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MEMORANDUM

January 17, 2003

To Our Clients and Friends

Re: Suspicious Activity Reporting for Mutual Funds

The Treasury Department has issued a proposed rule amending the Bank Secrecy Act to require mutual funds¹ to report suspicious transactions to the Financial Crimes Enforcement Network (“FinCEN”). The rule imposes reporting requirements similar to those applicable to banks, thrift institutions, and broker-dealers. Comments on the proposed rule are due by mid-March.

REQUIREMENTS

Mutual funds are required to report suspicious transactions relating to a possible violation of law or regulation to FinCEN on Suspicious Activity Report – Investment Companies (“SAR-SF”)² within 30 days after the mutual fund initially detects the suspicious transaction³.

A transaction is to be reported if it is conducted or attempted by, at or through a mutual fund, involves funds or assets of at least \$5,000 and the mutual fund knows, suspects or has reason to suspect that the transaction (or a pattern of transactions):

- involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

¹ Under the proposed rule a mutual fund is every investment company (as defined in section 3 of the Investment Company Act of 1940) that is an open-end company (as defined in section 5 of the Investment Company Act) and that is registered, or is required to register, with the Securities and Exchange Commission.

² The term “SF” is an abbreviation for “Securities and Futures Industry,” the form that will be used for reporting by members of the securities and futures industry.

³ In addition, situations requiring immediate attention, such as terrorist financing or ongoing money laundering schemes, should be reported immediately by telephone to the appropriate law enforcement authorities.

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- is designed to evade the requirements of Bank Secrecy Act regulations;
- has no business or apparent lawful purpose, or is not the sort of transaction in which the customer would normally be expected to engage, and the mutual fund knows of no reasonable explanation for the transaction; or
- involves use of the mutual fund to facilitate criminal activity.

Transactions do not have to involve currency to be reported, and mutual funds are encouraged to report suspicious transactions even when the rule does not explicitly require such reporting (e.g., the transaction involves less than \$5,000). Filing of a suspicious activity report does not relieve a mutual fund from complying with other reporting requirements of the Securities and Exchange Commission.

The proposed rule does not require reporting by affiliated persons of mutual funds although some affiliates may be subject to their own reporting rules. A mutual fund may contractually delegate performance of the reporting obligation to another affiliated or unaffiliated service provider, but the mutual fund remains responsible for assuring compliance with the rule and must actively monitor the procedure for reporting suspicious transactions.

The proposed rule permits all mutual funds involved in a particular transaction to file a single report as long as the report contains all relevant facts. In addition, a service provider that may have its own suspicious activity reporting obligation for a transaction, such as a broker-dealer, and with whom the mutual fund has contractually delegated its reporting responsibilities may file a single report on behalf of itself and all of the funds involved. A mutual fund is to maintain supporting documentation of the suspicious transaction for a period of five years from the date of filing.

A mutual fund is prohibited from notifying anyone involved in a suspicious transaction that it has been reported. The SAR-SF or supporting documentation cannot be disclosed to anyone except where such disclosure is requested by FinCEN, the SEC or another appropriate law enforcement or regulatory agency.

A mutual fund, and any director, officer, employee, or agent of such mutual fund, that files an SAR-SF is not liable under any law or regulation of the United States for any disclosure contained in, or for failure to disclose the fact of, such report.

The proposed rule can be found at www.schwartzandballen.com/WhatsNew.htm.

If you have any questions concerning the proposed rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.