MANAGED FUNDS ASSOCIATION

VIA ELECTRONIC MAIL: regcomments@fincen.treas.gov

July 7, 2003

FinCEN
P.O. Box 39
Vienna, VA 22183

Attention: Section 352 CTA Regulations and
Section 352 Investment Adviser Rule Comments

Dear Sir or Madam:

Managed Funds Association ("MFA") appreciates the opportunity to comment on the above-referenced notices of proposed rulemaking, and accompanying releases (collectively, the "Proposed Rules"), published by the U.S. Department of Treasury, Division of Financial Crimes Enforcement Network ("Treasury"). This letter addresses both the proposed rule requiring Anti-Money Laundering Programs ("AML Programs") for Commodity Trading Advisors ("CTA") (68 Fed. Reg. 23,640) (the "Proposed Rule for CTAs") and the proposed rule requiring AML Programs for Investment Advisers ("IA") (68 Fed. Reg. 23,646) (the "Proposed Rule for IAs"), both published May 5, 2003.

MFA, located in Washington, DC, is the only U.S.-based membership organization dedicated to serving the needs of professionals worldwide that specialize in the alternative investment industry—managed futures funds, hedge funds, and funds of funds. MFA has approximately 700 members who manage a significant portion of the over $600 billion invested in these alternative investment vehicles globally. Many of our members are CTAs and IAs. Accordingly, MFA, its members and the investors who invest in our members' funds have a vital interest in the Proposed Rules.

MFA generally supports the application of Section 352 of the USA PATRIOT[1] Act of 2001 (the "Act") to CTAs and IAs, subject to our comments below. We believe that with clarification of certain provisions of the Proposed Rules, the application of Section 352 to CTAs and IAs will achieve the dual goals of providing additional safeguards against money laundering and reducing unnecessarily burdensome or duplicative regulatory requirements for financial institutions.

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[1] The full title of this act is the "United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001."

MFA Support of Efforts to Combat Terrorist Financing and Money Laundering.

As we have emphasized in prior correspondence to Treasury, MFA strongly supports Treasury's efforts to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. We are particularly pleased that Treasury, in the Proposed Rules and related rules, has adopted a risk-based approach to AML Program compliance. To promote compliance with the Act by the hedge fund industry, MFA published its "Preliminary Guidance for Hedge Funds and Hedge Fund Managers on Developing Anti-Money Laundering Programs" (March 2002) which may be amended from time to time (the "MFA Guidance"). We believe the MFA Guidance provides our members with important practical guidance on developing internal policies and procedures in order to comply with the expected AML Program requirements under the Act. The MFA Guidance provides detailed information on, among other things, how one might rely on the investor identification procedures, and other due diligence, conducted by third-party administrators on behalf of hedge funds and other alternative investment funds. Moreover, the MFA Guidance recognizes the critical role of carrying out an effective AML Program and how to determine the effectiveness of a third party's AML Programs. In February 2003, MFA published its "USA PATRTIOT Act Update" to provide industry participants a summary of recent regulatory developments that have taken place since the passage of the Act in October 2001. Once the regulations applicable to our membership base have been finalized by Treasury, MFA intends to publish an update of the MFA Guidance.

Since the passage of the Act, MFA has also had frequent discussions with the staffs of Treasury and of other affected agencies to discuss implementing regulations under the Act. Moreover, MFA has submitted various comment letters to proposed rulemakings by Treasury regarding the implementation of the Act.[2] Most recently, in November 2002, MFA submitted its comments to Treasury's proposed rule to subject unregistered investment companies ("UIC"), including hedge funds and commodity pools, to AML Program requirements.[3] We have attached a copy of this letter hereto and incorporate it herein by reference. In particular, as we explain below, we would like to draw Treasury's attention to the sections therein entitled, "Delegation of Anti-Money Laundering Compliance Responsibility to Third Parties" and "Additional Issues Related to Third-Party Delegation of AML Duties Under the Act."[4] It is not clear that the current Proposed Rules take into account issues raised in these sections. We strongly urge Treasury to take the comments from these sections into account as well as our comments below in finalizing its Proposed Rules as they relate to both IAs and CTAs.

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[2] See MFA comment letter, dated February 11, 2002 (Correspondent Accounts for Foreign Shell Banks); MFA comment letter, dated July 1, 2002 (Notice of Proposed Rulemaking on Anti-Money Laundering Due Diligence Programs for Certain Foreign Accounts (Section 312 of USA PATRIOT Act)); and MFA comment letter, dated November 25, 2002 (Section 352 Unregistered Investment Company Regulations). These letters are available on MFA's Web site at: ***www.mfainfo.org.***

[3] See MFA comment letter, dated November 25, 2002, regarding Treasury's proposed rule under Section 352 of the Act for AML Programs for unregistered investment companies published by Treasury on September 26, 2002 (67 Fed. Reg. 60,617).

