(g) *Lack of verification.* The CIP shall include procedures for responding to circumstances in which the broker-dealer cannot form a reasonable belief that it knows the true identity of a customer.

(h) *Recordkeeping.* The CIP shall include procedures for making and retaining a record of all information obtained pursuant to the CIP.

(1) *Required records.* At a minimum, the CIP shall require the broker-dealer to make the following records:

(i) All identifying information provided by a customer pursuant to paragraph (c) of this section, and copies of any documents that were relied on pursuant to paragraph (d)(1) of this section that accurately depict the types of documents and any identification numbers they may contain;

(ii) The methods and results of any measures undertaken to verify the identity of a customer pursuant to paragraph (d)(2) of this section; and

(iii) The resolution of any discrepancy in the identifying information obtained.

(2) *Retention of records.* The broker-dealer must retain all records made or obtained when verifying the identity of a customer pursuant to its CIP until five years after the date the account of the customer is closed or the grant of authority to effect transactions with respect to an account is revoked. In all other respects, the records shall be maintained pursuant to the provisions of 17 CFR 240.17a-4.

(i) *Approval of CIP.* The CIP shall be approved by the broker-dealer's board of directors, managing partners, board of managers or other governing body performing similar functions or by a person or persons specifically authorized by such bodies to approve the CIP.

(j) *Exemptions.* The Commission, with the concurrence of the Secretary, may by order or regulation exempt any broker-dealer that registers with the Commission pursuant to 15 U.S.C. 78o (except broker-dealers that register under subsection (b)(11) of that section) or 15 U.S.C. 78o-4 or type of account from the requirements of this section. The Secretary, with the concurrence of the Commission, may exempt any broker-dealer that registers with the Commission pursuant to 15 U.S.C. 78o-5. In issuing such exemptions, the Commission and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act, and in the public interest, and may consider other necessary and appropriate factors.

Dated: July 15, 2002.

James F. Sloan,

Director, Financial Crimes Enforcement Network.

Dated: July 12, 2002.

By the Securities and Exchange Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–18192 Filed 7–22–02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC–25657; File No. S7–26–02]

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506–AA33

Customer Identification Programs for Mutual Funds

AGENCIES: Financial Crimes Enforcement Network, Treasury; Securities and Exchange Commission.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the Securities and Exchange Commission are jointly issuing a proposed regulation to implement Section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act). Section 326 requires the Secretary of the Treasury to jointly prescribe with the Securities and Exchange Commission a regulation that, at a minimum, requires investment companies to adopt and implement reasonable procedures to verify the identity of any person seeking to open an account, to the extent reasonable and practicable; maintain records of the information used to verify the person's identity; and determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to investment companies by any government agency. The proposed rule would apply to investment companies that are mutual funds.

DATES: Written comments on the proposed rule should be submitted to the Treasury Department and the Securities and Exchange Commission on or before September 6, 2002.

ADDRESSES: Because paper mail in the Washington area may be subject to delay, commenters are encouraged to e-mail comments. Comments should be sent by one method only.

Treasury: Comments may be mailed to FinCEN, Section 326 Mutual Fund Rule Comments, P.O. Box 39, Vienna, VA 22183, or sent to Internet address *regcomments@fincen.treas.gov* with the caption ''Attention: Section 326 Mutual Fund Rule Comments'' in the body of the text. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m. in the FinCEN Reading Room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354–6400 (not a toll-free number).

Securities and Exchange Commission: Comments also should be submitted in triplicate to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. Comment letters should refer to File No. S7–26–02; this file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549–0102. Electronically submitted comment letters will be posted on the Commission's Internet web site *(http://www.sec.gov).* Personal, identifying information, such as names or E-mail addresses, is not deleted from electronic submissions. Submit only information you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: *Securities and Exchange Commission:* Division of Investment Management, Securities and Exchange Commission, (202) 942–0720.

Treasury: Office of the Chief Counsel (FinCEN), (703) 905–3590; Office of the Assistant General Counsel for Enforcement (Treasury), (202) 622–1927; or the Office of the Assistant General Counsel for Banking & Finance (Treasury), (202) 622–0480.

SUPPLEMENTARY INFORMATION:

I. Background

A. Section 326 of the USA PATRIOT Act

On October 26, 2001, President Bush signed into law the USA PATRIOT Act.[1] Title III of the Act, captioned ''International Money Laundering Abatement and Anti-terrorist Financing Act of 2001,'' adds several new provisions to the Bank Secrecy Act (''BSA''), 31 U.S.C. 5311 *et seq.* These provisions are intended to facilitate the

[1] Pub. L. 107–56.

prevention, detection, and prosecution of international money laundering and the financing of terrorism.

Section 326 of the Act adds a new subsection (l) to 31 U.S.C. 5318 that requires the Secretary of the Treasury (''Secretary'') to prescribe regulations setting forth minimum standards for financial institutions and their customers that relate to the identification and verification of any person who applies to open an account. Section 326 provides that the regulations must require, at a minimum, financial institutions to implement reasonable procedures for: (1) Verifying the identity of customers, to the extent reasonable and practicable, when accounts are opened; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. In prescribing these regulations, the Secretary is directed to take into consideration the various types of accounts maintained by various types of financial institutions, the various methods of opening accounts, and the various types of identifying information available. Final regulations implementing Section 326 must be effective by October 25, 2002.

Section 326 applies to all ''financial institutions.'' This term is defined very broadly in the BSA to encompass a variety of entities including investment companies, banks, agencies and branches of foreign banks in the United States, thrifts, credit unions, brokers and dealers in securities or commodities, insurance companies, travel agents, pawnbrokers, dealers in precious metals, check-cashers, casinos, and telegraph companies, among many others. *See* 31 U.S.C. 5312(a)(2).[2]

Although the BSA includes ''an * * * investment company'' among the entities defined as financial institutions, Treasury has not previously defined the term for purposes of the BSA.[3] The Investment Company Act of 1940 (codified at 15 U.S.C. 80a–1, *et seq.*) (''1940 Act'') defines investment company broadly and subjects those entities to comprehensive regulation by the Commission.[4] However, privately offered entities commonly known as hedge funds, private equity funds and venture capital funds typically rely on exclusions from the 1940 Act definition of investment company.[5] For purposes of the Section 326 requirement, the scope of this proposed rule is limited to those entities that are required to register with the Commission as investment companies and that fall within the category of ''open-end company'' contained in section 5(a)(1) of the 1940 Act.[6] These entities are commonly referred to as ''mutual funds.''[7]

Regulations governing the applicability of Section 326 to other financial institutions, such as broker-dealers and those institutions regulated by the banking agencies, are being issued separately. Treasury, the Commission, the CFTC and the banking agencies consulted extensively in the development of all rules implementing Section 326 of the Act. All of the participating agencies intend the effect of the rules to be uniform throughout the financial services industry.[8]

The Secretary has determined that the records required to be kept by Section 326 of the Act have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, to protect against international terrorism.

