

## **MEMORANDUM**

TO: Our Clients and Friends

FROM: Godfrey & Kahn, S.C.

DATE: June 24, 2003

RE: Anti-Money Laundering Update: Final Customer Identification Rules Adopted

---

Mutual funds will be required to implement customer identification programs to verify the identity of new shareholders no later than October 1, 2003 pursuant to a new rule issued by the Treasury Department and the SEC. This rule is part of Treasury's response to the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism ("USA PATRIOT") Act of 2001, which mandates that the department enact certain legislation designed to aid in abatement of international money laundering and the financing of terrorism. This memorandum provides a summary of the final rule.

### *What is required of mutual funds under the rule?*

The new rule mandates that a mutual fund develop and operate a customer identification program ("CIP") as part of the fund's anti-money laundering compliance program. The CIP must include procedures to: (1) collect identifying information about customers prior to opening an account; (2) verify the identity of any customer within a reasonable amount of time after the account is opened, to the extent reasonable and practicable; (3) maintain records relating to the identification and verification of customers; (4) determine whether the customer appears on a government list of known or suspected terrorists or terrorist organizations; and (5) provide customers with adequate notice that the fund is requesting information to verify their identities. Mutual funds must base their CIPs on risks associated with their business operations, such as:

- the manner in which fund shares are distributed, and purchases, sales and exchanges are effected;
- the method by which customers open accounts (e.g., on-line, through the mail or in person);

- the types of accounts maintained by the fund;
- the type of identifying information available; and
- the customer base.

The procedures must allow the mutual fund to form a reasonable belief that it knows the true identity of the customer. Once these procedures have been established, the mutual fund's board of directors must approve the CIP.

*What customers are subject to the rule?*

The rule requires identification and verification of "customers," defined as any person who opens a new account with a mutual fund for himself or herself, for an individual who lacks legal capacity or for an entity that is not a legal person. "Customer" does not include (1) customers who had existing accounts prior to October 1, 2003, provided the mutual fund has a reasonable belief that it knows the true identity of the customer, (2) a financial institution regulated by a federal regulator, (3) a regulated state bank, (4) governmental agencies and (5) public companies traded on a stock exchange or Nasdaq.

*What information must be obtained by the mutual fund under the rule?*

Before opening any new account, a mutual fund must obtain, at a minimum, the following information:

- the person's name;
- date of birth, if applicable;
- residential or business street address, an Army Post Office (APO) or Fleet Post Office (FPO) box number or the residential or business street address of next of kin or of another contact individual; and
- taxpayer identification number, alien identification card number, or other government issued document containing a photograph or similar safeguard.

*Do funds have to "look through" omnibus accounts or trusts?*

For the purposes of the rule, the customer is the named accountholder. Accordingly, in the case of a trust account, a fund is not required to look through the trust to verify the identities of the beneficiaries. Similarly, with respect to an omnibus account established by an intermediary, such as a broker-dealer, a fund is not required to look through the intermediary to the underlying beneficial owners. In each case, the fund is required to verify the identity of the named accountholder (i.e., the trust or the broker-dealer).

*Are there any accounts that are exempt from the rule?*

Yes. Accounts opened for the purpose of participating in an employee benefit plan established pursuant to ERISA are excluded from the definition of “account” and, therefore, exempt from the requirements of the rule. In addition, any account that a fund acquires through an acquisition, merger, purchase of assets or assumption of liabilities from any third party is exempt from the requirements of the rule.

*What steps must be taken by the mutual fund to verify the information obtained?*

Mutual funds must use one of two primary methods to verify the identity of the customer within a reasonable time after the account is opened. The use of a particular method will depend upon the relevant risk factors associated with both the mutual fund’s business and the customer itself.

The first method outlined is “verification through documents.” The rule requires that mutual funds specify in their CIP when verification through documents will be used. Suitable documents for verification may include:

for individuals

- driver’s license, passport or other government-issued identification bearing a photograph;

for entities

- certified articles of incorporation;
- government-issued business licenses;
- partnership agreements; or
- trust agreements.

The second method is “verification through non-documentary methods.” The mutual fund’s CIP should specify the types of non-documentary methods and when these methods will be used. Non-documentary methods may include:

- customer contact;
- comparing identifying information provided against information obtained from a consumer reporting agency, public database, or other source;
- checking references with other financial institutions; and
- obtaining financial statements.

