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Division of Clearing and
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James L. Carley
Director

CFTC letter No. 05-05
March 14, 2005
No-Action
Division of Clearing and Intermediary Oversight

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Re: 31 CFR 103.123 and 17 CFR 42.2 – Request to Treat Certain CTAs as Subject to Anti-Money Laundering Program Rule for Purposes of Complying with Reliance Provision in Customer Identification Program Rule for FCMs and IBs

Dear Ms. Wierzynski:

This is in response to your letter dated May 5, 2004 to the Office of General Counsel ("OGC") of the Commodity Futures Trading Commission ("Commission"). By your correspondence, you request relief on behalf of futures commission merchants ("FCMs") and introducing brokers ("IBs") that will allow them to treat commodity trading advisors ("CTAs") that are registered with the Commission or are exempt from registration but are registered with the Securities and Exchange Commission ("SEC") as investment advisers ("IAs")[1] as if they are subject to an anti-money laundering program ("AMLP") rule ("AMLP Rule") under the Bank Secrecy Act ("BSA").[2] Specifically, you request confirmation that OGC will not recommend that the Commission commence any enforcement action against FCMs or IBs if they rely upon such CTAs to perform procedures of the FCM's or IB's customer identification program ("CIP") prior to the time that CTAs become subject to a final AMLP Rule. This matter has been referred to the Division of Cle aring and Intermediary Oversight ("Division") for response.

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[1] Commission Rule 4.14(a)(8) (17 C.F.R. 4.14(a)(8)) exempts from CTA registration certain IAs, including those that are registered with the SEC and that provide trading advice directed solely to and for the sole use of "qualifying entities," such as registered investment companies, under Rule 4.5 (17 C.F.R. § 4.5).

[2] 31 U.S.C. § 5311 et seq.

On April 29, 2003, the Commission jointly issued a rule (the "CIP Rule")[3] with the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") that requires FCMs and IBs to establish and implement CIPs.[4] The CIP Rule is set forth among the Part 31 regulations issued by FinCEN under the BSA. Commission Rule 42.2[5] requires FCMs and IBs[6] to comply with the CIP Rule, among other applicable BSA regulations.

The CIP Rule requires FCMs and IBs to implement CIPs that contain the following elements: (1) procedures for verifying the identities of customers; (2) procedures for making and maintaining records of the verification process; (3) procedures for checking customer names against lists of known or suspected terrorists or terrorist organizations; and (4) procedures for providing customers with notice that information is being collected to verify their identities.[7]

The CIP Rule permits FCMs and IBs to rely on certain financial institutions to perform procedures of the FCM's or IB's CIP with respect to shared customers. Such reliance is permissible where: (1) it is reasonable under the circumstances; (2) the relied-upon financial institution is subject to an AMLP Rule under 31 U.S.C. § 5318(h) of the BSA and regulated by a Federal functional regulator; and (3) the relied-upon financial institution enters into a contract requiring it to certify annually to the FCM or IB that it has implemented an AMLP, and that it (or its agent) will perform specified requirements of the FCM's or IB's CIP.[8] The reliance provision is designed to permit two financial institutions with mutual customers to reach agreements between themselves as to how they will allocate performance of the requirements of the CIP Rule and, thereby, rely on one another to avoid unnecessary duplication of efforts with respect to a given customer.

You argue that the interrelationships between FCMs and IBs on the one hand, and CTAs on the other hand, though not standardized or uniform, often are the types of situations that are intended to be covered by the reliance provision. In particular, you point out that CTAs may have the most direct relationship with the customers whose accounts they advise and, therefore, would be in the best position to perform some of the requirements of the CIP Rule. Moreover, many CTAs have discretion to direct futures transactions in a customer's futures account.

You note that staff of the SEC has granted relief that allows brokers and dealers ("BDs") to rely upon IAs that are registered with the SEC to perform elements of a BD's CIP.[9] The relief

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3 31 C.F.R. § 103.123.

4 68 Fed. Reg. 25149 (May 9, 2003). The CIP Rule implements Section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. 107-56.

5 17 C.F.R. § 42.2.

6 The terms "FCM" and "IB" are defined in the CIP Rule as any person required to register as such with the Commission under the Commodity Exchange Act ("CEA"), except persons who are notice-registered pursuant to 15 U.S.C. § 78o(b)(11). The Division uses the terms "FCM" and "IB" herein as they are defined in the CIP Rule, although it recognizes that not all such firms are members of the Futures Industry Association.

7 See 31 C.F.R. §§ 103.123(b)(2), (b)(3), (b)(4) and (b)(5), respectively.

8 31 C.F.R. § 103.123(b)(6).

9 Securities Industry Assn., SEC No-Action Letter, 2004 WL 307470 (Feb. 12, 2004), extended, http://www.sec.gov/divisions/marketreg/mr-noaction/antiml021005.htm (Feb. 10, 2005).

sought here would allow FCMs and IBs also to rely on such IAs where the IAs are exempt from CTA registration.