B. Codification of the Joint Proposed Rule

The substantive requirements of the joint proposed will be codified with other Bank Secrecy Act regulations as part of Treasury's regulations in 31 CFR part 103. To minimize potential confusion by affected entities regarding the scope of the joint proposed rule, the Commission is also proposing to add a provision in its own regulations in 17 CFR part 270 that will cross-reference the regulations in 31 CFR part 103. Although no specific text is being proposed at this time, the cross-reference will be included in a final rule published by the Commission concurrently with the joint final rule issued by Treasury and the Commission implementing section 326 of the Act.

II. Section-by-Section Analysis

A. Section 103.131(a) Definitions

(1) *Account.* The proposed rule's definition of ''account'' is intended to include all types of securities accounts maintained by mutual funds. This includes each account at a mutual fund.

(2) *Commission* means the United States Securities and Exchange Commission.

(3) *Customer.* The proposed rule defines ''customer'' as any shareholder

[2] For any financial institution engaged in financial activities described in section 4(k) of the Bank Holding Company Act of 1956 (section 4(k) institutions), the Secretary is required to prescribe the regulations issued under section 326 jointly with the Securities and Exchange Commission (''Commission''), the Commodity Futures Trading Commission (''CFTC''), and the banking agencies (''banking agencies''), namely, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration.

[3] 31 U.S.C 5312(a)(2)(I).

[4] Section 3(a)(1) defines ''investment company'' as any issuer which—

(A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

[5] *E.g.,* Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. Section 356 of the Act requires that the Secretary, the Board of Governors of the Federal Reserve System and the Commission jointly submit a report to Congress, not later than October 26, 2002, on recommendations for effective regulations to apply the requirements of the BSA to investment companies as defined in section 3 of the 1940 Act, including persons that, but for the provisions that exclude entities commonly known as hedge funds, private equity funds, and venture capital funds, would be investment companies.

[6] Other types of investment companies regulated by the Commission include closed-end companies and unit investment trusts. Closed-end companies typically sell a fixed number of shares in traditional underwritten offerings. Holders of closed-end company shares then trade their shares in secondary market transactions, usually on a securities exchange or in the over-the-counter market. Unit investment trusts are pooled investment entities without a board of directors or investment adviser that offer investors redeemable units in an unmanaged, fixed portfolio of securities. The Secretary and the Commission will continue to consider whether a CIP requirement would be appropriate for the issuers of these products, or whether they are effectively covered by the CIP requirements of other financial institutions involved in their distribution (e.g., broker-dealers).

[7] By interim rule published on April 29, 2002, Treasury required that mutual funds adopt anti-money laundering programs pursuant to Section 352 of the Act. 67 FR 21117 (April 29, 2002). Treasury temporarily exempted investment companies other than mutual funds from the requirement that they establish anti-money laundering programs and temporarily deferred determining the definition of ''investment company'' for purposes of the BSA. *Id.* However, it is likely that some of the entities excluded from the definition of ''investment company'' in the 1940 Act will be required to establish anti-money laundering programs and customer identification programs pursuant to sections 352 and 326 of the Act.

[8] Section 314(c) of the Act provides that: ''Compliance with the provisions of this title requiring or allowing financial institutions and any association of financial institutions to disclose or share information regarding individuals, entities, and organizations engaged in or suspected of engaging in terrorist acts or money laundering activities shall not constitute a violation of the provisions of title V of the Gramm-Leach-Bliley Act (Public Law 106–102).''

of record who opens a new account with a mutual fund and any person granted authority to effect transactions in the shareholder of record's account with a mutual fund. Under this definition, a shareholder of record prior to the effective date of the regulation would not be a ''customer.'' However, such a person becomes a ''customer'' if the person becomes a shareholder of record or is granted trading authorization in a different account after the effective date. Moreover, a person becomes a ''customer'' each time they open a different type of account. For example, after the effective date, if a person opens a taxable account and subsequently opens an IRA account, the person is a ''customer'' subject to the requirements of this rule on both occasions.[9] However, a shareholder who exchanges shares of one fund for shares of another fund within the same account (or initiates any other transaction that does not involve the opening of a separate account) does not become a ''customer'' for the purpose of this rule.

A person with trading authority prior to the effective date of the regulation is not a ''customer.'' However, any person granted trading authority after the effective date is a customer. This is true even if the person is granted authority with respect to an account that existed prior to the effective date or the person had been granted authority for another account prior to the effective date.

The requirements of Section 326 apply to any person who opens a new account or is granted trading authority for an account, but do not apply to persons seeking information about a mutual fund such as a request for a prospectus or profile. In addition, transfers of accounts from one mutual fund to another that are not initiated by the customer (*e.g.,* as a result of a merger, acquisition, or purchase of assets) fall outside of the scope of Section 326, and are not covered by the proposed regulation.[10]

(4) *Mutual Fund* means an entity that is required to register with the Commission as an ''investment company'' (as the term is defined in Section 3 of the 1940 Act) and that is an ''open-end company'' (as that term is defined in Section 5 of the 1940 Act).

(5) *Person.* The proposed regulation defines ''person'' as having the same meaning as that term is defined in section 103.11(z). Thus, the term includes natural persons, corporations, partnerships, trusts or estates, joint stock companies, associations, syndicates, joint ventures, any unincorporated organizations or groups, Indian Tribes, and all entities cognizable as legal entities.

(6) *Taxpayer identification number.* The proposed rule defines ''taxpayer identification number'' to have the same meaning as determined under the provisions of section 6109 of the Internal Revenue Code and the regulations of the Internal Revenue Service thereunder.

(7) *U.S. person.* The proposed rule defines ''U.S. person'' as a U.S. citizen or, for persons other than natural persons, an entity established or organized under the laws of a State or the United States.[11] A non-U.S. person is a person who does not satisfy these criteria.

B. Section 103.131(b) Customer Identification Program

Section 326 requires the Secretary and the Commission to prescribe regulations requiring mutual funds to adopt and implement ''reasonable procedures'' for: verifying the identity of customers ''to the extent reasonable and practicable;'' maintaining records associated with such verification; and consulting lists of known terrorists.

Paragraph (b) of the proposed rule sets forth the requirement that mutual funds must develop and operate a customer identification program (''CIP'') and sets forth relevant factors for the design of CIP procedures.[12] The degree to which a CIP is effective will be a function of a mutual fund's assessment of these factors and the nature of its response to them (as manifested in the CIP's procedures and guidelines). In addition, as Section 326 and the proposed rule provide, the reasonableness of the CIP also will be a function of what is practicable for the mutual fund.

In developing and updating CIPs, mutual funds should consider the type of identifying information available for customers and the methods available to verify that information. While certain minimum identifying information is required in paragraph (c) of this proposed rule and certain suitable verification methods are described in paragraph (d), mutual funds should consider on an on-going basis whether other information or methods are appropriate, particularly as they become available in the future.

Mutual funds must also base their CIPs on the risks associated with their business operations. Some relevant risk factors to be considered are set forth in paragraph (b) and discussed below in general terms.[13]

The first risk factor to consider is the mutual fund's size. For example, a large mutual fund that opens a substantial number of accounts on any given day will have different risks than one that opens a much smaller number of new accounts.

