INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

November 16, 2020

By Electronic Transmission

Michael Mosier
Deputy Director, Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, VA 22183

Re: Anti-Money Laundering Program Effectiveness; Regulatory Identification Number 1506-AB44; Docket Number FINCEN-2020-0011

Dear Mr. Mosier:

The Investment Company Institute ("ICI")[1] appreciates the opportunity to comment on the advance notice of proposed rulemaking (the "ANPRM") issued by the Financial Crimes Enforcement Network ("FinCEN") seeking comment on potential amendments to the anti-money laundering ("AML") program requirements to explicitly define and require that financial institutions maintain an "effective and reasonably designed" AML program.[2] The ANPRM describes FinCEN's collaborative efforts with law enforcement, federal functional regulators, and the financial services industry to "upgrade and modernize the national AML regime, where appropriate" and states that the ANPRM "is intended to further these efforts."

ICI and its members strongly support FinCEN's efforts to protect the U.S. financial system from money laundering, terrorist financing, and other illicit activities and have always appreciated

---

1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$26.1 trillion in the United States, serving more than 100 million U.S. shareholders, and US$7.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

2 Anti-Money Laundering Program Effectiveness, Advance notice of proposed rulemaking, 85 FR 58023 (Sept. 17, 2020).

FinCEN's thoughtful and collaborative approach to its rulemakings. We offer the following comments on the elements of the ANPRM that uniquely affect registered funds.

A. The Current State of AML Obligations for Mutual Funds

ICI and its members support efforts to update and modernize the AML requirements applicable to financial institutions. In doing so, we urge FinCEN to take into account the unique nature of the mutual fund industry in making any changes to the current AML program requirements applicable to mutual funds. The mutual fund industry operates differently from other financial institutions in many respects, including in ways that are directly relevant to the consideration of a mutual fund's AML obligations.

As FinCEN has acknowledged in prior rulemakings, "mutual funds are best understood as a form of financial product rather than as an institution providing financial services or investment advice."[3] In this vein, it is critical that any AML program rule amendments take into account the unique relationship among mutual funds, intermediaries, and fund shareholders. It is also critical to recognize that most mutual fund accounts are either low-risk employer sponsored retirement plans, or are introduced through intermediaries (primarily other federally regulated financial institutions) that have the direct relationships with mutual fund shareholders and generally have their own AML obligations with respect to such relationships.

B. Risk Assessment for Mutual Funds

FinCEN is considering amending the AML program rules to explicitly require "the establishment of a risk-assessment process that includes the identification and analysis of money laundering, terrorist financing, and other illicit financial activity risks faced by the financial institutions based on various factors, including its business activities, products, services, customers, and geographic locations in which the financial institution does business or services customers." While ICI does not object to mandating risk assessments by rule, FinCEN should take into consideration the low-risk profile of mutual funds in adopting any rule that changes mutual funds' current AML obligations.

As recognized in the Customer Due Diligence ("CDD") Final Rule, the risk of mutual funds being used as a tool for money laundering is low, primarily due to the intermediated nature of how mutual funds are sold, and the fact that mutual funds are a financial product and not a traditional financial institution. A number of factors contribute to the low-risk profile of mutual funds:

---

[3] Customer Due Diligence Requirements for Financial Institutions, Final Rule, 81 FR 29398, 29424 (May 11, 2016) ("CDD Final Rule").

- Because mutual funds are a financial product, rather than a financial services provider, there is typically no direct and ongoing relationship with the beneficial shareholder of fund shares. Notably, the redemption process is inherently low-risk because of other regulatory obligations, including, among others, existing customer identification program ("CIP")/CDD, Reg S-ID, and tax reporting obligations.

- A substantial percentage of mutual fund-owning households hold mutual funds in retirement plans, which are inherently low-risk.[4] ICI research shows that 82 percent of mutual fund-owning households owned funds through an employer-sponsored retirement plan; 50 percent owned funds through sales force channels (*e.g.*, full-service brokers, banks, insurance agents, and registered investment advisers); 19 percent purchased their fund shares directly from a mutual fund; and 4 percent identified mutual fund companies as their primary source for purchasing mutual funds.[5]

- Accordingly, mutual fund assets are commonly held through intermediaries, which increasingly are using omnibus accounts to transact in mutual funds, or retirement plans, where FinCEN has recognized the money laundering and terrorist financing risks are low.

