In recent weeks, the Financial Crimes Enforcement Network, a bureau of the Department of the Treasury ("Treasury") has issued four interim rules, and the Securities and Exchange Commission ("SEC") and Commodity Futures Trading Commission ("CFTC") have approved three self regulatory organization ("SRO") rules, all of which implement the anti-money laundering program requirements of the Patriot Act.1 In particular, Section 352 of the Patriot Act requires every "financial institution," as that term is broadly defined under the Bank Secrecy Act, to establish an anti-money laundering program that includes, at a minimum, the following:

- Development of internal policies, procedures, and controls;
- Designation of a compliance officer;
- Ongoing employee training program; and
- An independent audit function to test programs.

Section 352 requires Treasury to prescribe regulations that are commensurate with the size, location, and activities of "financial institutions" subject to anti-money laundering program requirements. Section 352 was effective April 24, 2002.

One Treasury rule provides an overview of anti-money laundering regulations issued by Treasury and by the SROs (the "Interim Rule"); the second rule prescribes anti-money laundering requirements for mutual funds; the third rule prescribes requirements for credit card operators; and the fourth rule prescribes anti-money laundering requirements for money services businesses.2 The SRO rules cover money laundering

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1 The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), Pub. L. 107-56.
program requirements for broker-dealers and futures commissions merchants. These new rules are briefly described below.

Part A of this advisory describes the background of anti-money laundering programs and of Section 352. Part B describes Treasury’s Interim Rule. Part C describes anti-money laundering program requirements under Treasury’s new interim rules for mutual funds, credit card operators, money services businesses and under new SRO rules for broker dealers, and futures commissions merchants and introducing brokers.

A. Background

Even absent new mandatory requirements imposed by the Patriot Act, all financial institutions had developed some form of Bank Secrecy Act policies and procedures to ensure compliance with various aspects of the Bank Secrecy Act and regulations to which they were subject. For example, the National Futures Association (“NFA”) (the SRO for commodities futures merchants) noted that, prior to the enactment of the Patriot Act, many futures commissions merchants already had Bank Secrecy Act procedures in place related to deposits of currency. The NFA advised firms to use their existing programs and procedures as building blocks for their new Patriot Act anti-money laundering programs.

Moreover, before enactment of the Patriot Act, certain financial institutions were subject to specific anti-money laundering program requirements. In 1987, the federal banking regulators issued rules requiring all federally insured depository institutions to put in place anti-money laundering programs to ensure compliance with the Bank Secrecy Act.

In 1992, the Annunzio-Wylie Anti-Money Laundering Act amended the Bank Secrecy Act by adding a new subsection (h) to 31 U.S.C. 5318. New Section 5318(h) authorized Treasury, in its discretion, to require financial institutions to carry out anti-money laundering programs. Although Treasury often cited Section 5318(h) as authority for various rulemakings, prior to the enactment of the Patriot Act, Treasury had imposed anti-money laundering program requirements only on casinos.

Section 352 of the USA Patriot Act amended Section 5318(h) to require all “financial institutions” to put in place anti-money laundering programs by April 24, 2002. As described below, Treasury has delayed this requirement for certain “financial institutions.”

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3 See 12 CFR 21.21 (national banks); 12 CFR 202.63 (state member banks); 12 CFR 326.8 (state nonmember banks); 12 CFR 563.177 (savings associations); and 12 CFR 748.2 (credit unions).

4 31 CFR 103.120(d).
B. Treasury’s Interim Rule—All Financial Institutions

Treasury’s Interim Rule provides a general overview of its current and expected anti-money laundering rules. A summary of key points follows:

Banks, Savings Associations, Credit Unions. The Interim Rule provides that a financial institution that is subject to regulation by a federal banking regulator will be deemed to be in compliance with the requirements of Section 352 if the financial institution complies with the regulations governing anti-money laundering programs issued by its federal banking regulator. As in the past, federal banking regulators will continue to examine banks, savings associations, and credit unions for compliance with the Bank Secrecy Act.

