

**MEMO# 16428**

August 12, 2003

## **ADDITIONAL GUIDANCE ISSUED ON FINAL CUSTOMER IDENTIFICATION PROGRAM RULE**

[16428] August 12, 2003 TO: 529 PLAN ADVISORY COMMITTEE No. 44-03 BROKER/DEALER ADVISORY COMMITTEE No. 25-03 BROKER/DEALER ASSOCIATE MEMBERS No. 4-03 COMPLIANCE ADVISORY COMMITTEE No. 60-03 INTERNAL AUDIT ADVISORY COMMITTEE No. 7-03 MONEY LAUNDERING RULES WORKING GROUP No. 49-03 OPERATIONS MEMBERS No. 23-03 PENSION COMMITTEE No. 25-03 SEC RULES MEMBERS No. 105-03 TRANSFER AGENT ADVISORY COMMITTEE No. 74-03 RE: ADDITIONAL GUIDANCE ISSUED ON FINAL CUSTOMER IDENTIFICATION PROGRAM RULE The staffs of the Securities and Exchange Commission and the Department of the Treasury have responded to the Institute's request for additional guidance on the customer identification program (CIP) rule for mutual funds.<sup>1</sup> The staff letter contains four questions and answers clarifying issues raised by the final CIP rule, two of which directly address the issues raised by the Institute. We are extremely pleased to report that the staffs of the SEC and Treasury have concurred with the Institute's view on both issues raised in our request for guidance. The four Q&As are summarized below and a copy of the Q&A letter is attached. The first question responds to the Institute's request for guidance on exchanges and new purchases by existing shareholders. This Q&A makes clear that mutual fund complexes do not have to perform customer identification procedures in this context, as long as the fund complex offers exchange privileges to its shareholders and has a reasonable belief that it knows their true identities. The Q&A states that: A shareholder of one fund who has exchange privileges with a second fund in the complex would be considered to have accounts 1 The final CIP rule for mutual funds was adopted in May. See 68 Fed. Reg. 25131 (May 9, 2003). In June, the Institute submitted a letter identifying two significant open issues that have broad significance for the mutual fund industry: (1) the treatment of exchanges and similar transactions under the rule; and (2) the application of the rule's definition of "customer" to transactions processed through the National Securities Clearing Corporation's Fund/SERV system. See Memorandum to Broker/Dealer Advisory Committee No. 19-03, Compliance Advisory Committee No. 49-03, Money Laundering Rules Working Group No. 40-03, SEC Rules Committee No. 59-03, Small Funds Committee No. 22-03, and Transfer Agent Advisory Committee No. 62-03 [16236], dated June 25, 2003. 2 with both funds under the mutual fund CIP rule. If the shareholder exchanges into the second fund and the second fund establishes a new account with the shareholder, the shareholder would be a person who already has an "existing account" with the second fund. The shareholder therefore would not be a "customer" of the second fund if it has a reasonable belief that it knows the true identity of the shareholder, and the second fund would not be required to perform its CIP procedures for that shareholder. The first Q&A also notes that this "reasonable belief" requirement would apply only with respect to

shareholders that were not identified and verified pursuant to a fund's CIP (i.e., those shareholders in existence before October 1, 2003). With respect to those people who initially become shareholders on or after October 1, 2003, the Q&A notes that the identification and verification performed when they become shareholders would normally satisfy the CIP obligations of all of the funds in that complex. The second question responds to the Institute's request for the staff's concurrence in our view with respect to accounts opened to facilitate transactions cleared and settled via Fund/SERV. The Q&A makes clear that the intermediary that opens an account with a mutual fund through the NSCC Fund/SERV system would be the fund's customer for purposes of the CIP rule and the intermediary's customers would not be the fund's customers. In addition, also consistent with the Institute's views, the Q&A makes no distinction based on whether the account is subject to a Networking arrangement. The third and fourth questions provide guidance on issues not raised by the Institute. The third Q&A states that the SEC staff would not object to a mutual fund's closing of an account and redemption of an investor's shares after reasonable efforts to verify his or her identity have failed, if the shares are valued in accordance with the net asset value next calculated after the mutual fund decides to close the account. The Q&A notes also that a mutual fund may want to consider whether the circumstances surrounding the failure to verify the customer's identity would warrant the filing of a Suspicious Activity Report (SAR). The fourth Q&A clarifies that mutual funds must obtain board approval of their CIPs by October 1, 2003. The Q&A states, however, that SEC and Treasury staff would not object if the fund were to obtain approval by a committee of the board by that date, and obtain approval by the full board at the next regularly scheduled board meeting. Robert C. Grohowski Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 16428, or call the ICI Library at (202) 326-8304 and request the attachment for memo 16428. Attachment (in .pdf format)