[4] See MFA comment letter, dated November 25, 2002, at 3-8.

Exclusions for Investment Advisers and CTAs Should be Parallel

Proposed Rule for IAs

In each of the Proposed Rules, Treasury has specifically requested comment on the respective definitions of CTAs and IAs. With respect to the Proposed Rule for IAs, Treasury has defined the term "investment adviser," for whom the Proposed Rules apply, to include two groups of advisers:

(1) Advisers registered with the Securities and Exchange Commission ("SEC") that have a principal office and place of business in the U.S. (the "U.S. advisers") and that report to the SEC that they have assets under management on form ADV; and
(2) U.S. advisers that are not registered with the SEC, but have $30 million or more of assets under management, and are relying on the registration exemption available under section 203(b)(3) of the Investment Advisers Act of 1940 (the "Advisers Act").[5]

The Proposed Rule for IAs excludes from its application the following types of IAs:

(1) Small, state registered firms with less than $30 million in assets under management that are not registered with the SEC;
(2) IAs that are registered with the SEC but do not manage client assets;[6] and
(3) Unregistered advisers required to have an AML Program under the BSA as a financial institution in another capacity and examined by a Federal functional regulator in that other capacity.

Treasury states in the Proposed Rule for IAs that, for a number of reasons, these categories of IAs "are unlikely to play a significant role in money laundering."[7]

Proposed Rule for CTAs

The Proposed Rule for CTAs would apply to any CTA[8] that is either registered or required to be registered with the CFTC and that directs client commodity futures or options

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[5] Section 203(b)(3) exempts from SEC-registration advisers who during the preceding 12 months have had fewer than 15 clients and who neither hold themselves out generally to the public as IAs nor act as IAs to any registered investment company or business development company.

[6] Under Section 203A of the Advisers Act, advisers with assets under management of less than $25 million are generally prohibited from registering with the SEC. Thus, all firms with assets under $25 million would be excluded from the Proposed Rule for IAs.

Under the Adviser Act, advisers with assets under management between $25-$30 million may choose whether to register with the SEC or with the states. Thus, firms with assets in this $25-$30 million range would only be subject to the Proposed Rule for IAs if they chose to register with the SEC.

[7] 68 Fed. Reg. at 23,648.

[8] Treasury has defined the term "Commodity Trading Advisor" generally as a person who, for compensation or profit, engages in the business of advising others, either directly or indirectly as to the value or advisability of trading futures contracts or commodity options, or who issues analyses or reports concerning trading futures or

accounts. As with the Proposed Rule for IAs, Treasury has also set forth certain exclusions from the AML Program for CTAs requirement:

(1) Any person who is not registered as a CTA under CFTC Rule 4.14(a);
(2) CTAs that provide commodity trading advice, but do not direct accounts; and
(3) Persons that choose to register with the CFTC as CTAs, even though they are not required to register, and who do not direct client accounts.

The Proposed Rule for CTAs does not contain an exclusion that is tied directly to the limited size of assets under management advised or directed by a CTA.

MFA's Recommendation

MFA believes that the exclusions under the Proposed Rule for CTAs should parallel the exclusions set forth under the Proposed Rule for IAs if those exclusions for IAs are to be adopted in the final rule. In the Proposed Rule for IAs, Treasury has essentially excluded all IAs that have less than $30 million in assets under management[9] from the requirement that they adopt an AML Program pursuant to Section 352 of the Act. In providing this exclusion for IAs, Treasury stated that "because these excluded firms … do not accept funds or hold financial assets directly, and have relatively few (or no) assets under management, these firms are unlikely to play a significant role in money laundering."[10] This exclusion for IAs appears to be based on the small amount of funds under management by the IA, rather than on its registration status with the SEC. The Proposed Rule for CTAs contains no similar exemption, even though the rationale for such an exemption is even stronger for CTAs than it is for IAs. CTAs are specifically prohibited from taking custody of clients' funds under the CEA and CFTC regulations. Moreover, if a CTA has only a relatively small amount of assets under management, then CTAs should similarly be granted an exclusion from the Proposed Rule for CTAs. For regulatory consistency, MFA believes that if Treasury is going to adopt the $30 million threshold for excluding certain IAs from AML Program requirements, it should also amend the Proposed Rule for CTAs to exclude all CTAs who direct or advise accounts of less than $30 million in assets under management.