- Mainly due to tax and regulatory obligations, the substantial majority of mutual fund shareholders are U.S. persons.[6]

Although ICI supports the notion that an AML program should be risk-based, we urge FinCEN not to require mutual funds to produce written risk assessments because, as discussed herein, mutual fund risk profiles are inherently low. FinCEN also should not impose a "one-size fits all" standard

---

4 FinCEN and the SEC have acknowledged that "these accounts are less susceptible to use for the financing of terrorism and money laundering, because, among other reasons, they are funded through payroll deductions in connection with employer plans that must comply with federal regulations that impose various requirements regarding the funding and withdrawal of funds from such accounts, including low contribution limits and strict distribution requirements." Joint Final Rule: Customer Identification Programs for Mutual Funds, SEC Release No. IC-26031 (Apr. 29, 2003) ("Mutual Fund CIP Rule"). *See also*, CDD Final Rule at 29412-13 (in excluding retirement accounts from the definition of account for purposes of the CDD Rule, FinCEN noted that the "accounts established to enable employees to participate in retirement plans established under ERISA are of extremely low money laundering risk").

5 *See* "Profile of Mutual Fund Shareholders, 2019," *ICI Research Report* (December 2019), at 19 and 21, available at https://www.ici.org/pdf/rpt_19_profiles19.pdf. A mutual fund-owning household may acquire mutual fund shares through more than one channel.

6 *See* ICI, *Market Access for Regulated Fund Managers in the United States and the European Union* (Updated as of March 2017), at 12-13, available at https://www.ici.org/pdf/pub_17_regulated_fund_access.pdf (describing "distributing" feature of US registered investment companies and "roll-up" structures of non-US regulated funds and advantages for non-US investors).

for a risk assessment requirement. Rather, ICI strongly believes that any codification of a written risk assessment requirement should allow for the greatest amount of flexibility possible for mutual funds to determine the best way to assess and document relevant risks.

C. Discussion of Specific Requests for Comment in the ANPRM:

a. *Question 4: Should regulatory amendments to incorporate the requirement for an "effective and reasonably designed AML program be proposed for all financial institutions currently subject to AML program rules? Are there any industry-specific issues that FinCEN should consider in a future notice of proposed rulemaking to further define an "effective and reasonably designed" AML program?*

ICI strongly agrees with FinCEN and the Federal Banking Agencies that "a risk-based [AML] compliance program enables a bank to allocate compliance resources commensurate with its risk."[7] Toward that end, ICI believes that in crafting any amendments with the view towards updating and modernizing AML program requirements FinCEN should also be looking to reduce compliance burdens in situations where an AML program has little purpose. Such an approach would allow for the more efficient and effective use of compliance resources. Accordingly, ICI suggests updating the term "mutual fund" as currently defined in 31 C.F.R. § 1010.100(gg) to exclude exchange-traded funds registered under the Investment Company Act of 1940 ("ETFs").

ETFs should not be treated the same as mutual funds because ETF shares are available to the general public only on exchanges. Federal regulators already have acknowledged that funds whose shares trade on an exchange do not present risks sufficient to justify subjecting such funds to AML program requirements.[8] The 2002 Report to Congress issued by the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission (SEC) concluded that closed-end funds should not be subject to AML regulation, noting that "purchases and sales of closed-end fund shares are effected through broker-dealers or banks, and

---

7 *See* ANPRM at 58026. As a general matter, FinCEN should define or provide guidance on how a financial institution determines whether information has "high degree of usefulness" and how such a term would be considered in connection with current AML program requirements and SAR filing determinations.