Broker-Dealers and Futures Commissions Merchants. The Interim Rule also provides that registered securities broker-dealers and futures commissions merchants will be deemed to be in compliance with the requirements of Section 352 if they comply with the rules of their respective SROs governing anti-money laundering programs.

The Interim Rule explains that SROs will examine their members for compliance and take enforcement actions in cases of noncompliance. The Interim Rule notes that the SEC has authority to examine registered broker-dealers for compliance with anti-money laundering program requirements under these rules. Similarly, the Interim Rule notes that the CFTC will examine the NFA for its enforcement of anti-money laundering program rules, and that the CFTC is authorized to take enforcement actions against the NFA in cases where the NFA fails to enforce the SRO’s rules.

Casinos. The Interim Rule further provides that a casino that is in compliance with Treasury regulations issued in 1993, which require casinos to implement anti-money laundering compliance programs, will be deemed to be in compliance with the requirements of Section 352.

Mutual Funds, Credit Card Operators, Money Services Businesses. These entities will be subject to anti-money laundering requirements in accordance with new interim rules issued by Treasury on April 23, 2002, which are described below. Such programs must be in place by July 24, 2002.

Other Financial Institutions—Temporary Exemption. The Interim Rule provides that the financial institutions identified below will be subject to a temporary exemption, until October 24, 2002, from the requirements of Section 352. Treasury granted these exemptions so that it could further analyze the particular money laundering risks posed by each type of business. Financial institutions temporarily exempt from the requirements of Section 352 are the following:

- Government agencies engaged in financial activities
- Dealers in precious metals, stones or jewels
- Pawnbrokers
- Loan and finance companies
• Sellers of vehicles, including automobiles, airplanes, and boats
• Persons involved in real estate closings and settlements
• Private bankers
• Insurance companies
• Commodity pool operators
• Commodity trading advisors
• Investment companies (other than mutual funds)
• Trust companies (See paragraph below on trust companies.)

Notwithstanding this exemption, many exempt “financial institutions” have opted to put in place anti-money laundering programs.

**Investment Companies (Other than Mutual Funds).** The Interim Rule states that Treasury temporarily is exempting investment companies, other than “open end companies” (i.e., mutual funds) from the requirements of Section 352. In particular, the Interim Rule notes that while “investment companies” are included in the definition of “financial institution” for purposes of the Bank Secrecy Act, Treasury is deferring determination of the scope of the Bank Secrecy Act definition of “investment company” pending further review and analysis.

**Hedge Funds and Personal Holding Companies.** Although hedge funds, private equity funds, venture capital funds, and personal holding companies are excluded from the definition of “investment company” under the Investment Company Act of 1940, Treasury anticipates that these entities will not be excluded from the definition of “investment company” under the Bank Secrecy Act and that they will be subject to anti-money laundering requirements.5

On a related matter, Section 356 of the Patriot Act requires that Treasury, the Federal Reserve, and the SEC submit a joint report to Congress, not later than October 26, 2002, on recommendations for effective regulations to apply the requirements of the Bank Secrecy Act—not just anti-money laundering program requirements—to investment companies, including hedge funds and personal holding companies.

**Trust Companies.** The Interim Rule does not mention trust companies. We have confirmed with Treasury counsel that it was – and is – the intention of Treasury to exempt trust companies from the requirements of Section 352 until October 24, 2002, or until Treasury issues a rule applicable to trust companies (if such a rule is issued), whichever is sooner.

**Investment Advisers.** The Interim Rule is silent on the issue of whether registered investment advisers will be subject to anti-money laundering program requirements. Investment advisers

are not currently included in the definition of “financial institution” under the Bank Secrecy Act. Notwithstanding the foregoing, SEC staff has indicated that examiners of investment advisers will “be looking at” investment advisers’ efforts to detect money laundering and terrorist funding activities. Accordingly, whether or not Treasury of the SEC issues formal regulatory requirements regarding investment adviser anti-money laundering programs, investment advisers may wish to consider implementing such programs. Furthermore, investment advisers that advise mutual funds may have some responsibilities under new anti-money laundering requirements applicable to mutual funds.