Prescriptions for AML Programs Should be Clarified

Proposed Rule for CTAs

In the Proposed Rule for CTAs, under Section III.B.2(1) entitled, "The Four Required Elements of Each Anti-Money Laundering Program,"[11] MFA believes that Treasury has not correctly described the division of responsibility between the CTA in managing an account and the futures commission merchant ("FCM") in holding account assets. The Proposed Rule states that "CTAs face higher vulnerability to money laundering when clients place their assets with a

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commodity options. Such CTAs must register with the Commodity Futures Trading Commission ("CFTC") unless exempt from the provisions of Section 4m of the Commodity Exchange Act ("CEA").
[9] See footnote 6.
[10] See Proposed Rule for IAs, 68 Fed. Reg. at 23,648.
[11] See 68 Fed. Reg. at 23,642-44.

futures commission merchant and the funds are directed by the CTA."[12] As an example, Treasury suggests that a CTA's AML procedures "seek to identify unusual transactions whereby clients deposit checks drawn on (or wire transfers made from) accounts of third parties with no family or business relation to the client."[13] The statements that a CTA receives would not show the identity of the accountholder from which a check or wire originated. Since the CTA is not involved in the flow of assets in and out of an account, cannot hold client assets, and can direct them only to the extent authorized by its advisory agreement, it would not have access to these details. Accordingly, MFA believes that the final rule for CTAs should clearly provide that CTAs may exclude from the scope of their AML Programs those accounts that are maintained with an FCM that is subject to AML Program requirements under the Act.

Proposed Rule for IAs

In the Proposed Rule for IAs, Treasury states that it is permissible for IAs to delegate the "implementation and operation of appropriate elements of its [AML Program]" to third party service providers.[14] We direct Treasury's attention to MFA's November 25th comment letter, attached hereto, and the section entitled, "Responsibility for Third Party's AML Program."[15] In that section, MFA refers to portions of the MFA Guidance that address the types of entities upon which it might be appropriate to rely for the performance of investor identification procedures. Furthermore, MFA provided detailed guidance on determining whether third-party administrators have adequate AML Programs in place. We still believe that the comments in our earlier letter regarding reliance upon third parties should be reflected in any final rules applicable to IAs and CTAs.

Federal Inspection Authority

Proposed Rule for CTAs

Under the Proposed Rule for CTAs, MFA supports Treasury's delegation of inspection authority to the CFTC. We believe that the CFTC's expertise, with the assistance of the National Futures Association ("NFA"), would be valuable in determining whether a CTA's AML Program was appropriate in light of a CTA's business risks. Both the CFTC and the NFA have the necessary resources to work with CTAs in developing effective AML Programs.

MFA Recommendation for Both Proposed Rules

In the Proposed Rules, on the issue of delegation of responsibilities to third-party service providers, Treasury states that both CTAs and IAs would remain "fully responsible for the effectiveness of its [AML Program], as well as for ensuring that federal examiners are able to

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[12] 68 Fed. Reg. at 23,643.
[13] *Id.* The CTA, who as an accounting matter can confirm inflows or outflows from an account, would not have enough information to question the source of checks or wires. A CTA's statements would not show the issuing institution for checks or wires or the destination institution or country of origin.
[14] 68 Fed. Reg. at 23,650.
[15] See MFA's comment letter, dated November 25, 2002, at 3.

obtain information and records relating to the program and to inspect the third party for purposes of the program."[16] MFA refers Treasury to its November 25th letter, attached hereto, and the section entitled "U.S. Federal Examination Authority."[17] Under the subsection, "Offshore Third Party Administrators", MFA addressed the difficulties involved in essentially requiring offshore fund administrators to open up their books and records to U.S. federal agents. MFA underscores its concerns about the feasibility of imposing extra-territorial jurisdiction of federal examiners over offshore administrators. We ask that Treasury reexamine its approach in the Proposed Rules consistent with our earlier comments.

Treasury Should Avoid Duplicative Regulation Over Financial Institutions

Treasury has also requested comment on the proposed provisions designed to avoid imposing overlapping or duplicative regulation of CTAs or IAs and other financial institutions that are also subject to AML Program requirements. In the Proposed Rule for CTAs, for instance, Treasury states, "to prevent overlap and redundancy, the proposed rule would permit CTAs covered by the rule to exclude from the anti-money laundering program any investment vehicle they advise that is subject to an anti-money laundering program requirement under BSA rules."[18] There is a similar provision in the Proposed Rule for IAs.[19] MFA believes that this exclusion should be clarified according to the general proposition we set forth below.

