INVESTMENT COMPANY INSTITUTE

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March 21, 2003

Judith R. Starr, Chief Counsel
Office of the Chief Counsel
Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183-0039

Re: NPRM – Suspicious Transaction Reporting – Mutual Funds

Dear Ms. Starr:

The Investment Company Institute[1] appreciates the opportunity to comment on the recently proposed rule that would require all mutual funds to file suspicious activity reports (SARs) with Treasury (the "proposed rule").[2] In general, transactions would be reportable if they are conducted or attempted by, at, or through a mutual fund, involve or aggregate funds or other assets of at least $5,000, and meet any one of four enumerated standards for determining their suspicious nature.[3]

The Institute strongly supports effective rules to combat potential money laundering activity in the financial services industry and supports the concept of an SAR rule for mutual funds.[4] We have several comments, however, on specific aspects of the proposed rule. Our comments address the standard for determining what constitutes a suspicious transaction, the

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,929 open-end investment companies ("mutual funds"), 553 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.322 trillion, accounting for approximately 95% of total industry assets, and over 90.2 million individual shareholders.

[2] *See* Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations – Requirement that Mutual Funds Report Suspicious Transactions, 68 Fed. Reg. 2716 (January 21, 2003) (the "NPRM").

[3] Section 103.15(a)(2) of the proposed rule provides that a transaction is reportable if the mutual fund knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part): (i) involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation; (ii) is designed, whether through structuring or other means, to evade any requirements of this part or any other regulations promulgated under the Bank Secrecy Act, Public Law 91–508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951–1959, and 31 U.S.C. 5311–5314, 5316–5332; (iii) has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the mutual fund knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or (iv) involves use of the mutual fund to facilitate criminal activity.

[4] *See* Letter from Craig S. Tyle, Investment Company Institute, to Judith R. Starr, FinCEN, dated March 1, 2002 (the ICI's comment letter on the broker-dealer SAR rule proposal) at 3.

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joint filing of SARs by mutual funds and other persons obligated to report the transaction, and the interplay between the SAR regime and the reporting of cash transactions to the Internal Revenue Service on Form 8300.

A. Reportable Transactions – The Standard for Identifying "Suspicious" Transactions

The commentary in the NPRM states that the "knows, suspects or has reason to suspect" standard in section 103.15(a)(2) of the proposed rule incorporates a concept of due diligence in the reporting requirement. As we stated in our earlier comment letter on the broker-dealer SAR rule, we believe it is critical that any SAR rule applicable to transactions in mutual fund shares adopt standards for identifying reportable transactions that take into account the nature of the fund business and the characteristics that distinguish it from traditional banking and brokerage businesses. In particular, we noted that a fund, its underwriter, and its transfer agent typically have no face-to-face contact with fund shareholders, and that, unlike many retail broker-dealers, a fund underwriter generally does not make investment recommendations to investors and is not required by the NASD to make suitability determinations with respect to transactions involving fund shares, and therefore often collects only limited information about shareholders. In response, the commentary accompanying the final broker-dealer SAR rule included the following statement:

> FinCEN recognizes that, based on the nature of the services they provide to their customers, certain types of broker-dealers will have more information available to them in making such determinations than other types of broker-dealers. The rule is intended to adjust to the different operating realities found in different types of financial institutions.[5]

We urge Treasury to make a similar statement in its commentary accompanying the adoption of a final mutual fund SAR rule. In particular, we urge Treasury to recognize that mutual funds have less information available to them in making SAR determinations than other types of financial institutions and that the mutual fund SAR rule is intended to take this operating reality into account. Accordingly, Treasury should state that mutual funds are expected to file SARs based on the information obtained by the fund, its underwriter, or its transfer agent in the normal course of establishing a shareholder relationship or processing transactions. Such a statement would complement and clarify the statement in the NPRM that "a mutual fund must base its determination as to whether a report is required on all the facts and circumstances relating to the transaction and the customer of the mutual fund in question."[6]

B. The Joint Filing of SARs – Sections 103.15(a)(3) and (d) of the Proposed Rule

Section 103.15(a)(3). The NPRM recognizes that, once a mutual fund SAR rule has been adopted and is effective, multiple financial institutions may have reporting obligations stemming from the same transaction or series of transactions involving mutual fund shares. Section 103.15(a)(3) of the proposed rule allows the filing of one report to satisfy these multiple

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[5] Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations – Requirement that Brokers or Dealers in Securities Report Suspicious Transactions, 67 Fed. Reg. 44048 (July 1, 2002), at 44054.

