

under their own authority.<sup>20</sup> The bank supervisory agency rules apply to banks, bank holding companies, and non-depository institution affiliates and subsidiaries of banks and bank holding companies. Money services businesses have been required to report suspicious transactions to the Department of the Treasury since the beginning of 2002. In July 2002, FinCEN took a further step in the creation of a comprehensive system for the reporting of suspicious transactions by the major categories of financial institutions operating in the United States, by requiring brokers and dealers in securities to report suspicious transactions.<sup>21</sup> In October 2002, FinCEN issued a final rule requiring casinos to report suspicious transactions. The proposed rule contained in this document would extend this requirement to mutual funds. Suspicious transaction reporting by mutual funds can provide highly useful information in law enforcement and regulatory investigations and proceedings, and in the conduct of intelligence activities to protect against international terrorism.<sup>22</sup>

## II. Specific Provisions

### A. 103.15(a)—Reports by Mutual Funds of Suspicious Transactions

Section 103.15(a) contains the rules setting forth the obligation of mutual funds to report suspicious transactions that are conducted or attempted by, at, or through a mutual fund and involve or aggregate at least \$5,000 in funds or other assets. It is important to recognize that the obligation to report a transaction under this rule and 31 U.S.C. 5318(g) would apply whether or not the transaction involves currency.<sup>23</sup> Treasury is aware that the use of currency by mutual funds is rare.

The obligation extends to transactions conducted or attempted by, at, or through, the mutual fund. However,

paragraph (a) also contains language designed to encourage the reporting of transactions that appear relevant to violations of law or regulation, even in cases in which the rule does not explicitly so require (for example, in the case of a transaction falling below the \$5,000 threshold in the rule).

Section 103.15(a) contains the general statement of the obligation to file reports. To clarify that the proposed rule creates a reporting requirement that is uniform with that for other financial institutions, the language of the reporting obligation incorporates language from the suspicious activity reporting rules applicable to other financial institutions, such as banks, casinos, and money services businesses, requiring the reporting of “any suspicious transaction relevant to a possible violation of law or regulation.” Furthermore, a mutual fund may also report “any suspicious transaction that it believes is relevant to a possible violation of any law or regulation but whose reporting is not required” by the proposed rule. For example, a mutual fund may report a suspected violation of law that involves less than \$5,000. Such voluntary reporting would be subject to the same protection from liability as mandatory reporting, pursuant to 31 U.S.C. 5318(g)(3).

The proposed rule requires reporting by mutual funds, but not by affiliated persons of mutual funds. Some affiliates, such as broker-dealers, are subject to their own reporting rule. Others may be subject to future rules.

Mutual funds typically conduct many operations through separate entities, which may or may not be affiliated persons of the mutual fund. Personnel of these separate entities may be in the best position to perform the reporting obligation. It is permissible for a mutual fund to contractually delegate performance of the reporting obligation to another affiliated or unaffiliated service provider, such as a transfer agent. The mutual fund, however, remains responsible for assuring compliance with the rule, and must actively monitor the procedures for reporting suspicious transactions.

Section 103.15 (a)(2) specifies that the proposed rule requires the reporting of suspicious transactions that involve or aggregate at least \$5,000 in funds or other assets. The suspicious transaction reporting rules, however, are not intended to operate (and indeed cannot properly operate) in a mechanical fashion. Rather, the suspicious transaction reporting requirements are intended to function in such a way as to have financial institutions evaluate

customer activity and relationships for money laundering risks.<sup>24</sup>

Section 103.15(a)(2) specifies four categories of transactions that require reporting if the mutual fund knows, suspects, or has reason to suspect that any such category applies to a transaction, or a pattern of transactions of which the transaction is a part. The “knows, suspects, or has reason to suspect” standard incorporates a concept of due diligence in the reporting requirement.

The first category, described in proposed section 103.15(a)(2)(i), includes transactions involving funds derived from illegal activity, or intended or conducted in order to hide or disguise funds derived from such illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation. The second category, described in section 103.15(a)(2)(ii), includes transactions designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act. The third category, described in section 103.15(a)(2)(iii), includes transactions that appear to serve no business or apparent lawful purposes, and for which the mutual fund knows of no reasonable explanation after examining the available facts relating to the transaction and the parties. The fourth category, described in section 103.15(a)(2)(iv), includes any other transactions that involve the use of the mutual fund to facilitate criminal activity.<sup>25</sup>

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.<sup>26</sup> Different fact patterns will

<sup>24</sup> 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.

<sup>25</sup> The fourth reporting category has been added to the suspicious activity reporting rules promulgated since the passage of the USA Patriot Act to make it clear that the requirement to report suspicious activity encompasses the reporting of transactions in which legally derived funds are used for criminal activity, such as the financing of terrorism.

<sup>26</sup> 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,

<sup>20</sup> See 12 CFR 21.11 (issued by the Office of the Comptroller of the Currency); 12 CFR 208.62 (issued by the Board of Governors of the Federal Reserve System); 12 CFR 353.3 (issued by the Federal Deposit Insurance Corporation); 12 CFR 563.180 (issued by the Office of Thrift Supervision); 12 CFR 748.1 (issued by the National Credit Union Administration).

<sup>21</sup> See 67 FR 44048 (July 1, 2002).

<sup>22</sup> See 31 U.S.C. 5311 (stating purpose of the reporting authority under the Bank Secrecy Act).

<sup>23</sup> Many currency transactions are *not* indicative of money laundering or other violations of law, a fact recognized both by Congress, in authorizing reform of the currency transaction reporting system, and by FinCEN, in issuing rules to implement that system (see 31 U.S.C. 5313(d) and 31 CFR 103.22(d), 63 FR 50147 (September 21, 1998)). Many non-currency transactions, (for example, fund transfers) *can* indicate illicit activity, especially in light of the breadth of the statutes that make money laundering a crime. See 18 U.S.C. 1956 and 1957.