For the reasons summarized above in Section II of this memorandum, we believe that it is appropriate for the Treasury to exercise its authority to exclude from coverage under the Unregistered Fund Rule (and any future related rules or regulations) Snowbird Funds and any other Canadian investment funds that may incidentally make their shares available to one or several U.S. persons in reliance on Section 3(c)(1) or otherwise, rather than solely in reliance on Rule 7d-2. These reasons include the following: (i) the extensive overlapping anti-money laundering regime in Canada, the country with the more direct interest in regulating the activities of Canadian investment funds than the United States; (ii) the significant compliance costs for largely redundant measures; and (iii) the absence of a demonstrated need. Accordingly, we believe that the Unregistered Fund Rule, as proposed, should be amended to expressly exclude Canadian investment funds whose shares are sold to or otherwise owned by one or several U.S. persons but which are not required to register under the Investment Company Act in reliance on Section 3(c)(1), Rule 7d-2 or otherwise.[30]

B. Requested Action

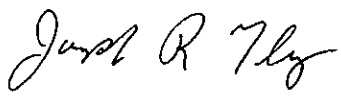
For the above reasons, we respectfully request that Section 103.132(a)(6)(ii) be revised by adding "(E) An investment fund organized under the laws of Canada."

* * *

[30] If you disagree, we suggest that, at a minimum, the Unregistered Fund Rule should be amended expressly to exclude from coverage any Canadian open-end mutual fund that is not required to register under the Investment Company Act and which is required to file its prospectus with an applicable provincial regulator in Canada.

We thank you in advance for taking the time to consider these issues and would appreciate any guidance that you may be able to provide on appropriate next steps. If you have any questions or if additional information would be helpful, please let me know.

Very truly yours,



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