[6] NPRM at 2718.

reporting obligations, so long as the report filed contains all relevant facts.[7] We strongly support section 103.15(a)(3) of the proposed rule and recommend that it be adopted as proposed.

In explaining section 103.15(a)(3), the commentary in the NPRM gives the following example:

> Moreover, a person such as a broker-dealer that is a service provider to the fund may have a separate suspicious activity reporting obligation with regard to the same transaction. The proposed rule would permit the mutual fund's report to satisfy that person's reporting obligation as well.[8]

The Institute is concerned that the reference in the first sentence quoted above to "a broker-dealer that is a service provider to the fund" could be read to limit the ability to file one SAR to satisfy multiple reporting obligations in an unnecessary and inappropriate manner. In addition to broker-dealers that act as service providers to funds (*i.e.*, fund underwriters), other broker-dealers also may have reporting obligations with respect to transactions involving mutual fund shares (*i.e.*, retail broker-dealers that sell fund shares). These retail broker-dealers are not considered to be "service providers" to those funds.

In our view, however, it is irrelevant for suspicious activity reporting purposes whether a broker-dealer is acting as a service provider to a fund. If a broker-dealer and a fund both have reporting obligations with respect to a particular transaction, and the broker-dealer files an SAR, the fund ought to be able to rely upon that filing provided that it contains all of the relevant information. Consistent with the rule, which expressly extends to "*any other person* obligated to report the transaction," Treasury should clarify that its references in the commentary to broker-dealers include all types of broker-dealers, whether they act as principal underwriters or in any other capacity, such as selling fund shares to the public.

Section 103.15(d). Section 103.15(d) of the proposed rule, which prohibits the disclosure of information filed in, or the fact of filing, an SAR, provides an exception from that prohibition "to the extent permitted by" section 103.15(a)(3). We strongly support the concept embodied in this exception. In order for multiple financial institutions to rely upon the filing of a single SAR as contemplated by section 103.15(a)(3), there must be an exception from section 103.15(d) so that those institutions can share information about the suspicious activity with each other.

It is not entirely clear, however, that the rule as proposed allows this to occur, since the exception in section 103.15(d) of the proposed rule applies only "to the extent permitted by paragraph (a)(3)" of the proposed rule. Clearly, Treasury's intent with respect to this exception was to allow funds and other persons obligated to report the transaction to share information

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[7] Specifically, section 103.15(a)(3) provides that:

> The obligation to identify and properly and timely to report a suspicious transaction rests with each mutual fund involved in the transaction, provided that no more than one report is required to be filed by the mutual funds involved in a particular transaction or any other person obligated to report the transaction, so long as the report filed contains all relevant facts.

[8] NPRM at 2719.

on suspicious activity.[9] However, paragraph (a)(3) does not expressly permit the sharing of information – it merely states that no more than one report is required to be filed with respect to a particular transaction or series of transactions.

We therefore recommend that Treasury clarify the scope of the exception in section 103.15(d) and expressly provide, preferably in the rule text, that the sharing of information among financial institutions in order to facilitate the filing of SARs on behalf of more than one entity would not violate the non-disclosure provisions in the rule.[10]

C. SARs and Form 8300

Some mutual funds currently are required to report the receipt of cash or certain non-cash instruments to the IRS on Form 8300 because they or their transfer agents are deemed "nonfinancial trades or businesses" pursuant to IRS regulations implementing Section 6050I(c)(1)(B) of the Internal Revenue Code (Section 6050I).[11] Once a mutual fund SAR rule is adopted, these transactions also will be reportable as suspicious, subjecting these funds to reporting requirements that are both duplicative and conflicting. We believe that this outcome serves no valid law enforcement or public policy purpose, and we recommend that mutual funds and/or their transfer agents not be required to report transactions involving cash equivalents on Form 8300.

There are several reasons for this recommendation. First, the Form 8300 and SAR regimes have directly conflicting disclosure provisions. The subject of a Form 8300 is *required* to be notified that a report has been filed, whereas the SAR rule strictly *prohibits* notifying any person involved in a reported transaction that an SAR has been filed.[12] Disclosure of the fact of filing a Form 8300 effectively would undermine the policy goals of the SAR non-disclosure provision – that the subject of an investigation into suspicious activity should not be tipped off as to the existence of that investigation.

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[9] In explaining section 103.15(d) of the proposed rule, the commentary in the NPRM states that the prohibition on disclosure "does not prohibit mutual funds from discussing with each other (or with service providers that are involved in the transaction, such as their investment advisers, transfer agents, principal underwriters, and broker-dealers) for purposes of section 103.15(a)(3), suspicious activity...." NPRM at 2719.