On the particular issue of "preventing overlap and redundancy" in requiring AML Programs for financial institutions, it is helpful to remember, as underscored in the legislative history of the Act and by Treasury, that this requirement is not one that is "one-size-fits all." Rather, each financial institution subject to the Act should have the flexibility to tailor its program to fit its business, using the risk-based approach endorsed by Treasury. Since the passage of the Act, Treasury has proposed various amendments to the definition of "financial institution" in other proposed rulemakings mandating the adoption of an AML Program.[20] If Treasury's various proposed rules are adopted as final rules, then the term "financial institution" could encompass entities such as hedge funds, commodity funds, CTAs, IAs, and others such as FCMs and registered broker-dealers. Many entities or individuals may fit into more than one of these categories. For example, many CTAs covered by the Proposed Rule are also CFTC-registered commodity pool operators ("CPOs"). The commodity funds operated by CPOs would be subject to the proposed rule for unregistered investment companies ("UIC"), published last September, if they meet the criteria set forth in the final rule.

The Proposed Rules acknowledge that many CTAs and IAs, respectively, direct accounts of pooled investment vehicles and other types of accounts. These entities, such as hedge funds, will also be covered by the Act under currently-proposed or adopted rulemakings by Treasury.

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[16] 68 Fed. Reg. at 23,643 (Proposed Rule for CTAs); 68 Fed. Reg. at 23,650 (Proposed Rule for IAs).
[17] MFA comment letter, dated November 25, 2002, at 6.
[18] 68 Fed. Reg. at 23,642.
[19] 68 Fed. Reg. at 23,648.
[20] See, e.g., Financial Crimes Network; Anti-Money Laundering Programs for Commodity Trading Advisors (68 Fed. Reg. 23,640) (May 5, 2003); Financial Crimes Network; Anti-Money Laundering Programs for Investment Advisers (68 Fed. Reg. 23,646) (May 5, 2003); Financial Crimes Network; Anti-Money Laundering Programs for Unregistered Investment Companies (67 Fed. Reg. 60,617) (September 26, 2002).

As currently drafted, the Proposed Rules for IAs and CTAs permit such advisers to exclude from their AML Program investment vehicles which are themselves subject to the AML Program requirements under the Act. However, the Proposed Rules do not explicitly permit CTAs, IAs, or other impacted financial institutions, to exclude offshore funds located in FATF-Compliant Jurisdictions[21] from their AML Programs using the risk-based approach set forth in the MFA Guidance.[22] Thus, in order to avoid duplicative and unnecessary burdens on such inter-related financial institutions, MFA proposes that Treasury permit IAs and CTAs to rely upon the AML Programs of foreign financial institutions where, and to the extent that, such reliance is determined to be appropriate. The MFA Guidance provides fund managers with clear recommendations on how to determine whether reliance upon third parties with respect to AML procedures and responsibilities is appropriate.[23] The approach set forth in the MFA Guidance would be consistent with Treasury's risk-based approach to AML Program compliance and would help financial institutions avoid duplicative regulatory obligations through the adoption of clear channels of responsibilities among third parties with whom it conducts business.

Conclusion

Overall, MFA would like to commend Treasury for its efforts in bringing numerous financial institutions into compliance with the Act in a manner that seeks a risk-based approach. Accordingly, MFA is hopeful that Treasury will carefully consider our comments and those from other industry participants and take them into account in drafting final rules. Specifically, MFA also supports the comments submitted by NFA on the Proposed Rules for CTAs. MFA believes that the implementation of the Proposed Rules, and similar rules applicable to the managed funds industry, is very important and we strongly believe that a meeting between Treasury and representatives of affected parties would be helpful in finalizing various rulemakings under Section 352 of the Act.

If you have any particular questions about the issues MFA has raised in connection with the Proposed Rules, please contact me at 202.367.1140.

Sincerely,

/s/ John G. Gaine
John G. Gaine
President

Attachment

[21] The MFA Guidance defines "FATF Compliant Jurisdiction" as a jurisdiction that: (i) is a member in good standing of FATF; and (ii) has undergone two rounds of FATF mutual evaluations.
[22] See MFA comment letter, dated November 25, 2002, at 6 (urging Treasury to permit delegation of AML responsibilities to third parties located in FATF-Compliant Jurisdictions).
[23] The MFA Guidance covers the following topics in the section entitled, "Reliance Upon Investor Identification Procedures Performed by Third Parties": (1) relationships between hedge fund managers and third parties, (2) deciding to rely upon investor identification procedures performed by third parties, and (3) allocation of responsibilities between the parties.