C. New Anti-Money Laundering Program Requirements—Mutual Funds, Credit Card Operators, Money Services Businesses, Broker-Dealers, Futures Commissions Merchants

As discussed below, anti-money laundering programs must be in place by July 24, 2002, for mutual funds, credit card operators, and money services businesses. Broker-dealers and futures commissions merchants should already have put in place, as of April 24, 2002, anti-money laundering programs.

New rules applicable to these institutions briefly are described below:

**Mutual Funds.** Treasury has limited the application of Section 352 requirements to open-end investment companies, which are commonly known as “mutual funds.” An open-end fund generally offers its shares continuously and is required to provide its shareholders the right to redeem shares at net asset value on a daily basis.

Treasury’s interim rule regarding mutual funds requires that, by July 24, 2002, mutual funds must have anti-money laundering programs in place. The preamble to the rule noted that because such funds operate through various business models, one general anti-money laundering program for the industry is not possible. Thus, a mutual fund must develop a program based on its own business structure and the particular risks it faces. The preamble also cites a number of examples that should raise “red flags” for a mutual fund. One example is the frequent purchase of fund shares followed by large redemptions, particularly where proceeds are wired to unrelated third parties or bank accounts in foreign countries. Another example involves transfers to accounts in countries where drugs are known to be produced.

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7 We note that investment advisers that are nonbank subsidiaries of bank holding companies are subject to certain Bank Secrecy Act requirements under the Board’s Regulation Y. See 12 C.F.R. 225.4(f).

8 Other types of investment companies include closed-end investment companies and unit investment trusts.
Polices and procedures also must ensure compliance with applicable Bank Secrecy Act requirements. Currently, under the Bank Secrecy Act and implementing regulations, mutual funds must report receipt of currency of more than $10,000 in one transaction or two or more related transactions. In the future, mutual funds also will be required to obtain accountholder identification and verification information pursuant to Section 326 of the Patriot Act. Mutual funds also might be subject to suspicious activity reporting requirements under the Bank Secrecy Act.

At a minimum, mutual fund anti-money laundering programs must include:

- Policies and procedures and internal controls to prevent the mutual fund from being used for money laundering or the financing of terrorist activities and to achieve compliance with applicable provisions of the Bank Secrecy Act;
- Independent testing for compliance;
- Designation of a person or persons responsible for implementing and monitoring the program;
- Ongoing training for appropriate persons.

The interim rule also delegates to the SEC authority to examine mutual funds for compliance with anti-money laundering program requirements.

**Credit Card Operators.** One of Treasury’s interim rules covers “credit card operators.” The rule focuses on the relationships of credit card operators with “issuing institutions” and “acquiring institutions.” A “credit card operator” is defined as any entity that (i) operates a system that clears and settles transactions involving its credit card and (ii) authorizes another entity to serve as an issuing or acquiring institution for the operator’s credit card. A credit card operator could be a bank, an association of banks, or other entity. An “issuing institution” is any entity authorized by the operator to issue the operator’s credit card. An “acquiring institution” is any entity authorized by the operator to contract with merchants to process transactions involving the operator’s credit card.

Under the interim rule, a credit card operator must establish by July 24, 2002, an anti-money laundering program addressing the operator’s performance of reasonable due diligence on banks or other entities that it authorizes to be issuing or acquiring institutions for the operator’s credit card. The rule directs operators to conduct due diligence before accepting an institution into the system, and on an on-going basis, commensurate with the money laundering or terrorist funding risk posed by the particular institution. (Under the rules, for example, certain foreign shell banks are presumed to pose greater risk.)

The program also must include:

- Independent auditing to monitor and maintain the program;
- Designation of a compliance officer;
• Ongoing training for appropriate personnel.

The preamble notes that most credit card operators already have taken many of the steps outlined in the interim rule.

Money Services Businesses. Treasury’s interim rule regarding money services businesses notes that those businesses are diverse and that they are particularly vulnerable to the risk of money laundering. Money services businesses are defined to include: currency dealers or exchanges; check cashers; issuers of traveler’s checks, money orders, or stored value; sellers or redeemers of traveler’s checks, money orders, or stored value; and money transmitters.9

Under the interim rule, a money services business must put in place, by July 24, 2002, an anti-money laundering program that is “reasonably designed” to prevent the business from being used to facilitate money laundering. The program must be commensurate with the risks posed by the location and size of the money services business and by the nature and volume of its business.