The second risk factor is the method by which customers open accounts at the mutual fund. Accounts opened exclusively on-line present different, and perhaps greater, risks than those opened in-person on the firm's premises.

The third risk factor is the type of accounts offered by the mutual fund. Mutual funds should assess whether there are different risks (and degrees of risk) associated with the various types of accounts they provide to customers (*e.g.,* taxable, IRA, 401(k) and 403(b) accounts).

The fourth risk factor is the customer base. Mutual funds should assess the risks associated with different types of customers. For example, a mutual fund should examine whether it is opening accounts for customers located in countries the Secretary determines to be of ''primary money laundering concern'' pursuant to Section 311 of the Act. Verification procedures should account for the concerns raised by such customers. In addition, certain types of customers may pose greater risks (*e.g.,* individuals and certain types of business entities, such as closely held corporations, may pose a greater risk than institutional shareholders).

Because mutual funds typically conduct their operations through separate entities, which may or may not be affiliated, some elements of the CIP

[9] As discussed *infra,* this does not necessarily mean that a customer whose identity has been verified by a mutual fund must always have their identity verified every time they subsequently becomes a customer with respect to a different account.

[10] However, there may be situations involving the transfer of accounts where it would be appropriate for a mutual fund to verify the identity of customers associated with the accounts acquired by the mutual fund. Therefore, Treasury and the Commission expect procedures for transfers of accounts to be part of a mutual fund's overall anti-money laundering program required under section 352 of the Act.

[11] The terms ''State'' and ''United States'' are defined at 31 CFR 103.11.

[12] An interim rule issued by Treasury pursuant to Section 352 of the Act requires all mutual funds to establish anti-money laundering programs that, at a minimum, include (1) The development of internal policies, procedures, and controls; (2) the designation of a compliance officer; (3) an ongoing employee training program; and (4) an independent audit function to test programs. 67 FR 21117 (April 29, 2002). The proposed rule requires that the CIP be incorporated into a mutual fund's program established under Section 352. At the same time that it issued the interim rule under Section 352 of the Act, Treasury delegated to the Commission authority to examine mutual funds for compliance with Bank Secrecy Act regulations.

[13] This discussion of risk factors is not intended to be comprehensive or exhaustive.

will best be performed by personnel of these separate entities. It is permissible for a mutual fund to contractually delegate the implementation and operation of its CIP to another affiliated or unaffiliated service provider, such as a transfer agent. However, the mutual fund remains responsible for assuring compliance with this rule. Accordingly, the mutual fund must actively monitor the operation of its CIP program and assess its effectiveness.

A mutual fund's CIP does not have to include verification of individuals' identities whose transactions are conducted through an omnibus account. Typically, a fund has little or no identifying information for the individual customers represented in an omnibus account. For example, when fund shares are sold through a broker-dealer, the shareholders' accounts are opened at the broker-dealer. The broker-dealer obtains the identifying information about the customers. This rule does not require that a mutual fund obtain any additional information regarding the identities of individual shareholders who open their accounts through an omnibus accountholder. Of course, the omnibus account holder is itself a customer for purposes of this rule.[14]

Finally, paragraph (b) requires that the identity verification procedures must enable the mutual fund to form a reasonable belief that it knows the true identity of the customer. This provision makes clear that, while there is flexibility in establishing these procedures, the mutual fund is responsible for exercising reasonable efforts to ascertain the identity of each customer.

C. Section 103.131(c) Required Information

Paragraph (c) of the proposed regulation provides that a mutual fund's CIP must require customers to provide, at a minimum, certain identifying information before an account is opened for the customer or the customer is granted trading authority over an account. Specifically, the mutual fund must obtain each customer's: (1) Name, (2) date of birth, if applicable, (3) addresses,[15] and (4) identification number.[16]

The rule only specifies the minimum identifying information that must be obtained from each customer. Mutual funds, in assessing the risk factors in paragraph (b), should determine whether obtaining other identifying information is necessary to form a reasonable belief as to the true identity of each customer. There may be circumstances when a mutual fund should obtain additional identifying information. The CIP should set forth guidelines regarding what those circumstances are and what additional information should be obtained in such circumstances.

Treasury and the Commission recognize that a new business may need to open a mutual fund account before it has received an employer identification number (''EIN'') from the Internal Revenue Service. For this reason, the proposed regulation contains a limited exception to the requirement that an EIN be provided prior to establishing an account. Accordingly, in the case of person other than an individual (such as a corporation, partnership or trust) that has applied for, but has not received, an EIN, the EIN may be provided within a reasonable period of time after an account is established, provided that a copy of the EIN application is submitted to the mutual fund prior to the time the account is established. Currently, the IRS indicates that the issuance of an EIN can take up to five weeks. This length of time, coupled with when the entity applied for the EIN, should be considered by the mutual fund in determining the reasonable period of time within which the entity should provide its EIN to the mutual fund.

D. Section 103.131(d) Required Verification Procedures

After obtaining identifying information from a customer, the mutual fund must take steps to verify some, or all, of that information in order to form a reasonable belief that it knows the true identity of the customer. Accordingly, paragraph (d) of the proposed rule requires a mutual fund's CIP to have procedures for verifying identifying information provided by the customer. The mutual fund need not verify each piece of identifying information obtained pursuant to paragraph (c), if it is able to form a reasonable belief that it knows the customer's identity after verifying only certain of the information.

Paragraph (d) further requires that the verification procedures must be undertaken within a reasonable time before or after a customer's account is opened or a customer is granted authority to effect transactions with respect to an account. This flexibility must be exercised in a reasonable manner, given that verifications too far in advance may become stale and verifications too long after the fact may provide opportunities to launder money while verification is pending. The amount of time it will take a mutual fund to verify the identity of a customer may depend on the type of account opened, whether the customer opens the account in-person, and on the type of identifying information available. In addition, provided that the appropriate disclosure is made, a mutual fund may choose to place limits on the account, such as temporarily limiting additional purchases in an account until the customer's identity is verified. Therefore, the proposed rule provides mutual funds with the flexibility to use a risk-based approach to determine when the identity of a customer must be verified relative to the opening of an account or granting of trading authority.

A person becomes a customer each time they open a new account with a mutual fund. Therefore, upon the opening of each account, the verification requirements of this rule would apply. However, if a customer whose identification has been verified previously opens a new account, the mutual fund would not need to verify the customer's identity a second time, provided that the mutual fund continued to have a reasonable belief that it knew the true identity of the customer based on the previous verification.

The rule provides for two methods of verifying identifying information: verification through documents and/or verification through non-documentary means. For natural persons, suitable documents for verification include unexpired government-issued identification documents evidencing nationality or residence and bearing a

[14] This treatment of omnibus accounts is consistent with the legislative history of the Act which includes the following: [W]here a mutual fund sells its shares to the public through a broker-dealer and maintains a ''street name'' or omnibus account in the broker-dealer's name, the individual purchasers of the fund shares are customers of the broker-dealer, rather than the mutual fund. The mutual fund would not be required to ''look through'' the broker-dealer to identify and verify the identities of those customers. Similarly, where a mutual fund sells its shares to a qualified retirement plan, the plan, and not its participants, would be the fund's customers. Thus, the fund would not be required to ''look through'' the plan to identify its participants. H.R. Rep. 107–250, pt. 1, at 62(2001).

