The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 26148

May 7, 2012

ICI Comment Letter on FinCEN's Advance Notice of Proposed Rulemaking on Possible Customer Due Diligence Obligation for Financial Institutions

[26148]

May 7, 2012

TO: AML COMPLIANCE WORKING GROUP No. 4-12
TRANSFER AGENT ADVISORY COMMITTEE No. 30-12
BROKER/DEALER ADVISORY COMMITTEE No. 22-12
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 20-12
OPERATIONS COMMITTEE No. 15-12 RE: ICI COMMENT LETTER ON FINCEN'S ADVANCE NOTICE OF PROPOSED RULEMAKING ON POSSIBLE CUSTOMER DUE DILIGENCE OBLIGATION FOR FINANCIAL INSTITUTIONS
On May 4th, the Institute submitted the attached comment letter in response to the advance notice of proposed rulemaking issued by the Financial Crimes Enforcement Network ("FinCEN") seeking comment on a wide range of questions relating to the development of an explicit customer due diligence ("CDD") obligation for financial institutions (the "ANPRM"). [1] The ANPRM describes FinCEN's concern with the lack of uniformity and consistency in the way financial institutions address CDD and beneficial ownership. FinCEN therefore believes that issuing an express CDD rule, including a requirement to obtain beneficial ownership information, may be necessary to protect the United States financial system from criminal abuse and to guard against terrorist financing, money laundering and other financial crimes.

The Institute's letter states that, while we recognize FinCEN's rationale for considering the adoption of an explicit CDD rule, FinCEN must fully understand and evaluate the ramifications of such a rule on the various and different types of financial institutions, including mutual funds, and the costs and benefits of such a requirement, prior to proposing a CDD rule. The letter describes the Institute's primary concerns with how the CDD elements contemplated by FinCEN would apply to mutual funds, and includes an Appendix explaining mutual fund distribution and how information moves between shareholders, financial intermediaries and mutual funds.

The key points addressed in the Institute's letter are the following:

- It is critical that any CDD rule take into account the unique relationship among mutual

funds, intermediaries and fund shareholders, and recognize that most mutual fund accounts are either low-risk employer sponsored retirement plans, or are introduced through intermediaries (that are primarily financial institutions) that have the direct relationship with the fund's shareholder. Consequently, given the expertise and experience of the SEC's Division of Investment Management with mutual funds, and because the ANPRM incorporates elements of Section 326 of the USA PATRIOT Act, we believe that any CDD rule applicable to mutual funds should be adopted jointly by both FinCEN and the SEC.

- We believe that the concept of CDD, as described in the ANPRM, represents a fundamental change to the AML requirements applicable to mutual funds, and that any cost/benefit analysis of a proposed CDD rule must start from the presumption that mutual funds currently are not subject to formal CDD obligations.
- The notion of understanding the "nature and purpose" of an account, as described in the ANPRM, is inconsistent with the existing regulatory obligations of mutual funds, and is particularly impracticable given the highly intermediated nature of the industry.
- Because Congress never intended that mutual funds be required to identify or verify beneficial owners under the Bank Secrecy Act ("BSA"), and given the low-risk customer base of mutual funds, FinCEN, as part of a cost/benefit analysis, should precisely indicate the statutory basis for subjecting mutual funds to beneficial ownership requirements and the reasons why it is now appropriate to subject mutual funds to such requirements.
- Requiring mutual funds to obtain beneficial ownership information is ineffective, because beneficial ownership information cannot be reliably verified until such time as entities are required to disclose such information at the time of their formation.
- The definition of "beneficial owner" in the ANPRM is vague and unworkable. Approaches used outside the United States for identifying controlling beneficial owners should be considered.
- Notwithstanding our concerns about the ANPRM, we believe that it is reasonable for mutual funds to obtain additional information, including beneficial ownership information, on a risk-based determination, and to verify such information on a risk sensitive basis in a manner similar to what is required by the CIP rules. However, mutual funds should not be required to obtain or verify beneficial ownership information in the context of customer relationships exempt from the mutual fund CIP rule, or from intermediaries holding shares through omnibus accounts or accounts that function in a manner similar to omnibus accounts. Moreover, mutual funds should be allowed to apply simplified due diligence, and not obtain beneficial ownership information, in connection with customer relationships introduced by regulated intermediaries.

Subsequent to the filing of the Institute's letter, FinCEN extended the comment period on the CDD ANPRM for 30 days (after the Federal Register publishes the notice).

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Attachment

endnotes

[1] Customer Due Diligence Requirements for Financial Institutions, 77 FR 13,046 (proposed March 5, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-03-05/pdf/2012-5187.pdf (the “ANPRM”).
