

MEMO# 15551

January 15, 2003

TREASURY PROPOSES MUTUAL FUND SUSPICIOUS ACTIVITY REPORTING RULE

[15551] January 15, 2003 TO: BROKER/DEALER ADVISORY COMMITTEE No. 4-03 MONEY LAUNDERING RULES WORKING GROUP No. 3-03 SEC RULES COMMITTEE No. 7-03 TRANSFER AGENT ADVISORY COMMITTEE No. 4-03 RE: TREASURY PROPOSES MUTUAL FUND SUSPICIOUS ACTIVITY REPORTING RULE The Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has proposed a rule that would require mutual funds to report suspicious transactions. The proposed rule, an advance copy of which is attached, is briefly summarized below.¹ The Institute will hold a conference call of the Working Group to discuss the Institute's comments on the proposed rule. Information on that call will be sent to the Working Group in a separate memorandum. Summary of the Proposed Rule

Suspicious Transactions The proposed rule would require mutual funds² to report any suspicious transaction relevant to a possible violation of law or regulation. Under the proposal, a transaction would be reportable if: 1. It is conducted or attempted by, at, or through a mutual fund; 2. It involves or aggregates funds or other assets of at least \$5,000; and 3. 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): a. Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part 1 The proposed rule should be available on FinCEN's web site (http://www.fincen.gov/bsar_main.html) and published in the Federal Register shortly. 2 The proposed rule defines mutual funds as open-end investment companies registered or required to be registered with the Securities and Exchange Commission under the Investment Company Act of 1940. 2 of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation; b. Is designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act; c. 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 d. Involves use of the mutual fund to facilitate criminal activity. This is the same test adopted in the SAR rule for broker-dealers.³ The commentary accompanying the proposed rule states 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. The commentary notes that the rule is not intended to operate in a mechanical fashion, and thus, for example, transactions involving investments by the pension fund of a publicly traded corporation, even though involving a large dollar amount, would likely require a more limited scrutiny than less typical transactions such as those involving customers who wish to use currency or money orders to purchase mutual fund

shares, even though the dollar amounts in those latter cases may be relatively small. Also, footnote 26 addresses omnibus accounts by stating: In the case of a transaction conducted through an omnibus account maintained by an intermediary, a mutual fund may not know, suspect, or have reason to suspect that the transaction is one for which reporting would be required, because a fund typically has little or no information about individual customers represented in an omnibus account. Omnibus accounts are, however, usually maintained by a person, such as a broker-dealer, that has a reporting obligation. The omnibus account holder (i.e., the financial intermediary) is itself a customer of the mutual fund for purposes of the proposed rule. SARs The proposed rule would permit a single report to satisfy the reporting obligations of all of the mutual funds involved in a particular transaction, as well as any service providers to the fund(s) that have their own reporting obligations, such as a principal underwriter to the funds, as long as the report contains all of the relevant facts. 3 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) (the “B-D SAR Rule”). 3 The proposed rule would appear to require mutual funds to report suspicious transactions on Form SAR-SF, the same form used by broker-dealers. Reports would have to be made within 30 days after the mutual fund becomes aware of a suspicious transaction. The proposed rule would allow funds that do not identify a suspect on the date of the initial detection to delay filing for an additional 30 days. The proposed rule would require mutual funds to retain any filed SAR-SFs and any supporting documentation for five years. Delegation The commentary accompanying the proposed rule states that it is permissible for a mutual fund to contractually delegate performance of the reporting obligation to an affiliated or unaffiliated service provider, such as a transfer agent. It further states, however, that the fund remains responsible for assuring compliance with the rule and must actively monitor the procedures for reporting suspicious transactions. Non-Disclosure Provisions Consistent with the SAR rules for broker-dealers and banks, the proposed rule prohibits mutual funds filing SAR-SFs from making any disclosure, except to law enforcement and regulatory agencies, about either the reports themselves or supporting documentation. The commentary accompanying the proposed rule states that this would 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), suspicious activity involving a transaction with which the mutual funds have been involved, or the determination of which mutual fund will file a SAR-SF in such a case. Safe Harbor Like the bank and broker-dealer SAR rules, the proposed rule includes a safe harbor that protects any mutual fund and any director, trustee, officer, employee or agent of a mutual fund from civil liability for reporting suspicious activity. Effective Date The proposed rule includes an effective date 180 days after the publication of a final rule in the Federal Register. Robert C. Grohowski Associate Counsel Attachment (in .pdf format)

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