[15] With respect to addresses, each customer must provide a mailing address and, if different, the address of the customer's residence (if a natural person) or principal place of business (if not a natural person).

[16] If the customer is a U.S. person, he must provide a U.S. taxpayer identification number (*e.g.,* social security number or employer identification number). If the customer is a non-U.S. person, he must provide a U.S. taxpayer identification number, an alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. The term ''similar safeguard'' is included to permit the use of any biometric identifiers (*e.g.,* fingerprints) that may be used in addition to, or instead of, photographs.

photograph or similar safeguard. For non-natural persons, suitable documents must evidence the existence of the entity, such as registered articles of incorporation, a government-issued business license, a partnership agreement, or a trust instrument.

The proposed rule requires a mutual fund's CIP to address both methods of verification. Depending on the type of customer and the method of opening an account, it may be more appropriate to use either documents or non-documentary methods. In some cases, it may be appropriate to use both methods. The CIP should set forth guidelines describing when documents, non-documentary methods, or a combination of both will be used. These guidelines should be based on the mutual fund's assessment of the factors described in paragraph (b) of the proposed rule.

The risk a mutual fund will not know a customer's true identity will be heightened for certain types of accounts, such as accounts opened in the name of a corporation, partnership, or trust that is created, or conducts substantial business, in jurisdictions designated as primary money laundering concerns or designated as non-cooperative by an international body. Obtaining sufficient information to verify a given customer's identity can reduce the risk a mutual fund will be used as a conduit for money laundering and terrorist financing. A mutual fund's identity verification procedures must be based on its assessments of the factors in paragraph (b). Accordingly, when those assessments suggest a heightened risk, the mutual fund should utilize additional verification measures.

1. Verification Through Documents

Paragraph (d)(1) provides that the CIP must describe when a mutual fund will verify identity through documents and set forth the documents that will be used for this purpose. The rule also lists certain documents that are suitable for verification. For example, documentary verification could include obtaining a driver's license or passport from a natural person or articles of incorporation from a company.

2. Verification Through Non-documentary Methods

Paragraph (d)(2) provides that the CIP must describe non-documentary verification methods and when such methods will be employed in addition to, or instead of, verification through documents. The rule allows for the exclusive use of non-documentary methods because some accounts are opened by telephone, mail, or over the Internet. However, even if the customer presents identification documents, it may be appropriate to use non-documentary methods as well. Ultimately, the mutual fund is responsible for employing sufficient verification methods to be able to form a reasonable belief that it knows the true identity of the customer.

The proposed rule sets forth certain non-documentary methods that would be suitable for verifying identity. These methods include contacting a customer after the account is opened; obtaining a financial statement; comparing the identifying information provided by the customer against fraud and bad check databases to determine whether any of the information is associated with known incidents of fraudulent behavior; comparing the identifying information with information available from a trusted third-party source, such as a credit report from a consumer reporting agency; and checking references with other financial institutions. The mutual fund also may wish to analyze whether there is logical consistency between the identifying information provided, such as the customer's name, street address, ZIP code, telephone number (if provided), date of birth, and social security number.

Paragraph (d)(2) also provides that the CIP must require the use of non-documentary methods in certain cases; specifically, when a natural person is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard and when the mutual fund is presented with unfamiliar documents to verify the identity of a customer, does not obtain documents to verify the identity of a customer, does not meet face-to-face a customer who is a natural person, or is otherwise presented with circumstances that increase the risk the mutual fund will be unable to verify the true identity of a customer through documents.

Treasury and the Commission recognize that identification documents, including those issued by a government entity, may be obtained illegally and may be fraudulent. In light of the recent increase in identity fraud, mutual funds are encouraged to use non-documentary methods, even when a customer has provided identification documents.

E. Section 103.131(e) Government Lists

The proposed rule requires that a mutual fund's CIP must include reasonable procedures for determining whether a customer's name appears on any list of known or suspected terrorists or terrorist organizations prepared by any federal government agency and made available to the mutual fund. This requirement applies only with respect to lists circulated, directly provided, or otherwise made available by the Federal government. In addition, the proposed rule states that mutual funds must follow all Federal directives issued in connection with such lists. A mutual fund must have procedures for responding to circumstances when a customer is named on such a list.

F. Section 103.131(f) Customer Notice

Section 326 provides that financial institutions must give their customers notice of their identity verification procedures. Therefore, a mutual fund's CIP must include procedures for providing customers with adequate notice that the mutual fund is requesting information to verify their identities. A mutual fund may satisfy the notice requirement by generally notifying its customers about the procedures the fund must comply with to verify their identities. If an account is opened electronically, such as through an Internet website, the mutual fund may provide notice electronically. However, notice must be provided to the customer before the account is opened or trading authority is granted.

G. Section 103.131(g) Lack of Verification

Paragraph (g) of the proposed rule states that a mutual fund's CIP must include procedures for responding to circumstances in which it cannot form a reasonable belief that it knows the true identity of a customer. A mutual fund's CIP should specify the actions to be taken when it cannot form a reasonable belief that it knows the customer's true identity, which could include closing the account or placing limitations on additional purchases. There also should be guidelines for when an account will not be opened (*e.g.,* when the required information is not provided). In addition, the CIP should address the terms under which a customer may conduct transactions while the customer's identity is being verified. Mutual funds are also encouraged, but not required at this time, to adopt procedures for voluntarily filing Suspicious Activity Reports with FinCEN and for reporting suspected terrorist activities to FinCEN using its Financial Institutions Hotline (866–566–3974).

H. Section 103.131(h) Recordkeeping

Section 326 of the Act requires procedures for maintaining records of the information used to verify a person's identity, including name, address, and other identifying information. Paragraph

(h) of the proposed rule sets forth recordkeeping procedures that must be included in a mutual fund's CIP. These procedures must provide for the maintenance of all information obtained pursuant to the CIP. Information that must be maintained includes all identifying information provided by a customer pursuant to paragraph (c). Thus, the mutual fund must make a record of each customer's name, date of birth (if applicable), addresses, and identification numbers provided. Mutual funds also must maintain copies of any documents that were relied on pursuant to paragraph (d)(1) evidencing the type of document and any identification number it may contain. For example, if a customer produces a driver's license, the mutual fund must make a copy of the driver's license that clearly indicates it is a driver's license and legibly depicts any identification number on the license.

Mutual funds also must make and maintain records of the methods and results of measures undertaken to verify the identity of a customer pursuant to paragraph (d)(2). For example, if a mutual fund obtains a report from a credit bureau concerning a customer, the report must be maintained. Mutual funds also must make and maintain records of the resolution of any discrepancy in the identifying information obtained. To continue with the previous example, if the customer provides a residence address that is different than the address shown on the credit report, the mutual fund must document how it resolves this discrepancy or, if the discrepancy is not resolved, how it forms a reasonable belief that the mutual fund knows the true identity of the customer, notwithstanding the discrepancy.