The minimum requirements of an anti-money laundering program are the following:

• Policies and procedures to comply with applicable Bank Secrecy Act regulations regarding requirements for (i) verifying customer identification, (ii) filing reports, (iii) recordkeeping, and (iv) responding to law enforcement requests;

• Integration of compliance procedures with existing automated data processing systems;

• Allocation by agreement of responsibilities regarding anti-money laundering policies and procedures between money services businesses and certain of their agents;

• Designation of a person who is responsible for day-to-day compliance;

• Education and/or training for appropriate personnel;

• Independent review to monitor and maintain the program.

Broker-Dealers. The SEC recently approved NASD Rule 3011 and NYSE Rule 445, which require each member firm to develop and implement anti-money laundering programs.10 These rules are similar to rules issued by the federal banking agencies applicable to insured depository institutions.

9 The definition of money services businesses captures grocery stores, convenience stores, gas stations and other businesses to the extent those businesses provide money services.

10 Philadelphia Stock Exchange, Inc. also recently filed a notice of proposed rule relating to anti-money laundering compliance programs for its member organizations. See 67 Fed. Reg. 22472 (May 3, 2002).
At a minimum, member firms’ anti-money laundering programs must:

- Include policies and procedures that reasonably can be expected to detect and cause the reporting of suspicious activity reports under 31 U.S.C. 5318(g);\(^\text{11}\)
- Include policies and procedures and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and implementing regulations;\(^\text{12}\)
- Provide for independent testing for compliance;
- Designate a person or persons responsible for implementing and monitoring the day-to-day operations and internal controls of the program;
- Provide ongoing training for appropriate persons.

More comprehensive guidance regarding anti-money laundering programs applicable to broker-dealers is available from other sources.\(^\text{13}\)

**Futures Commissions Merchants and Introducing Brokers.** The NFA recently adopted new Rule 2-9 outlining anti-money laundering program requirements for futures commissions merchants and introducing brokers. The CFTC approved the rule on April 23, 2002.

Much like the new rules applicable to broker-dealers, Rule 2-9 provides that futures commissions merchants and introducing brokers must, at a minimum:

- Establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the applicable provisions of the Bank Secrecy Act and regulations thereunder;
- Provide for independent testing for compliance;
- Designate an individual or individuals responsible for implementing and monitoring day-to-day operations of the program;
- Provide ongoing training for appropriate personnel.


\(^{13}\) See Securities Industry Association (“SIA”) Preliminary Guidance for Deterring Money Laundering Activity.
The NFA commentary in the NFA Rulebook provides useful guidance regarding the types of risks that futures commissions merchants and introducing brokers must address.\(^{14}\)

The NFA has identified various compliance considerations resulting from relationships among various financial institutions. For example, the NFA has noted the following:

- Bank and bank holding company-owned futures commissions merchants and introducing brokers already were required to comply with certain components of the anti-money laundering programs of banks.

- Futures commissions merchants and introducing brokers that are registered as broker-dealers are subject to similar anti-money laundering program requirements under applicable broker-dealer rules. In most cases, programs that comply with requirements applicable to broker-dealers will comply with the requirements of Rule 2-9.

- With respect to customer identification and verification requirements, a futures commissions merchant and an introducing broker may allocate between themselves certain customer identification and verification procedures. The introducing broker, for example, might use its direct relationship with a customer to obtain certain identification information, and the futures commissions merchant might use its automated systems for certain verification functions, such as checking customer names against government lists. Under guidance provided by Treasury, any such allocation would not relieve the futures commissions merchant or the introducing broker of its independent obligation to comply with applicable customer identification and verification rules.

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\(^{14}\) See [www.nfa.futures.org/compliance/manual/M11Interp_44.html](http://www.nfa.futures.org/compliance/manual/M11Interp_44.html).