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SUPPLEMENTARY INFORMATION:

I. Background

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (Pub. L. 107–56) (the Act). Title III of the Act makes a number of amendments to the anti-money laundering provisions of the Bank Secrecy Act (BSA), which are codified in subchapter II of chapter 53 of title 31, United States Code. These amendments are intended to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism.

Section 352(a) of the Act, which became effective on April 24, 2002, amended section 5318(h) of the BSA. As amended, section 5318(h)(1) requires every financial institution to establish an anti-money laundering program that includes, at a minimum: (i) The development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test programs. Section 5318(h)(2) authorizes the Secretary of the Treasury (Secretary), after consulting with the appropriate Federal functional regulator,¹ to prescribe minimum standards for anti-money laundering programs, and to exempt from the application of those standards any financial institution that is not subject to BSA regulation.

Commodity trading advisors (CTAs) that are registered or required to register with the CFTC are defined as “financial institutions” under the BSA.² CTAs, as well as futures commission merchants and commodity pool operators (CPOs), which are also CFTC registrants, were added to the statutory definition of “financial institution” by the Act,³ and thus are subject to the BSA’s anti-money laundering program requirements. Previously, Treasury and FinCEN temporarily exempted certain financial institutions, including CTAs and CPOs, from the requirement that they establish anti-money laundering programs.⁴ In

addition, FinCEN has issued interim final rules for numerous types of financial institutions⁵ and proposed rules for other financial institutions,⁶ and is studying how to design such standards for numerous other types of financial institutions.

FinCEN, in this proposed rule, identifies and defines those CTAs that will be subject to the requirement that financial institutions have anti-money laundering programs, and sets forth minimum requirements for an anti-money laundering program for these entities that are based on the minimum standards set forth in BSA section 5318(h)(1).

FinCEN also is proposing today a similar rule for investment advisers, which is published elsewhere in this issue of the **Federal Register**.

II. Money Laundering and Commodity Trading Advisors

Money laundering occurs when money from illegal activity is moved through the financial system in such a way as to make it appear that the funds came from legitimate sources. Money laundering usually involves three stages: the placement, layering, and integration stages. In the placement stage, cash or cash equivalents are placed into the financial system. In the layering stage, the money is transferred or moved to other accounts through a series of financial transactions designed to obscure the origin of the money. Finally, in the integration stage, the funds are reintroduced into the economy so that the funds appear to have come from legitimate sources. The crime of money laundering also encompasses the movement of funds to support terrorism or terrorist organizations.⁷ These funds may be from illegitimate or legitimate sources. Even where the funds derive from legitimate sources, their movement may follow the money laundering pattern described above in order to disguise the identity of the originator of the funds.

Commodity futures and options accounts are vehicles that could be used to launder illicit funds. CTAs who

direct such accounts are in a unique position to observe activity that may be indicative of money laundering. As such, they need to be aware of what types of activity may indicate potential money laundering or terrorist financing and implement a compliance program designed, among other things, to deter and detect such activity.⁸

III. Section-by-Section Analysis

A. Definition of Commodity Trading Advisor

Section 103.133(a)(1) of the proposed rule defines “commodity trading advisor” as any person registered or required to be registered with the CFTC as a CTA under the Commodity Exchange Act (CEA)⁹ and that directs client commodity futures or options accounts. Section 103.133(a)(2) defines “directs” in this context based upon the definition of “direct” in the CFTC’s regulations.¹⁰

The CEA defines a CTA generally as any person who, for compensation or profit, engages in the business of advising others, either directly or indirectly, as to the value or advisability of trading futures contracts or commodity options authorized under the CEA, or issues analyses or reports concerning trading futures or commodity options.¹¹ CTAs are required to register with the CFTC,¹² although there are a limited number of

⁸ 18 U.S.C. 1956 and 1957 make it a crime for any person, including an individual or company, to engage knowingly in a financial transaction with the proceeds from any of a long list of crimes or “specified unlawful activity.” Although the standard of knowledge required is “actual knowledge,” actual knowledge includes “willful blindness.” Thus, a person could be deemed to have knowledge that proceeds were derived from illegal activity if he or she ignored “red flags” that indicated illegality.

⁹ 7 U.S.C. 1 *et seq.*

¹⁰ CFTC Rule 4.10(f), 17 CFR 4.10(f), provides that the term “direct” refers to “agreements whereby a person is authorized to cause transactions to be effected for a client’s commodity interest account without the client’s specific authorization.” CFTC Rule 4.10(a), 17 CFR 4.10(a), defines “commodity interest” as “(1) any contract for the purchase or sale of a commodity for future delivery; and (2) any contract, agreement or transaction subject to [CFTC] regulation under section 4c or 19 of the [CEA].”

¹¹ The CEA defines the term “commodity trading advisor” as “any person who * * * for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in” futures or commodity options, or who “for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports” concerning trading in futures or commodity options. 7 U.S.C. 1a(6).

¹² 7 U.S.C. 6m. According to the National Futures Association (NFA), the self-regulatory organization for the futures industry, as of January 31, 2003 there were 2,734 CTAs registered with the CFTC.

⁵ *Anti-Money Laundering Programs for Financial Institutions*, 67 FR 21110 (April 29, 2002); *Anti-Money Laundering Programs for Mutual Funds*, 67 FR 21117 (April 29, 2002); *Anti-Money Laundering Programs for Money Services Businesses*, 67 FR 21114 (April 29, 2002); *Anti-Money Laundering Programs for Operators of a Credit Card System*, 67 FR 21121 (April 29, 2002).

⁶ *Anti-Money Laundering Programs for Unregistered Investment Companies*, 67 FR 60617 (Sept. 26, 2002); *Anti-Money Laundering Programs for Insurance Companies*, 67 FR 60625 (Sept. 26, 2002); *Anti-Money Laundering Programs for Dealers in Precious Metals, Stones, or Jewels*, 68 FR 8480 (Feb. 21, 2003).

⁷ 18 U.S.C. 1956, 2339A and 2339B.

¹ The Federal functional regulator for commodity trading advisors is the Commodity Futures Trading Commission (CFTC).

² 31 U.S.C. 5312(c).

³ Section 321(b).

⁴ See 31 CFR 103.170, 67 FR 67547 (Nov. 6, 2002).