The mutual fund must retain all of these records for five years after the date the account is closed. Nothing in this proposed regulation modifies, limits or supersedes Section 101 of the Electronic Records in Global and National Commerce Act, Public Law 106–229, 114 Stat. 464 (15 U.S.C. 7001) (''E-Sign Act''). Thus, a mutual fund may use electronic records to satisfy the requirements of this regulation in accordance with previously issued Commission guidance.[17]

Treasury and the Commission emphasize that the collection and retention of information about a customer, as an ancillary part of collecting identifying information, do not relieve a mutual fund from its obligations to comply with anti-discrimination laws or regulations.

I. Section 103.131(i) Approval of Program

Paragraph (i) of the proposed rule requires that the mutual fund's CIP be approved by its board of directors or trustees. The board should periodically assess the effectiveness of its CIP and should receive periodic reports regarding the CIP from the person or persons responsible for monitoring the fund's anti-money laundering program pursuant to 31 CFR 103.130(c)(3).

J. Section 103.131(j) Exemptions

Section 326 states that the Secretary and the Federal functional regulator jointly issuing the rule may by order or regulation exempt any financial institution or type of account from this regulation in accordance with such standards and procedures as the Secretary may prescribe. The proposed rule provides that the Commission, with the concurrence of the Secretary, may exempt any mutual fund or type of account from the requirements of this section. The Commission and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act, and in the public interest, and may consider other necessary and appropriate factors.

III. Request for Comments

Treasury and the Commission invite comment on all aspects of the proposed regulation, and specifically seek comment on the following issues:

1. Whether the proposed definition of ''account'' is appropriate and whether other examples of accounts should be added to the regulatory text.

2. How mutual funds can comply with the requirement to obtain both the address of a person's residence, and, if different, the person's mailing address in situations involving natural persons who lack a permanent address.

3. Whether non-U.S. persons that are not natural persons will be able to provide a mutual fund with the identifying information required in § 103.131(c)(4), or whether other categories of identifying information should be added to this section. Commenters on this issue should suggest other means of identification that mutual funds currently use or could use in this circumstance that would allow a mutual fund to form a reasonable belief that it knew the true identity of the entity.

4. The extent to which the verification procedures required by the proposed regulation will use information that mutual funds currently obtain in the account opening process. We note that the legislative history of Section 326 indicates that Congress intended ''the verification procedures prescribed by Treasury [to] make use of information currently obtained by most financial institutions in the account opening process.'' *See* H.R. Rep. No. 107–250, pt. 1, at 63 (2001).

IV. The Commission's Analysis of the Costs and Benefits Associated With the Proposed Rule

The Commission is considering the costs and benefits associated with the proposal and requesting comment on all aspects of this cost-benefit analysis, including identification and assessment of any other costs and benefits not discussed in the analysis. Commenters are encouraged to identify, discuss, analyze, and supply relevant data concerning the costs and benefits of the proposed rule's implementation of Section 326 requirements.

Section 326 of the Act requires Treasury and the Commission to prescribe regulations setting forth minimum standards for mutual funds regarding the identities of customers that shall apply in connection with the opening of an account. The statute also provides that the regulations issued by Treasury and the Commission must, at a minimum, require financial institutions to implement reasonable procedures for: (1) Verification of customers' identities; (2) determination of whether a customer appears on a government list; and (3) maintenance of records related to customer verification. The Commission believes that the requirements in the proposed rule are reasonable and practicable. Accordingly, the costs to mutual funds to (1) establish a CIP; (2) obtain certain identifying information from customers; (3) verify identifying information of customers; (4) check customers against lists provided by federal agencies, (5) provide notice to customers that information may be requested in the process of verifying their identities; and (6) make and maintain records related to the CIP are attributable to the statute.

While the Commission believes the costs are attributable to the statute, it nonetheless has undertaken an analysis of the costs and benefits of the requirements. The Commission seeks comment on whether the costs are attributable to the statute. The Commission also seeks comment on whether the proposed rule, by setting forth minimum requirements, creates a benefit or, conversely, imposes costs because mutual funds will not have to establish their own minimum requirements as required by the statute.

[17] *See* Investment Company Act Release No. 24991 (May 24, 2001) [66 FR 29224 (May 30, 2001)].

A. Benefits Associated With the Proposed Rule

The anti-money laundering provisions in the Act are intended to prevent, detect and prosecute money laundering and the financing of terrorism. The proposed rule is an important part of this effort. It requires mutual funds to establish a program for verifying the true identities of their customers, thereby reducing the risk that mutual funds will be unwittingly aiding criminals, including terrorists, in accessing U.S. financial markets to launder money or move funds for illicit purposes. Additionally, the implementation of such programs should make it more difficult for persons to successfully engage in fraudulent activities involving identity theft or the placing of fictitious orders to buy or sell securities. It is virtually impossible to quantify in monetary terms those benefits.

B. Costs Associated With the Proposed Rule

Section 326 of the Act and the proposed rule allows for great flexibility in developing CIPs. Given the considerable differences among mutual funds regarding their distribution channels, customers, and exposure to other relevant risk factors, it is difficult to quantify a cost per mutual fund. Most mutual funds already have some procedures in place for detecting fraud in the account opening process by looking for inconsistencies in the information provided by customers and/or checking customer names against certain databases. In those instances, the Section 326 requirements supplement those procedures.

Section 326 requirements will impose initial, one-time costs and ongoing costs on mutual funds. The costs associated with establishment of CIPs and modification of account applications (both paper and web-based applications) to require that customers provide the information required by the CIP and to provide the required notice regarding use of that information will primarily be initial, one-time costs.

Ongoing costs for mutual funds will be associated with the need to: (1) Collect the information required by the CIPs, (2) verify customers' identities, (3) determine whether customers appear on lists provided by federal agencies, and (4) make and maintain records related to CIPs. These ongoing costs will primarily be a function of the number of new accounts opened at a mutual fund. From January 1, 1990 through December 31, 2001, approximately 16 million mutual fund accounts were added annually.[18]

1. Establishment of a CIP

There are approximately 3,060 mutual fund companies that are registered with the Commission (''mutual fund registrants'').[19] For estimating the total costs associated with Section 326 requirements, the Commission assumes that each mutual fund registrant will be responsible for establishing a CIP.[20]

The Commission staff believes that it will take mutual funds on average approximately 50 hours to establish a CIP. The Commission staff believes that the hourly personnel cost and overhead associated with development of CIPs will be approximately $125. Therefore, the estimated total cost per mutual fund to establish a CIP will be approximately $6,250. Consequently, the estimated initial cost for the 3,060 mutual fund registrants will be approximately $19,125,000.

