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COMMENT

September 6, 2002

Ms. Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Section 326 Proposed Rule—Customer Identification
67 *Fed.Reg.* 48238, July 23, 2002

Dear Ms. Webb:

The Futures Industry Association ("FIA")[1] is pleased to submit these comments in support of the rules that the Department of the Treasury ("Treasury") and the Commodity Futures Trading Commission ("Commission") have proposed to implement the provisions of section 326 of the USA PATRIOT Act.[2] (Treasury and the Commission are collectively referred to herein as the "Agencies".) Consistent with section 326, the proposed rules require futures commission merchants ("FCMs") and introducing brokers to implement procedures for (a) verifying the identity of any person seeking to open an account "to the extent reasonable and practical"; (b) maintaining records of the information used to verify the person's identity, including the person's name, address and other identifying information; and (c) determining whether the person's name appears on any lists of known or suspected terrorists or terrorist organizations.

FIA applauds the Agencies for proposing rules that generally effect a risk-based approach to the development and implementation of customer identification programs. We also appreciate and welcome the guidance that the Agencies have provided with respect to the implementation of a risk-based approach in particular circumstances. Our comments below are designed primarily to seek clarification on certain points and to suggest revisions that will enhance further the customer identification programs of FCMs and introducing brokers by assuring more efficient use of these registrants' resources.

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[1] FIA is a principal spokesman for the commodity futures and options industry. Our regular membership is comprised of approximately 50 of the largest futures commission merchants in the United States. Among our associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of our membership, FIA estimates that our members effect more than 90 percent of all customer transactions executed on US contract markets.

[2] Uniting and Strengthening America by Providing Appropriate Tools required to Intercept and Obstruct Terrorism Act of 2001, Pub, L. No. 107-56 (2001).

Customer Defined. Section 103.123(a)(4) of the proposed rules provides that a "customer" means (i) any person who opens a new account with an FCM; and (ii) any person "who is granted authority to effect transactions with respect to the account." FIA requests the Agencies to clarify their intent with respect to the class of persons intended to fall within the latter group. In the *Federal Register* release, the Agencies' limited discussion of persons "granted authority to effect transactions" refers only to outside advisors.[3] Nonetheless, the term is broad enough to include any individual authorized to enter trades for the account of an entity, including the entity's employees and the employees of the entity's outside advisor.

FIA does not interpret this definition to include authorized traders that are employees of the entity in whose name the account is carried or of the entity's outside advisor. FIA suggests that, for purposes of these rules, it is only the identity of the entity itself (or the outside advisor) that is important. Moreover, particularly among institutional customers, the number of such authorized traders is usually quite large and their identities can change frequently. Requiring an FCM to verify the identity of such individuals could impose a substantial administrative burden of the FCM as well as prevent legitimate transactions from being effected for the customer's account.

In the event the Agencies do not agree with our interpretation, we request the Agencies to confirm that, consistent with the risk-based approach reflected in these proposed rules, FCMs and introducing brokers may establish procedures that would require a registrant to verify the identity of such authorized traders only in defined circumstances. For example, such procedures could provide that a registrant would be required to verify the identity of individual traders only when the potential for money-laundering activities in the customer's account is present, based on consideration of such factors as the customer's location, the statutory and regulatory regime, if any, that applies to the customer's activities, its reputation, its business, and the nature of its trading activities. In contrast, a registrant would not be required to verify the identity of authorized traders of a publicly traded corporation or other entities that are known to the registrant.

Customer Identification Requirements for "New Accounts". FIA supports section 103.123(d) of the proposed rules, which provides that an FCM or introducing broker is not required to verify the identity of a customer each time the customer opens a new account, if (a) the registrant previously verified the customer's identity in accordance with procedures consistent with this rule, and (b) the registrant continues to have a reasonable belief that it knows the true identity of the customer. However, we ask the Agencies to clarify the meaning of a "new account" under the proposed rules. In the *Federal Register* release accompanying the proposed rules, the Agencies state that the term "account" includes "all *types* of accounts", including but not limited to futures accounts, options on futures accounts, options on physicals, cash accounts, margin accounts, and others. [Emphasis supplied.] The Agencies further state that a person becomes a new customer each time the person opens a "different type of account" at an FCM.

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[3] 67 *Fed.Reg.* 48328, 48330.

As the Commission certainly is aware, a customer may maintain different accounts for the purpose of trading futures for any number of reasons. For example, commercial customers may maintain separate hedging and speculative accounts; hedge funds may maintain separate accounts for different trading strategies or for trading different products. Moreover, we anticipate that customers that trade security futures products may want to maintain these positions in a separate account. Although these accounts have different numbers and are accounted for separately, they are the same type of account. That is, they are all accounts for trading futures contracts.

