

June 22, 2006

Memorandum to Our Mutual Fund Clients and Friends

Amendment to the Bank Secrecy Act Regulations

Requiring Mutual Funds to Report Suspicious Transactions

Introduction

The Treasury Department's Financial Crimes Enforcement Network ("FinCEN") recently adopted a rule under the Bank Secrecy Act (the "Rule") that requires registered open-end investment companies ("mutual funds") to report suspicious transactions to FinCEN. The Rule is a part of a series of steps that FinCEN has taken to address comprehensively the risk of money laundering through mutual funds. As a result of the adoption of the Rule, mutual funds have the same suspicious activity reporting obligations as banks, registered broker-dealers and other financial institutions.

Effective and Compliance Dates

- *Effective Date:* **June 5, 2006**
- *Compliance Date:* The Rule will apply to transactions occurring after **October 31, 2006**.

Suspicious Activity Reporting

The Rule requires mutual funds to file Suspicious Activity Reports on Form SAR-SF ("Suspicious Activity Report by the Securities and Futures Industries") with respect to suspicious transactions involving or aggregating at least \$5,000 where a mutual fund knows, suspects, or has reason to suspect that the transaction falls into one of the following four categories:

- (i) the transaction involves funds derived from illegal activity, or is intended or conducted in order to hide or disguise funds derived from such illegal activity;
- (ii) the transaction is designed, through structuring or otherwise, to evade the requirements of the Bank Secrecy Act;
- (iii) the transaction appears to serve no business or apparent lawful purpose, and for which the mutual fund knows of no reasonable explanation after examining the available facts relating to the transaction and the parties; or
- (iv) the transaction involves the use of the mutual fund to facilitate criminal activity.

In its adopting release, FinCEN did not provide an exhaustive list of suspicious transactions that would require the filing of a Form SAR-SF and stated that the determination to file a report must be based on all the facts and circumstances relating to the transaction and the customer in question. As an example, FinCEN stated that if a mutual fund closes the account and redeems the shares of a customer whose identity the fund is unable to verify under its customer identification program, the fund should consider whether the circumstances surrounding its failure to verify the customer's identity would warrant the filing of a Form SAR-SF.

FinCEN also stated that in the case of omnibus accounts a mutual fund may not know, suspect, or have reason to suspect that a transaction is one for which reporting would be required and that the omnibus account holder is the mutual fund's customer for purposes of the Rule. It noted that omnibus accounts are usually maintained by other financial institutions, such as broker-dealers, that have reporting obligations with regard to their customers.

The Rule requires reporting by mutual funds, but not by affiliated persons or other service providers of mutual funds, such as investment advisers, principal underwriters, administrators, custodians and transfer agents. Mutual funds may (and will likely) contract with their service provider(s) to perform their reporting obligations. Mutual funds, however, remain responsible for assuring compliance with the Rule and therefore must monitor the performance of their reporting obligations.

In cases where more than one mutual fund or other financial institution, such as a broker-dealer, are involved in a particular transaction and would be obligated to report the same transaction, the Rule permits filing of a single joint report by a mutual fund or financial institution on behalf of all of the mutual fund(s) and other financial institution(s) involved in the transaction. The joint report must identify the other mutual funds on whose behalf the report is being filed and each mutual fund must maintain a copy of the joint report and any supporting documentation. The Rule also encourages voluntary reporting, even in cases where the Rule does not explicitly require reporting.

Filing Procedures

Mutual funds must report a suspicious transaction by completing and filing a Form SAR-SF within 30 days after the initial detection of the suspicious transaction. If a mutual fund does not identify a suspect on the date of the initial detection, it may delay filing a Form SAR-SF for 30 days, but may not delay filing more than 60 days after the date of the initial detection.

Retention of Records

The Rule requires a mutual fund to maintain copies of any Form SAR-SF that it files or that are filed on its behalf (including joint reports), and the original (or business record equivalent) and copies of related supporting documents, for a period of five years from the date of filing.

Confidentiality of Reports

The Rule prohibits a mutual fund filing a Form SAR-SF from disclosing, except to FinCEN, the SEC, or another appropriate law enforcement or regulatory agency, that such a report has been filed or from providing any information that would disclose that a report has been prepared or filed, whether the report is required by the Rule or is filed voluntarily. The prohibition also applies to joint reports, except that a mutual fund is allowed to engage in discussions with any other financial institution or service provider involved in the transaction, other than the person who is or expected to be the subject of the report, to determine whether the transaction must be reported, determine which party will file the report, provide the filer with the necessary information and supporting documents, and confirm the filing to each mutual fund involved in the transaction. Similarly, the rule does not prohibit a service provider who performs reporting obligations under contract with one or more mutual funds from sharing information as an agent of the mutual fund(s).

Safe Harbor

The Rule provides a safe harbor from civil liability for mutual funds filing Form SAR-SFs. This safe harbor extends to officers and directors of a mutual fund filing a Form SAR-SF and to agents of the mutual fund, including transfer agents and other service providers, filing Form SAR-SFs.

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If you have any questions or need more information, please contact Kathleen Clarke or Paul Miller at (202)737-8833.

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