The actual development costs associated with a single CIP may be higher than the $6,250 estimate. For mutual fund registrants that delegate implementation of their CIP to unaffiliated service providers, the burden per mutual fund registrant may be less because those service providers will likely use the same or similar software and systems for several different registrants. Similarly, the cost per registrant on registrants that utilize a CIP developed by their fund complex may be less. Consequently, the Commission believes this is a reasonable estimate of the cost per mutual fund registrant of developing and implementing the requisite CIPs.

2. Obtaining Identifying Information

Generally, mutual funds currently only require a name and mailing address from a customer in order to open an account. While most mutual funds request a social security number, they generally will open an account if the customer does not provide one. Most funds currently do not require that customers provide a residential address (if different from the mailing address) or a date of birth.

Collecting identifying information for the majority of new accounts should create no additional burden on mutual funds. Most of the burden associated with this requirement will be associated with those account applications where the customer did not provide some of the required information, thus requiring follow-up by the mutual fund. Mutual funds can minimize this burden with clear disclosure on account applications that an account cannot be opened without the requisite information.

The Commission staff believes that the average time spent collecting the requisite information will be one minute per account and that the hourly personnel and overhead cost associated with these requirements will be $25 per hour. Therefore, the estimated cost to the industry from this requirement is: (16 million new accounts per year * 1/60 of an hour * $25). Thus, the estimated annual, industry-wide cost will be approximately $6,666,667.

3. Providing Notice to Customers

A mutual fund may satisfy the notice requirement by generally notifying its customers about the procedures the mutual fund must comply with to verify their identities. If an account is opened electronically, such as through an Internet website, the mutual fund may provide notice electronically. The Commission expects that mutual funds will provide the required notice to customers by modifying their paper and electronic account applications.

The Commission staff believes that it will take mutual funds on average approximately two hours to modify account applications to provide the adequate notice. The Commission staff estimates that the hourly personnel cost and overhead associated with this modification will be approximately $125. Therefore, the estimated total cost per mutual fund to modify its account applications will be approximately $250. Consequently, the estimated initial cost associated with modifying account applications to provide the requisite notice to customers for the 3,060 mutual fund registrants will be approximately $765,000.

4. Verifying Customers' Identities

The proposed rule provides mutual funds with substantial flexibility in establishing how they will independently verify the information provided by customers. For example, customers that open accounts on a

[18] This estimate is derived from information reported in the Investment Company Institute's 2002 Mutual Fund Fact Book. It represents the net annual increase in the number of mutual fund accounts. The actual number of new accounts that were opened during this period is probably higher as this estimate is reduced by the number of accounts that were closed during the same period. No data are available regarding the number of accounts that were closed.

[19] This estimate is based on figures compiled by the Commission staff from Commission filings.

[20] Using the number of mutual fund registrants to estimate the total costs associated with development of CIPs may result in a high estimate of those costs. A mutual fund complex (or mutual fund family) often comprises several mutual fund registrants. The Commission assumes that, in many instances, a single CIP will be developed by a mutual fund complex and utilized by all of the mutual fund registrants in that complex.

mutual fund's premises can simply provide a driver's license or passport, or if the customer is not a natural person, it can provide a copy of any documents showing its existence as a legal entity (*e.g.*, articles of incorporation, business licenses, partnership agreements or trust instruments). There are also a number of options for customers that open accounts via the telephone or Internet. In these cases, mutual funds may obtain a financial statement from the customer, check the customer's name against a credit bureau or database, or check the customer's references with other financial institutions.

The documentary and non-documentary verification methods set forth in the rule are not meant to be an exclusive list of the appropriate means of verification. Other reasonable methods may be available now or in the future. The purpose of making the rule flexible is to allow mutual funds to select verification methods that are, as section 326 requires, reasonable and practicable. The proposed rule allows mutual funds to employ such verification methods as would be suitable to a given firm to form a reasonable belief that it knows the true identities of its customers.

The Commission believes that verifying the identifying information could result in costs for mutual funds because some firms currently may not use verification methods. The estimated total annual cost to the industry to verify the identifying information will be $49,333,333.[21]

5. Determining Whether Customers Appear on Government Lists

Mutual funds should already have procedures for checking customers against government lists. There are substantive legal requirements associated with the lists circulated by Treasury's Office of Foreign Asset Control of the U.S. Treasury (OFAC). The failure of a firm to comply with these requirements could result in criminal and civil penalties. The Commission believes that, given the events of September 11, 2001, most mutual funds that receive lists from the federal government have implemented procedures for checking their customers against them. The Commission believes that this requirement could result in some additional costs for mutual funds because some may not already check such lists. The estimated annual cost to the industry to check such lists is $3,333,333.[22]

6. Recordkeeping

The Commission believes that the recordkeeping requirement could result in additional costs for some mutual funds that currently do not maintain certain of the records for the prescribed time period. The estimated total annual cost to the industry to make and maintain the required records is $13,333,333.[23]

V. Paperwork Reduction Act

Certain provisions of the proposed rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[24] Treasury has submitted the proposed rule to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C 3507(d). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Collection of Information Under the Proposed Rule

The proposed rule contains recordkeeping and disclosure requirements that are subject to the Paperwork Reduction Act of 1995. In summary, the proposed rule requires mutual funds to (1) maintain records of the information used to verify customers' identities and (2) provide notice to customers that information they supply may be used to verify their identities. These recordkeeping and disclosure requirements are required under Section 326 of the Act.

B. Proposed Use of the Information

Section 326 of the Act requires Treasury and the Commission jointly to issue a regulation setting forth minimum standards for mutual funds to verify the identities of their customers. Furthermore, Section 326 provides that the regulations must require, at a minimum, mutual funds to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

The purpose of Section 326, and the proposed rule, is to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. In issuing the proposed rule, Treasury and the Commission are seeking to fulfill their statutorily mandated responsibilities under Section 326 and to achieve its important purpose.

C. Respondents

If adopted, the proposed rule would apply to approximately 3,060 mutual fund companies that are registered with the Commission.[25]

D. Total Annual Reporting and Recordkeeping Burden

1. Recordkeeping

The requirement to make and maintain records related to the CIP will be an ongoing burden. The total burden will depend on the number of new accounts added each year. From January 1, 1990 through December 31, 2001, approximately 16 million mutual fund accounts were added annually.[26] The Commission estimates that mutual funds, on average, will spend two minutes per account making and maintaining the required records. Therefore, in complying with this requirement, the Commission estimates an annual, industry-wide burden of

[21] The Commission staff believes that the processing costs associated with verification methods will be approximately $1.00 per account. The Commission staff further estimates that the average time spent verifying an account will be five minutes. The hourly cost of the person who would undertake the verification is estimated to be $25 per hour including overhead. Therefore, the estimated costs to the industry reported above are: (16 million new accounts per year) * ($1.00) + (number of new accounts per year) * (1/12 of an hour) * ($25).

[22] The Commission staff believes that it will take mutual funds on average thirty seconds to check whether a customer appears on a government list and that the cost (including overhead) of this process will be $25 per hour. Therefore, the costs to the industry reported above are: (16 million new accounts per year) * (1/120 of an hour) * ($25).