FIA believes that it would be appropriate to interpret the provisions of section 103.123(d) to require an FCM or introducing broker to verify a customer's identity each time the customer opens a new *type* of account, not each time a customer requests an FCM to establish a different account for trading the same type of product.[4] We ask the Agencies to clarify this point. If the Agencies nonetheless conclude that an FCM must verify the identity of a customer each time the customer opens a new account rather than a new type of account, FIA respectfully requests the Agencies to consider granting a no-action position with respect to accounts established for the purpose of trading security futures products. It is likely that trading in these products will commence at approximately the same time that these proposed rules become final. If FCMs are required to verify the identity of each customer that elects to trade security futures in a different account, the immediate administrative burden on FCMs and introducing brokers could be substantial.[5]

Transfer of Accounts. In the *Federal Register* release accompanying the proposed rules, the Agencies state that if a customer account is transferred from one FCM to another and the customer does not initiate the transfer, the receiving FCM is not required to verify the identity of a customer. The Agencies cite as examples of such transfers, transfers resulting from bankruptcy, merger, acquisition or purchase of assets. FIA notes that the rule itself does not provide such an exception and suggests that the Agencies consider amending the rules for this purpose.

Further, FIA has identified at least one circumstance in which it believes that a receiving FCM should not be required to verify the identity of a customer, although customer has initiated the transfer. Specifically, an associated person or group of associated persons may move from one FCM to another and, in connection with such move, the customers of the associated persons may request their FCM to transfer their accounts. The number of accounts being transferred could be significant, and it would be difficult for the receiving FCM to obtain the required information prior to opening the account without impairing the customers' ability to conduct business. FIA respectfully requests the Agencies to revise the proposed rules further to permit an FCM in these

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[4] From the FCM's perspective, the customer is opening a subaccount of an existing account, not an entirely new account.

[5] We understand that the proposed rule would not require a registrant to confirm the identity of the customer that elects to trade security futures in a separate account, if the registrant previously verified the customer's identity in accordance with procedures consistent with this rule, and the registrant continues to have a reasonable belief that it knows the true identity of the customer.

circumstances to receive the transferred accounts without first being required to obtain the required information from each customer. The obligation of the receiving FCM to verify the identity of the transferring customers within a reasonable time after the accounts have been opened would remain.

Reliance on Non-US Affiliates. Section 103.123(b) of the proposed rules and the accompanying *Federal Register* release make clear that an FCM or introducing broker, in appropriate circumstances, may rely upon another FCM or introducing broker to perform the customer identification function. Further, the *Federal Register* release notes that, in appropriate circumstances, an FCM can rely on non-US intermediaries.[6] In this latter regard, we request the Agencies to confirm that a US FCM may rely on its non-US affiliates to perform the necessary customer identification functions with respect to customers that its affiliates introduce to the US FCM. Such reliance is consistent with the risk-based approach reflected throughout the release and will permit the more efficient use of resources devoted to anti-money laundering compliance.

Give-Up Arrangements. In their discussion of proposed section 103.123(b), the Agencies have identified give-up arrangements as one example of the circumstances in which one registrant may rely on another to verify the identity of a customer with which each has a relationship. FIA agrees. However, the discussion of give-up arrangements is understandably brief, and we want to be certain that the Agencies share our understanding of the scope of an FCM's authority in this area.

First, the release states that an executing broker could obtain from a clearing FCM a certification that the clearing FCM has performed the necessary customer identification or verification functions "either as part of a give-up agreement or on a transaction-by-transaction basis."[7] We do

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[6] Specifically, with respect to intermediated accounts, the release states:

> In most instances, given Treasury's risk-based approach to anti-money laundering programs for financial institutions generally, it is expected that the focus of each futures commission merchant's and introducing broker's CIP will be the intermediary itself, and not the underlying participants or beneficiaries. Thus, futures commission merchants and introducing brokers should assess the risks associated with different types of intermediaries based upon an evaluation of relevant factors, including the type of intermediary; its location; the statutory and regulatory regime that applies to a foreign intermediary (*e.g.*, whether the jurisdiction complies with the European Union anti-money laundering directives or has been identified as non-cooperative by the Financial Action Task Force); the futures commission merchant's or introducing broker's historical experience with the intermediary; references from other financial institutions regarding the intermediary; and whether the intermediary is itself a BSA financial institution required to have an anti-money laundering program. 67 *Fed.Reg.* 48328, 48331.