8 *See* Report to Congress Pursuant to Section 356(c) of the USA PATRIOT Act (December 31, 2002) (the "2002 Report") ("Closed-end funds typically do not have an account relationship with their investors. As a result, those funds (and their service providers) are not in a position to detect and prevent money laundering. Purchases and sales of closed-end fund shares are effected through broker-dealers or banks, and these entities are already subject to anti-money laundering regulation. For these reasons, closed-end funds do not appear to present a risk of money laundering that would be effectively addressed by subjecting them to additional regulation, and Treasury has not extended BSA regulatory requirements to closed-end funds.").

these entities are already subject to [AML] regulation."[9] The Report concludes that, "because these funds' securities operate much like securities issued by a corporation, these funds do not appear to present a money laundering risk sufficient to warrant regulation at this time."[10]

The only shareholders that may transact directly with ETFs are authorized participants ("APs"), which are members or participants of SEC-registered clearing agencies, such as broker-dealers or banks that are already subject to AML program requirements. Otherwise, ETF shares are available to the public only on exchanges, similar to how shares of corporations and other issuers generally are traded. As a result, we are aware of no circumstance under which an ETF is dealing directly with a person that is not subject to AML program requirements.[11] Accordingly, ETFs should not be subject to AML regulation, and instead should be permitted to reallocate compliance resources to other compliance efforts that have a more meaningful application.

For the aforementioned reasons, ICI recommends that the definition of "mutual fund" in the BSA rules be amended to exclude ETFs. ETFs, for purposes of this exclusion, should be defined consistent with new SEC Rule 6c-11 under the Investment Company Act of 1940 as:

> [A] registered open-end management company: (A) That issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount if any; and (B) Whose shares are listed on a national securities exchange and traded at market-determined prices.[12]

Question 6: Should FinCEN issue Strategic AML Priorities, and should it do so every two years or at a different interval? Is an explicit requirement that risk assessments consider the Strategic AML Priorities appropriate? If not, why? Are there alternatives that FinCEN should consider?

ICI believes that publication of Strategic AML Priorities would be helpful guidance to financial institutions in connection with maintaining their AML programs. ICI does not have a view on the interval period for publication and defers to FinCEN's judgment in this regard. However, any

---

9 *See Id.*

10 *See Id.*

11 The 2002 Report also concluded that Unit Investment Trusts ("UITs") should not be subject to AML program requirements because UIT securities could only be purchased through broker-dealers and life insurance companies, financial institutions that would themselves be subject to AML program requirements. The 2002 Report concluded that with respect to UITs, "[a]pplying another set of [AML] rules . . . appears unlikely to increase protection against money laundering."

12 *See* 17 C.F.R. 270.6c-11(a)(1). We note that the exclusion should only be tied to the definition of "exchange-traded fund" under Rule 6c-11 and should not be dependent on whether an ETF is able to rely on the rule itself.

requirement to consider Strategic AML Priorities should make clear that: (i) financial institutions ultimately have the discretion to determine whether and to what extent any such Priorities are relevant to the particular financial institution, and how (if at all) to address any Priority in their AML program, and (ii) FinCEN and other regulators will defer to the financial institution's judgment in making such determinations. Given the nature of a mutual fund as a financial product and not a traditional financial institution, most Strategic AML Priorities would likely not be relevant to a mutual fund, and a mutual fund's commitment of resources to non-relevant topics would be both wasteful and inefficient, as it would needlessly divert compliance resources.[13]

> *Question 8: As financial institutions vary widely in business models and risk profiles, even within the same category of financial institution, should FinCEN consider any regulatory changes to appropriately reflect such differences in risk profile? For example, should regulatory amendments to incorporate the requirement for an "effective and reasonably designed" AML program be proposed for all financial institutions within each industry type, or should this requirement differ based on the size or operational complexity of these financial institutions, or some other factors? Should smaller, less complex financial institutions, or institutions that already maintain effective BSA compliance programs with risk assessments that sufficiently manage and mitigate the risks identified as Strategic AML Priorities, have the ability to "opt in" to making changes to AML programs as described in this ANPRM?*

As discussed above, due to the low-risk nature of the mutual fund industry, any new requirement imposed on mutual funds should take into account whether the benefits of the requirement in preventing and detecting money laundering or terrorist financing outweigh the cost of any re-allocation of resources away from other, higher-risk compliance areas for mutual funds. In particular, ICI believes that current requirements and guidance with respect to negative news screenings, customer risk-profiles, and screening for politically exposed persons are not as relevant for mutual funds since, as a financial product, funds ordinarily do not have direct interface with the owners of fund shares.