Because these CTAs are registered with either the Commission or the SEC, they meet the requirement in paragraph (b)(6)(ii) of the CIP Rule that a Federal functional regulator must regulate the relied-upon financial institution. CTAs are not currently subject to an AMLP Rule under the BSA and, consequently, they do not meet this specific requirement in paragraph (b)(6)(ii). FinCEN has proposed AMLP Rules for certain registered CTAs and IAs.[10] Final rules have not yet been adopted. You have asked for relief that would allow FCMs and IBs to treat CTAs that are registered with the Commission or are registered as IAs with the SEC but are exempt from CTA registration as if they are subject to an AMLP Rule for the purposes of complying with paragraph (b)(6) of the CIP Rule.[11]

In support of your request for relief, you assert that some of these CTAs have implemented AMLPs and will agree to enter into reliance contracts with an FCM or IB, as applicable. If such relief is granted and FinCEN ultimately decides not to issue AMLP Rules for these CTAs, you also ask that FCMs and IBs be permitted to continue to rely on these CTAs under paragraph (b)(6) until thirty days after FinCEN publicly announces such a decision.

Based on the foregoing, and with the consent of FinCEN as this relates to a joint rulemaking, this Division will not recommend that the Commission commence any enforcement action against FCMs or IBs for failure to comply with Rule 42.2 if an FCM or IB relies upon a CTA that either is registered with the Commission as a CTA or is exempt from registration as a CTA because it is registered as an IA with the SEC prior to the time that such CTA becomes subject to an AMLP Rule. This relief is granted on condition that all of the other requirements in paragraph (b)(6) of the CIP Rule are met, namely that: (1) such reliance is reasonable under the circumstances; (2) the CTA is regulated by a Federal functional regulator; and (3) the CTA enters into a contract requiring it to certify annually to the FCM or IB that it has implemented an AMLP, and that it (or its agent) will perform specified requirements of the FCM's or IB's CIP.

Neither this letter nor the CIP Rule, however, impose affirmative obligations on CTAs to perform CIP functions for FCMs or IBs. Thus, a CTA is not required to enter into a contractual agreement with an FCM or IB permitting reliance. The relief provided by this letter is available only where the CTA has affirmatively entered into such an agreement with an FCM or IB, and

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[10] 68 Fed. Reg. 23640 (May 5, 2003) (proposed rule that would require certain CTAs to adopt and implement AMLPs); 68 Fed. Reg. 23646 (May 5, 2003) (proposed rule that would require certain IAs to adopt and implement AMLPs).

[11] You have not requested that this relief address reliance on commodity pools operated by Commission-registered commodity pool operators. Staff has received inquiries as to whether an FCM that opens a commodity pool account may rely upon the pool or its commodity pool operator to perform CIP functions with respect to the participants in that pool. FinCEN has issued a proposed rule requiring certain unregistered investment companies, including commodity pools, to adopt and implement AMLPs (67 Fed. Reg. 60617, September 26, 2002); however, unlike IAs and CTAs, no proposed AMLP Rule has been issued for commodity pool operators. No reliance issue arises in such circumstances, however, because the FCM's customer is the pool itself, not the underlying pool participants. As the Commission and Treasury noted in adopting the CIP Rule, with respect to commodity pools and other collective investment vehicles: "The focus of the CIP with respect to intermediated accounts will be the intermediary itself. . . . This is not because the [Firm] is relying upon the intermediary to perform its required due diligence. . . . [W]hen an intermediary opens an account . . . in the name of its collective investment vehicle, the . . . collective investment vehicle is the firm's 'customer.'" 68 Fed. Reg. 25149, 25151 (May 9, 2003).

only with respect to those CIP elements set out in such an agreement negotiated between the CTA and the FCM or IB.

This letter does not excuse FCMs or IBs from compliance with any other applicable requirement contained in the CEA or in the Commission's regulations issued thereunder. For example, FCMs and IBs remain subject to the relevant antifraud provisions of the CEA and the Commission's regulations, the customer identification requirements of Commission Rule 1.37 (17 C.F.R. § 1.37), and, as applicable, the relevant reporting requirements under Parts 15, 17 and 21 of the Commission's regulations.

This letter and the no-action position taken herein are based upon your representations. Any different, changed, or omitted material facts or circumstances might render this no-action void. Moreover, this letter represents the position of this Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. It may be withdrawn or modified if staff determines that such action is necessary to be consistent with the BSA or the CEA and in the public interest.

Finally, this letter will be deemed to be withdrawn automatically, without further action, (1) with respect to CTAs registered with the Commission, upon the earlier of: (a) the date upon which AMLP Rules for CTAs become effective, or (b) 30 days after FinCEN publicly announces that it will not issue AMLP Rules for CTAs; and (2) with respect to CTAs exempt from registration with the Commission but registered with the SEC as IAs, upon the earlier of (a) the date upon which AMLP rules for IAs become effective or (b) 30 days after FinCEN publicly announces that it will not issue AMLP Rules for IAs.

Best regards,

James L. Carley
Director, Division of Clearing & Intermediary Oversight

cc: William J. Fox
Director, FinCEN