

B. Overview of Comments Received

On July 23, 2002, Treasury and the SEC jointly proposed a rule to implement section 326 with respect to mutual funds.¹¹ Treasury and the SEC proposed general standards that would require each mutual fund to design and implement a customer identification program (CIP) tailored to the mutual fund's size, location, and type of business. The proposed rule also included certain specific standards that would be mandated for all mutual funds.

Treasury and the SEC received eight comments in response to the proposal.¹² Commenters included investment companies, a financial services holding company, a registered investment adviser, a transfer agent, trade associations, and a company engaged in the sale of technologies and services used to locate persons and authenticate identities. Commenters generally supported the proposal but suggested revisions.

Two commenters agreed with the largely risk-based approach set forth in the proposal, which allows each mutual fund to develop a CIP based on its specific operations, taking into consideration variables such as size and type of business. Five commenters suggested that the final rule make greater use of a risk-based approach, in lieu of specific identification and verification requirements. They suggested that such a comprehensively risk-based approach would give mutual funds appropriate discretion to focus efforts and resources on the high-risk

accounts that are most likely to be used by money launderers and terrorists. All of the commenters recommended that the final rule include more specific requirements addressing the risks presented by particular situations.¹³ Seven of the eight commenters suggested that we had underestimated the burdens that would be imposed by certain elements of the proposal. Three commenters suggested that mutual funds be given greater flexibility when dealing with established customers and be permitted to rely on identification and verification of customers performed by third parties, including other funds in the same fund complex.

All of the commenters asked for additional guidance concerning one or more elements of the proposed rule. Six commenters requested guidance regarding the requirement to check government lists of known and suspected terrorists and terrorist organizations. Four commenters requested guidance concerning the proposal to require notice to customers that the mutual fund is requesting information to verify the customer's identity. Seven commenters requested that the final rule contain a delayed implementation date in order to provide mutual funds with sufficient time to design CIPs, obtain board approval, alter existing policies and procedures, forms, and software, and train staff.

We have modified the proposed rule in light of these comments. The section-by-section analysis that follows discusses the comments and the modifications that we have made to the rule.

C. Codification of the Joint Final Rule

The final rule is being issued jointly by Treasury, through FinCEN, and by the SEC. The substantive requirements of this joint final rule are being codified as part of Treasury's BSA regulations located in 31 CFR Part 103. In addition, to provide a reference to the joint final rule in the SEC regulations for investment companies, the SEC is concurrently publishing a provision in its own regulations in 17 CFR Part 270 that cross-references this final rule.¹⁴

D. Compliance Date

Six commenters requested that mutual funds be given adequate time to develop and implement the requirements of any final rule implementing section 326. The transition periods suggested by

commenters ranged from 90 days to 12 months after the publication of a final rule.

The final rule modifies various aspects of the proposed rule and eliminates some of the requirements that commenters identified as being most burdensome. Nonetheless, we recognize that some mutual funds will need time to develop a CIP, obtain board approval, and implement the CIP, which will include various measures, such as training staff, reprinting forms, and developing new software. Accordingly, although this rule will be effective 30 days after publication, mutual funds will have a transition period to implement the rule. Treasury and the Commission have determined that each mutual fund must fully implement its CIP by October 1, 2003.

II. Section-by-Section Analysis

Section 131(a) Definitions

Section 103.131(a)(1) Account. We proposed to define "account" as any contractual or other business relationship between a customer and a mutual fund established to effect financial transactions in securities, including the purchase or sale of securities.¹⁵ The final rule limits the definition of "account" to relationships between a person and a mutual fund that are established to effect *transactions in securities issued by the mutual fund* in order to clarify that the purchase or sale of a mutual fund's underlying portfolio securities does not establish an "account" for purposes of this rule.¹⁶

The proposed rule stated that transfers of accounts from one mutual fund to another are outside the definition of "account" for purposes of

¹¹ Proposed rule, *supra* note 1. Treasury simultaneously published (1) jointly with the banking agencies, a proposed rule applicable to banks (as defined in 31 CFR 103.11(c)) and foreign branches of insured banks; (2) a proposed rule applicable to credit unions, private banks and trust companies that do not have a federal functional regulator; (3) jointly with the SEC, a proposed rule applicable to broker-dealers; and (4) jointly with the CFTC, a proposed rule applicable to futures commission merchants and introducing brokers. Customer Identification Programs for Banks, Savings Associations, and Credit Unions, 67 FR 48290 (July 23, 2002); Customer Identification Programs for Certain Banks (Credit Unions, Private Banks and Trust Companies) That Do Not Have a Federal Functional Regulator, 67 FR 48299 (July 23, 2002); Customer Identification Programs for Broker-Dealers, 67 FR 48306 (July 23, 2002); Customer Identification Programs for Futures Commission Merchants and Introducing Brokers, 67 FR 48328 (July 23, 2002). Treasury, the Commission, the CFTC, and the banking agencies received approximately five hundred comments in response to these proposed rules. Many of those commenters raised issues similar to those we received in connection with the proposal respecting mutual fund customer identification programs.

¹² The comment letters are available for public inspection and copying in the SEC's Public Reference Room, 450 5th Street, N.W., Washington, DC (File No. S7-26-02).

¹³ For example, two commenters suggested that the rule exclude accounts opened by participants in qualified retirement plans or other qualified benefit plan customers.

¹⁴ 17 CFR 270.0-11.

¹⁵ See proposed § 103.131(a)(1).

¹⁶ See § 103.131(a)(1)(i). Three commenters suggested that the definition of "account" be limited to formal ongoing relationships, as in the CIP rules proposed by Treasury and the banking agencies. These commenters suggested that, as proposed, the definition could be read to include isolated transactions where an account relationship with the mutual fund is not established. Treasury and the banking agencies proposed to limit the definition of "account" to "ongoing transactions" to specifically address situations where a person obtains certain services or products from a bank such as cashing or buying a check or purchasing a wire transfer or money order. The final rules being issued by the Treasury and the banking agencies do not include the term "ongoing" in their definitions of "account." Instead, their definitions of "account" now specifically exclude these types of products or services and any others where a "formal banking relationship" is not established with a person. Mutual funds do not offer these types of products or services to persons who are not fund shareholders. Thus, we did not include the term "ongoing" in the definition of account or adopt the specific exclusions included in the bank rules.