[23] The Commission staff believes that it will take approximately two minutes per new account to make and maintain the required records. This estimate takes into account the fact that, for many new accounts, the recordkeeping will be fairly simple (*e.g.*, making a photocopy of a driver's license or financial statement, or keeping a record of the results of a public database search or credit bureau query. The estimated cost associated with the recordkeeping is $25 per hour (including overhead). The estimated cost to the industry is: (16 million new accounts per year) * (1/30 of an hour) * ($25).

[24] 44 U.S.C. 3501 *et seq.*

[25] This estimate is based on figures compiled by the Commission staff from Commission filings.

[26] This estimate is derived from information reported in the Investment Company Institue's 2002 Mutual Fund Fact Book. It represents the net annual increase in the number of mutual fund accounts. The actual number of new accounts that were opened during this period is probably higher as this estimate is reduced by the number of accounts that were closed during the same period. No data available regarding the number of accounts that were closed.

533,333 hours will be associated with the record-keeping requirements of the proposed rule.

2. Notice to Customers

The requirement for mutual funds to provide the required notice to customers regarding use of customers' information will necessitate the amendment of mutual funds' account applications, both paper and web-based applications. The Commission estimates that the approximately 3,060 mutual fund registrants will each spend approximately two hours modifying their account applications to satisfy the notice requirement. Thus, the Commission estimates an initial, industry-wide burden of 6,120 hours to modify fund applications.

E. Collection of Information Is Mandatory

This collection of information is mandatory.

F. Confidentiality

The collection of information pursuant to the proposed rule would be provided by customers and other sources to mutual funds and maintained by mutual funds. In addition, the information may be used by federal regulators, self-regulatory organizations, and authorities in the course of examinations, investigations, and judicial proceedings. No governmental agency regularly would receive any of the information described above.

G. Record Retention Period

The proposed rule will require that the records with respect to a given customer be retained until five years after the date the account of a customer is closed or the grant of authority to effect transactions with respect to an account is revoked.

H. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), Treasury and the Commission solicit comments to:

(1) Evaluate whether the proposed collection of information is necessary, and whether it would have practical utility;

(2) Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms on information technology.

Comments concerning the recordkeeping and disclosure requirements in the proposed rule should be sent (preferably by fax (202–395–6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to *jlackeyj@omb.eop.gov*), with a copy to FinCEN by mail or the Internet at the addresses previously specified.

VI. Regulatory Flexibility Act

Treasury and the Commission are sensitive to the impact our rules may impose on small entities. Congress enacted the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), to address concerns related to the effects of agency rules on small entities. In this case, we believe that the proposed rule likely would not have a ''significant economic impact on a substantial number of small entities.'' 5 U.S.C. 605(b). As discussed in Section IV (The Commission's Analysis of the Costs and Benefits of the Section 326 Requirements), we believe that the impact on mutual funds, including small entities, is imposed by the statute itself, and not by the proposed rule. Moreover, the economic impact on small entities should not be significant because we believe that most small entities are likely to have a relatively small number of accounts, and thus compliance should not impose a significant economic impact. Treasury and the Commission seek comment on whether the proposed rule would have a significant economic impact on a substantial number of small entities and whether the costs are imposed by the statute itself, and not the proposed rule.

While we believe that the proposed rule likely would not have a significant economic impact on a substantial number of small entities, we do not have complete data at this time to make this determination. We have therefore prepared this Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603.

A. Reason for the Proposed Action

Section 326 of the Act requires Treasury and the Commission jointly to issue a regulation setting forth minimum standards for mutual funds and their customers regarding the identity of the customer that shall apply in connection with opening of an account at the mutual fund. Furthermore, Section 326 provides that the regulations must require, at a minimum, mutual funds to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

The purpose of Section 326, and this proposed rule, is to prevent, detect and prosecute money laundering and the financing of terrorism. In issuing the proposed rule, Treasury and the Commission are seeking to fulfill their statutorily mandated responsibilities under Section 326 and to achieve its important purpose.

B. Objective

The objective of the proposed regulation is to make it easier to prevent, detect and prosecute money laundering and the financing of terrorism. The rule seeks to achieve this goal by requiring mutual funds to obtain identifying information from customers that can be used to verify the identity of the customers. This will make it more difficult for persons to use false identities to establish customer relationships with mutual funds for the purposes of laundering money or moving funds to effectuate illegal activities, such as financing terrorism.

C. Legal Basis

The proposed rule is being promulgated pursuant to Section 326 of the Act, which mandates that Treasury and the Commission issue a regulation setting forth minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with opening of an account at the financial institution.

D. Small Entities Subject to the Rule

The proposed rule would affect mutual funds that are small entities. For purposes of the Regulatory Flexibility Act, the Commission has determined that an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[27] Approximately 156 mutual funds meet this definition.[28]

[27] 17 CFR 270.0–10.

[28] This estimate is based on figures compiled by the Commission staff from outside databases.

E. Reporting, Recordkeeping and Other Compliance Requirements

Section 326 requires mutual funds to adopt reasonable procedures to: (1) Verify the identities of their customers; (2) check customers against lists provided by federal agencies, (3) provide notice to customers that information the customers provide may be used to verify customers' identities; and (4) make and maintain records related to the CIP.

F. Duplicative, Overlapping or Conflicting Federal Rules

We have not identified any federal rules that duplicate, overlap or conflict with the proposed rule. Congress has mandated that Treasury and the Commission issue a regulation that requires mutual funds to verify their customers' identities. This congressional directive cannot be followed absent the issuance of a new rule.

G. Significant Alternatives

If an agency does not certify that a rule will not have a significant economic impact on a substantial number of small entities, the Regulatory Flexibility Act directs Treasury and the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any adverse impact on small entities.

In connection with the proposed amendments, we considered the following alternatives: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The proposed rule provides for substantial flexibility in how each mutual fund may meet its requirements. This flexibility is designed to account for differences between mutual funds, including size. Nonetheless, Treasury and the Commission did consider alternatives such as exempting certain small entities from some or all of the requirements of the proposed rule. Treasury and the Commission do not believe that such an exemption is appropriate, given the flexibility built into the rule to account for, among other things, the differing sizes and resources of mutual funds, as well as the importance of the statutory goals and mandate of section 326. Money laundering can occur in small firms as well as large firms.

H. Solicitation of Comments

Treasury and the Commission encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis, including comments regarding the number of small entities that may be affected by the proposed rule. Such comments will be considered by Treasury and the Commission in determining whether a Final Regulatory Flexibility Analysis is required, and will be placed in the same public file as comments on the proposed amendment itself. Comments should be submitted to Treasury or the Commission at the addresses previously indicated.

VII. Executive Order 12866

The Department of the Treasury has determined that this rule is not a significant regulatory action for purposes of Executive Order 12866. As noted above, the proposed rule closely parallels the requirements of section 326 of the Act. Accordingly, a regulatory impact analysis is not required.