FIA concurs with the Agencies' position in this regard. Further, we note that, subject to the risk assessment described above, FCMs may rely on foreign intermediaries in accepting both customer omnibus accounts and fully-disclosed accounts.

[7] 67 *Fed.Reg.* 48328, 48332, fn. 10.

not interpret this discussion as limiting the manner by which an executing broker may receive the appropriate certification from the clearing FCM. In this connection, we believe that an executing broker could receive the necessary assurance if the clearing FCM provides that executing broker with a letter to the effect that, in connection with each customer for which the FCM acts as the clearing broker, the FCM certifies that it has performed the required customer identification or verification functions.[8] The Agencies' favorable reference to the guidance offered by the UK's Joint Money Laundering Steering Group supports our position.

Second, we do not interpret the rule as prohibiting reliance on non-US brokers. In particular circumstances, the give-up relationship may be initiated by non-US affiliates of US FCMs. For example, a customer in London that has an account with a UK carrying broker may enter into a give-up relationship with a London-based executing broker to execute transactions on its behalf both in the UK and the US. Alternatively, the customer may begin the relationship with solely European give-ups and determine at a later time to use the executing broker for transactions in the US. In either case, the UK executing broker will use its US affiliate to execute trades in the US.[9]

Similarly, the UK carrying broker usually will clear the trades through the customer omnibus account that the UK carrying broker maintains with its US affiliate. In these circumstances, the US executing broker and US carrying broker will not enter into a separate agreement with the London-based customer. The US executing broker and carrying broker each will rely on the agreement entered into between their respective UK affiliates and the customer.[10] FIA believes that this latter interpretation is both reasonable and consistent with the views of the Agencies with respect to the use of non-US intermediaries, discussed above.[11]

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[8] Indeed, we believe that, unless the executing broker has knowledge that the carrying broker is not fulfilling its customer verification responsibilities under applicable laws and regulations, an executing broker should be entitled to rely on the carrying broker to perform these responsibilities, even in the absence of any written certification to this effect. Generally, it is the carrying broker that has the more direct, more comprehensive relationship with the customer. It is only the carrying broker that: (1) enters into an account agreement with the customer, establishing the parties' respective rights and obligations and, in the process, conducts a credit review and obtains documentation from the customer covering areas such as identity verification, legal entity structure and authority to trade; (2) is responsible for maintaining records of, and is able to monitor on a daily basis, each of the customer's transactions that it carries; and (3) most important for purposes on anti-money laundering programs, accepts customer funds to margin or secure such transactions and disburses such funds in accordance with the customer's instructions.

[9] Typically, the customer will call the US executing broker directly. In circumstances in which the customer is not identified to the US FCM, we understand that the proposed rules generally would not impose an obligation on the US FCM to look behind the non-US intermediary.

[10] The relationship can also start with a US executing broker and carrying broker. Affiliates in other jurisdictions will then rely on the agreements executed in the US.

[11] Such reliance, of course, must be reasonable, based on a consideration of factors including those described in fn. 5 above.

Notice to Customers. Section 103.123(f) of the proposed rules provides that each registrant's customer identification program must include procedures for notifying customers that the FCM or introducing broker will be requesting information to verify the customers' identity. At the outset, we question the necessity of this provision at all. We recognize that section 326 of the USA PATRIOT Act implies that customers should receive adequate notice that a financial institution must verify identity of any customer seeking to open an account. However, section 326 does not require that the financial institution provide such notice. FIA respectfully suggests that other, more efficient means exist to assure that customers are generally aware that Commission registrants have such an obligation. In this regard, we see no reason why the adoption of these rules alone would not be sufficient notice. Certainly, the development of enhanced anti-money laundering regulations governing the financial services industry generally has received widespread public notice. Alternatively, the Commission or the National Futures Association could undertake a public education program.

If the Agencies nonetheless conclude that the burden of notifying customers should be placed on registrants, FIA requests the Agencies to confirm that a registrant will be deemed to have provided adequate notice in all circumstances if it posts such a notice on its website. There is no reason to limit notice in these circumstances to customers that open accounts electronically. To the contrary, FIA believes that posting notice on a registrant's website is more effective than posting a notice in the registrant's lobby.

Conclusion

FIA appreciates this opportunity to comment on the proposed rules governing the development and implementation of customer identification programs for Commission registrants in compliance with the provisions of section 326 of the USA PATRIOT Act. If either the Commission or Treasury has any questions concerning the comments in this letter, please contact Barbara Wierzynski, FIA's General Counsel, at (202) 466-5460.

Sincerely,

John M. Damgard
President