

## Mutual Funds Regulated as BSA Financial Institutions

BY KAREN BENSON

**F**inCEN issued a final rule that defines mutual funds as “financial institutions” under rules implementing the Bank Secrecy Act (BSA). As such, mutual funds will be subject to rules under the BSA on (i) the filing currency transaction reports (CTRs) and (ii) the creation, retention and transmittal of records or information on transmittal of funds and other specified transactions (the Recordkeeping and Travel Rule).



*Mutual funds on board as BSA institutions*

The final rule replaces a mutual fund’s requirement to file an IRS/FinCEN Form 8300 with a requirement to file a CTR on FinCEN Form 104. Both forms document a transaction in currency over \$10,000, but differ in technical respects regarding the definition of “currency” and the treatment of multiple transactions.

Mutual funds must also comply with the Recordkeeping and Travel Rule, subject to certain exceptions. The Recordkeeping and Travel Rule requires that a financial institution obtain and retain certain information relating to transmittal of funds of \$3,000 or more, and that this information be passed along to other financial institutions in the payment chain. The amount and type of information a financial institution must obtain, retain, and/or transmit depends upon its role in the funds transfer process. Additionally, mutual funds must comply with the recordkeeping requirements relating to extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit.

Finally, the rule harmonizes the definition of mutual fund in the AML program rule with definitions found in the other BSA rules as well as amends the rule to clarify the delegation of authority to examine institutions for BSA compliance to the SEC and not the IRS.

The CTR filing requirement becomes effective May 14, 2010. Mutual funds must comply with the Recordkeeping and Travel Rule and related recordkeeping requirements by January 10, 2011.

## SEC Staff to Review Derivatives Use by Funds and ETFs

BY RICHARD CHOI

**I**n late March, the SEC staff announced that it was reviewing the use of derivatives by mutual funds, exchange-traded funds (ETFs), and other investment companies to determine whether additional protections are necessary under the Investment Company Act of 1940 (Act).

Pending its review, the staff stated that it would defer action on new and pending exemptive requests under the Act to operate ETFs that intend to make significant use of derivatives. The deferral will affect certain actively-managed and leveraged ETFs that “particularly rely on swaps and other derivative instruments to achieve their investment objectives,” but does not affect any existing ETFs or other types of fund applications. Among other things, the staff will be evaluating whether:

- current market practices involving derivatives are consistent with the leverage, concentration, and diversification provisions of the Act,
- funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of the fund’s derivatives transactions,
- fund boards of directors are providing appropriate oversight of the use of derivatives by funds,
- existing rules sufficiently address matters such as the proper procedure for a fund’s pricing and liquidity determinations regarding its derivatives holdings,
- existing prospectus disclosures adequately address the particular risks created by derivatives, and
- funds’ derivative activities should be subject to special reporting requirements.

The SEC staff also will seek to determine whether any changes in SEC rules or guidance may be warranted. In a recent speech, SEC Director Buddy Donohue explained that the SEC staff’s goal regarding derivatives is not simply to react to recent market events, but, rather, to develop an appropriate regulatory framework for the proper use of derivatives by funds.