Lists of Subjects in 31 CFR Part 103

Administrative practice and procedure, Authority delegations (Government agencies), Banks, banking, Brokers, Currency, Foreign banking, Foreign currencies, Gambling, Investigations, Law enforcement, Penalties, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons set forth in the preamble, part 103 of title 31 of the Code of Federal Regulations is proposed to be amended as follows:

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

1. The authority citation for part 103 is revised to read as follows:

Authority: 12 U.S.C. 1786(q), 1818, 1829b and 1951–1959; 31 U.S.C. 5311–5332; title III, secs. 312, 313, 314, 319, 326, 352, Pub L. 107–56, 115 Stat. 307.

2. Subpart I of part 103 is amended by adding § 103.131 to read as follows:

§ 103.131 Customer identification programs for mutual funds.

(a) *Definitions.* For the purposes of this section:

(1) *Account* means 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.

(2) *Commission* means the United States Securities and Exchange Commission.

(3) *Customer* means:

(i) Any mutual fund shareholder of record who opens a new account with a mutual fund; and

(ii) Any person authorized to effect transactions in the shareholder of record's account with a mutual fund.

(4) *Mutual Fund* means an entity that is required to register with the Commission as an ''investment company'' (as the term is defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) (''Investment Company Act'')) and is an ''open-end company'' (as that term is defined in Section 5 of the Investment Company Act, 15 U.S.C. 80a–5).

(5) *Person* has the same meaning as that term is defined in § 103.11(z).

(6) *Taxpayer identification number.* The provisions of Section 6109 of the Internal Revenue Code of 1986 (26 U.S.C. 6109) and the regulations of the Internal Revenue Service promulgated thereunder shall determine what constitutes a taxpayer identification number.

(7) *U.S. person* means:

(i) Any U.S. citizen; and

(ii) Any corporation, partnership, trust, or person (other than a natural person) that is established or organized under the laws of a State or the United States.

(8) *Non-U.S. person* means a person that is not a U.S. person.

(b) *Customer identification program.* A mutual fund shall establish, document, and maintain a written Customer Identification Program (''CIP''). A mutual fund's CIP procedures must enable it to form a reasonable belief that it knows the true identity of the customer. A mutual fund's CIP must be a part of its anti-money laundering program required under 31 U.S.C. 5318(h). A mutual fund's CIP procedures shall be based on the type of identifying information available and on an assessment of relevant risk factors including:

(1) The mutual fund's size;

(2) The manner in which accounts are opened, fund shares are distributed, and purchases, sales and exchanges are effected;

(3) The mutual fund's types of accounts; and

(4) The mutual fund's customer base.

(c) *Required information.* (1) *General.* Except as permitted by paragraph (c)(2) of this section, the CIP shall require the mutual fund to obtain specified identifying information about each

customer before an account is opened or a customer is granted authority to effect transactions with respect to an account. The specified information must include, at a minimum:

(i) Name;

(ii) Date of birth, for a natural person;

(iii) Addresses:

(A) Residence and mailing (if different) for a natural person; or

(B) Principal place of business and mailing (if different) for a person other than a natural person; and

(iv) Identification numbers:

(A) A taxpayer identification number from each customer that is a U.S. person; or

(B) A taxpayer identification number, passport number and country of issuance, alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard from each customer that is not a U.S. person.

(2) *Limited exception.* In the case of a person other than a natural person that has applied for, but has not received, an employer identification number, the CIP may allow such information to be provided within a reasonable period of time after the account is established, if the mutual fund obtains a copy of the application for the employer identification number prior to such time.

(d) *Required verification procedures.* The CIP shall include procedures for verifying the identity of customers, to the extent reasonable and practicable, using information obtained pursuant to paragraph (c) of this section. Such verification must occur within a reasonable time before or after the customer's account is opened or the customer is granted authority to effect transactions with respect to an account:

(1) *Verification through documents.* The CIP must describe when the mutual fund will verify customers' identities through documents and describe the documents that the mutual fund will use for this purpose. Suitable documents for verification may include:

(i) For natural persons, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard; and

(ii) For persons other than natural persons, documents showing the existence of the entity, such as registered articles of incorporation, a government-issued business license, partnership agreement, or trust instrument.

(2) *Verification through non-documentary methods.* The CIP must describe non-documentary methods a mutual fund will use to verify customers' identities and when these methods will be used in addition to, or instead of, relying on documents. Non-documentary verification methods may include contacting a customer; independently verifying information through credit bureaus, public databases, or other sources; and checking references with other financial institutions. Non-documentary methods shall be used when a customer who is a natural person is unable to present an unexpired, government-issued identification document that bears a photograph or similar safeguard; the mutual fund is presented with unfamiliar documents to verify the identity of a customer; or the mutual fund does not obtain documents to verify the identity of a customer, does not meet face-to-face a customer who is a natural person, or is otherwise presented with circumstances that increase the risk the mutual fund will be unable to verify the true identity of a customer through documents.

(e) *Government lists.* The CIP shall include procedures for determining whether a customer's name appears on any list of known or suspected terrorists or terrorist organizations prepared by any federal government agency and made available to the mutual fund. Mutual funds shall follow all federal directives issued in connection with such lists.

(f) *Customer notice.* The CIP shall include procedures for providing customers with adequate notice that the mutual fund is requesting information to verify the customer's identity.

(g) *Lack of verification.* The CIP shall include procedures for responding to circumstances in which the mutual fund cannot form a reasonable belief that it knows the true identity of a customer.

(h) *Recordkeeping.* The CIP shall include procedures for maintaining a record of all information obtained pursuant to the CIP. A mutual fund must retain all records made or obtained when verifying the identity of a customer pursuant to its CIP until five years after the date the account of the customer is closed. Records subject to the requirements in this paragraph (h) include:

(1) All identifying information provided by a customer pursuant to paragraph (c) of this section, and copies of any documents that were relied on pursuant to paragraph (d)(1) of this section evidencing the type of document and any identification number it may contain;

(2) The methods and results of any measures undertaken to verify the identity of a customer pursuant to paragraph (d)(2) of this section; and

(3) The resolution of any discrepancy in the identifying information obtained.

(i) *Approval by the board.* The CIP shall be approved by the mutual fund's board of directors or trustees.

(j) *Exemptions.* The Commission, with the concurrence of the Secretary, may by order or regulation exempt any mutual fund or type of account from the requirements of this section. The Commission and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act (31 U.S.C. 5311 *et seq.*) and in the public interest, and may consider other necessary and appropriate factors.

Dated: July 15, 2002.

James F. Sloan,

Director, Financial Crimes Enforcement Network.

Dated: July 12, 2002.

By the Securities and Exchange Commission.

Margaret H. McFarland,

Deputy Secretary.

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038–AB90

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506–AA34

Customer Identification Programs for Futures Commission Merchants and Introducing Brokers

AGENCIES: Financial Crimes Enforcement Network, Treasury; United States Commodity Futures Trading Commission.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the United States Commodity Futures Trading Commission (CFTC or Commission) are jointly issuing a proposed regulation to implement section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act). Section 326 of the Act requires Treasury to jointly prescribe with the CFTC a regulation that, at a minimum, requires