Screenings of these types ordinarily are performed by intermediaries — financial services providers with direct interface with their clients. For direct-sold accounts, these types of screenings are not efficient or effective to the overall goal of preventing money laundering or terrorist financing. In the context of direct-sold accounts and the purchase or sale of mutual funds, the risk of money laundering or terrorist financing is mitigated because the transfer of money will, in most circumstances, be received from or sent to an account at a financial institution that has its own AML

---

[13] For example, guidance such as FinCEN's October 2020 guidance on human trafficking would not be applicable to mutual funds because a mutual fund ordinarily would be unable to take meaningful steps to identify such activity given the nature of the product. *See* FinCEN Advisory, FIN-2020-A008, "Supplemental Advisory on Identifying and Reporting Human Trafficking and Related Activity," (October 15, 2020).

obligations. As a consequence, additional screenings would be duplicative and a drain of resources from the mutual fund's overall AML program.

In addition, ICI believes that participation among financial institutions in information sharing programs pursuant to the safe harbor under Section 314(b) (the "314(b) Safe Harbor") of the USA PATRIOT Act is extremely valuable in preventing and detecting terrorist financing and money laundering activities and should be encouraged.[14] To encourage participation, FinCEN should clarify the circumstances under which a financial institution may avail itself of the 314(b) Safe Harbor.

In its 2009 Guidance, FinCEN stated that "a financial institution participating in the section 314(b) program may share information relating to transactions that the institution suspects ***may involve the proceeds*** of one or more specified unlawful activities ("SUAs") and such institution shall remain within the protection of the section 314(b) safe harbor from liability."[15] However, in 2012, FinCEN stated that "information shared for the purpose of identifying fraud or other [SUA] that is ***not related to a transaction*** involving the possibility of money laundering and/or terrorist financing is not covered by the statutory safe harbor." (emphasis added)[16] We understand some financial institutions have expressed concern that sharing information for the purpose of identifying fraud or other SUAs may be outside the scope of the 314(b) Safe Harbor, notwithstanding FinCEN's 2009 Guidance and the statute's broad language and policy intent. This narrow interpretation could preclude the 314(b) Safe Harbor from applying to situations where a financial institution suspects that a transaction involving an SUA, such as fraud, may be occurring but has not yet resulted in any proceeds and therefore cannot be a transaction involving money laundering or terrorist financing.

We therefore recommend that FinCEN clearly and strongly reaffirm its 2009 Guidance, *i.e.*, that the 314(b) Safe Harbor is available when a financial institution shares information relating to transactions that the institution suspects may involve the proceeds of a specified unlawful activity, including but not limited to identifying fraud. This is consistent with the text of section 314(b),

---

[14] Section 314(b) of the USA PATRIOT Act states that "2 or more financial institutions and any association of financial institutions may share information with one another regarding individuals, entities, organizations, and countries suspected of possible terrorist or money laundering activities." It further provides a statutory safe harbor when a financial institution or association "transmits, receives, or shares such information for the purpose of identifying and reporting activities that ***may involve terrorist acts or money laundering***" (emphasis added).

[15] *Guidance on the Scope of Permissible Information Sharing Covered by Section 314(b) Safe Harbor of the USA PATRIOT Act*, FIN-2009-G002 (June 16, 2009) ("2009 Guidance") (emphasis added).

[16] *See Administrative Ruling Regarding the Participation of Associations of Financial Institutions in the 314(b) Program,* FIN-2012-R006 (July 25, 2012) ("2012 Administrative Ruling").

because a transaction suspected of involving the proceeds of one or more SUAs necessarily is a transaction that "*may involve* … money laundering" (emphasis added). Moreover, this view is consistent with the policy underlying section 314(b), which is to encourage financial institutions and their associations to share information relating to possible money laundering or terrorist financing activity.

* * * * *

ICI appreciates the opportunity to present our views on the ANPRM and looks forward to providing more specific comments on any proposal developed by FinCEN. If you have any questions about the matters discussed in this letter, please contact Susan Olson (at 202-326-5813 or solson@ici.org), Joanne Kane (at 202-326-5850 or joanne.kane@ici.org), or Matthew Thornton (at 202-371-5406 or matt.thornton@ici.org).

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel – Investment Company Institute

/s/ Joanne Kane

Joanne Kane
Senior Director, Operations & Transfer Agency