Additionally, the SEC recommends that mutual funds analyze whether there is logical consistency between the identifying information provided.

The CIP must address situations where, based on the mutual fund's risk assessment of a new account opened by a customer that is not an individual, the fund will obtain information about individuals with authority or control over such account to verify the customer's identity. This verification method applies only when the fund cannot verify the customer's true identity using the verification methods described above.

The mutual fund's CIP should also outline what types of transactions the customer will be able to conduct during the verification process, the procedures that should be followed in the event that the customer's identity is unable to be verified, and when an account will not be opened or an open account will be closed. Mutual funds should also consider filing "suspicious activity reports" with FinCEN when identity records are unable to be verified, but at this time, are under no statutory requirement to do so. The SEC and FinCEN have proposed a rule to require mutual funds to file suspicious activity reports, and a final rule is expected in the near future.

*To what extent must mutual funds determine whether the customer appears on any list of known or suspected terrorists or terrorist organizations?*

Customer names must be checked against lists of known or suspected terrorists or terrorist organizations circulated by the federal government, such as the Office of Foreign Asset Control (OFAC), within a reasonable period of time after the account is opened. The federal government will designate lists that may be used and will notify mutual funds of the lists that must be consulted. In addition, the CIP must require the mutual fund to follow all federal directives issued in connection with such lists.

*What type of notice must be provided to customers regarding the verification of their identity under the rule?*

The rule requires that customers be given adequate notice that the mutual fund is requesting information to verify their identity. The following sample language may be used:

***IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT***

*To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.*

*What this means for you: When you open an account, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.*

The notice must be provided in a manner reasonably designed to ensure a customer receives notice before opening an account, and may include posting the notice on the fund's website, written notice on account applications or any other form of written or oral notice.

*What records must be maintained and for how long?*

Mutual funds are required to document their record retention policies in their CIP. All identifying information must be maintained for five years after the account is closed. A description of any document obtained to verify the identity of the customer, the methods and results of the methods used to verify the identity of the customer, as well as a description of the resolution of any discrepancies identified during the customer identification procedures, must be retained for five years after the record is created.

*Can funds rely on other financial institutions to implement their CIPs?*

The CIP may specify when the fund will rely on another financial institution (including a fund affiliate) to perform any procedures in the fund's CIP with respect to any customer of the fund that is opening, or has opened, an account or has established a similar business relationship with the other financial institution to provide or engage in services, dealings or other financial transactions. In order for a fund to rely on the other financial institution: (1) such reliance must be reasonable under the circumstances, (2) the financial institution must be required to implement an anti-money laundering program under the Bank Secrecy Act and be regulated by a federal regulator, and (3) the other financial institution must enter into a contract with the fund requiring it to certify annually to the fund that it has implemented an anti-money laundering program and that it (or its agent) will perform the specific requirements of the fund's CIP. If these conditions are not satisfied, then the fund remains solely responsible for applying its CIP to each customer.

*Can funds delegate CIP responsibilities to service providers?*

It is permissible for a mutual fund to contractually delegate implementation of its CIP to affiliated or unaffiliated service providers such as transfer agents even if the service provider is not another financial institution subject to the Bank Secrecy Act; however, the mutual fund remains responsible for assuring compliance with the rule and must actively monitor the operation of the CIP and assess its effectiveness.

\* \* \*

We hope this has been helpful. If you have any questions, please do not hesitate to contact us.

Godfrey & Kahn Investment Management Practice Group

Kenneth C. Hunt, [khunt@gklaw.com](mailto:khunt@gklaw.com)

Carol A. Gehl, [cgehl@gklaw.com](mailto:cgehl@gklaw.com)

Pamela M. Krill, [pkkrill@gklaw.com](mailto:pkkrill@gklaw.com)

Ellen R. Drought, [edrought@gklaw.com](mailto:edrought@gklaw.com)

Michelle M. Nelson, [mnelson@gklaw.com](mailto:mnelson@gklaw.com)

Jake C. Blavat, [jblavat@gklaw.com](mailto:jblavat@gklaw.com)

C.J. Wauters, [cwauters@gklaw.com](mailto:cwauters@gklaw.com)

Susan M. Hoaglund, [shoaglund@gklaw.com](mailto:shoaglund@gklaw.com)