[10] The sharing of information between two financial institutions that have filed notices pursuant to the rules adopted under section 314(b) of the Patriot Act would be free from liability based on the safe harbor in those rules. However, some of the entities involved (*e.g.*, fund transfer agents) may not be eligible for the 314(b) safe harbor or may not have filed the required notice.

[11] Not all mutual funds or their agents are required to file reports on Form 8300. It is 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 currency transaction reporting requirements under the BSA, 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 currency transaction reporting requirements under the BSA, 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. This would include, as appropriate, requirements to report the receipt of cash on currency transaction reports (CTRs) and the receipt of suspicious non-cash instruments on SARs.

[12] *See* 26 CFR Section 1.6050I-1(e) (requiring a written statement to be sent to every person whose name is set forth in a Form 8300 report) and Section 103.15(d) of the proposed rule (prohibited disclosure of facts contained in, or the fact of filing of, an SAR).

Second, Form 8300 and SAR reporting would be needlessly duplicative. In general, cash equivalents (*i.e.*, money orders, traveler's checks, cashier's checks, and bank drafts with a face amount of $10,000 or less) are reportable on Form 8300 if the recipient knows that the cash equivalents are being used in an attempt to avoid cash reporting requirements.[13] Similarly, transactions (including transactions involving cash equivalents) would be reportable as suspicious transactions under the proposed SAR rule if they are designed to evade any transaction reporting requirement under federal law.[14] As a result, any transactions in fund shares involving cash equivalents that otherwise would be reportable on Form 8300 also would be reportable suspicious transactions, resulting in duplicative reporting by some (but not all) funds.[15]

Finally, eliminating reporting on Form 8300 would reduce the expense and burden of cash transaction reporting for mutual funds and their transfer agents. In this regard, we note that the added expenses and burdens of filing both Form 8300 and SARs are only borne by *some* mutual funds and transfer agents, since, as explained above, only some mutual funds and transfer agents are required to file reports on Form 8300.[16] Since essentially the same information would still be reported under the SAR regime, these cost savings would be realized without diminishing the quality or quantity of useful information reported to Treasury.

For all of these reasons, we recommend that Treasury take one of the two approaches described below to the reporting of cash and cash equivalents. Either approach would effectively obviate the need for funds and their transfer agents to file Form 8300.

Approach #1: Subject Funds to the CTR Requirements Under the BSA. Treasury could subject mutual 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 Section 6050I and BSA Section 5331. Under this approach, currency transactions would be reported under the CTR regime and suspicious cash equivalents would be reported under the SAR regime.

Approach #2: Exempt Funds from Reporting Cash Equivalents on Form 8300. Alternatively, the regulations implementing Section 6050I and Section 5331 of the BSA could be amended to exempt mutual funds (and/or their transfer agents) from having to file Form 8300 for cash equivalents and only require filing for any reportable cash transactions. This alternative is consistent with Section 6050I itself, which 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] In

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[13] 26 CFR Section 1.6050I-1(c)(1)(ii)(B)(2); 31 CFR Section 103.30(c)(1)(ii)(B).

[14] Section 103.15(a)(2)(ii) of the proposed rule.

[15] We noted that we expected this to be the case in an earlier comment letter. *See* Letter from Craig S. Tyle, Investment Company Institute, to Judith R. Starr, FinCEN, dated May 29, 2002, at 5-6.

[16] We also note that not every financial institution bears these expenses and burdens, since Section 6050I(c)(1)(B) expressly exempts banks, broker-dealers, and certain other financial institutions from the Form 8300 reporting requirements.

[17] Section 6050I(c)(1)(A).

addition, this approach would be consistent with the cash reporting requirements for banks and broker-dealers (the CTR requirements) because those requirements do not apply to transactions involving cash equivalents.[18]

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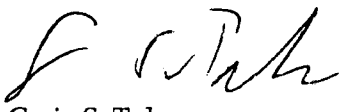
Thank you for considering our comments on the proposed rule. If you have any questions or need additional information, please contact me at (202) 326-5815, Frances Stadler at (202) 326-5822 or Bob Grohowski at (202) 371-5430.

Sincerely,



Craig S. Tyle
General Counsel

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

[18] One difference in the treatment of mutual funds and broker-dealers under this approach would be that mutual funds would remain obligated to report currency transactions on Form 8300. However, we would expect that mutual funds would rarely trigger this filing obligation, since most funds do not accept cash to purchase shares.