

March 1, 2002

Office of Chief Counsel
Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 1618
Vienna, VA 22183-1618

Attention: NPRM – Suspicious Transaction Reporting – Brokers or Dealers in Securities

Re: Proposed Amendment to the Bank Secrecy Act
Regulations – Requirement of Brokers or Dealers in
Securities to Report Suspicious Transactions

Ladies and Gentlemen:

The Futures Industry Association (“FIA”)¹ appreciates this opportunity to comment on proposed amendments to the Code of Federal Regulations requiring broker-dealers to report suspicious activity (the "proposed rule" or the "B-D SAR rule") issued by the Financial Crimes Enforcement Network (“FinCEN”) of the Department of the Treasury (“Treasury”).² In accordance with the USA PATRIOT Act,³ and pursuant to its authority under section 356(a) of the Act, FinCEN is proposing to amend the Bank Secrecy Act (“BSA”)⁴ regulations to require broker-dealers to file suspicious activity reports (“SARs”).

¹ The FIA is the only association representative of all organizations that have an interest in the futures market. FIA has more than 180 corporate members, reaching thousands of industry participants. Regular Members are futures commission merchants. We estimate that our regular members are responsible for more than 80% of the customer business transacted on U.S. futures exchanges. Through these members we represent the needs of futures industry customers; in fact, our members include the top 20 firms in terms of customer equity. Associate Members include international exchanges, banks, legal and accounting firms, introducing brokers, commodity trading advisors, commodity pool operators and other market users, and information and equipment providers headquartered in the U.S.A. and abroad. (More information about the FIA is available on its home page: <http://www.futuresindustry.org>.)

² 66 Fed. Reg. 67669-67677 (Dec. 31, 2001).

³ “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,” (“USA PATRIOT Act”) Pub. L. No. 107-56 (2001), signed into law by President George W. Bush on October 26, 2001.

⁴ 31 U.S.C. § 5311 et seq.

The FIA historically has been supportive of the anti-money laundering laws and has worked with Treasury and the Commodity Futures Trading Commission ("CFTC") to propose anti-money laundering rules for the futures industry. Indeed, some futures commission merchants ("FCMs") who are not obligated by any rule to file SARs have undertaken to report suspicious activity voluntarily. In furtherance of the industry's commitment to combating money laundering, the FIA believes that it is appropriate to have a separate SAR regulation specifically directed toward futures transactions. The FIA is concerned that the instant proposed rule, applicable to broker-dealers, is not the proper mechanism by which to bring FCMs under the SAR regulatory rule.

FCMs are not directly covered by the proposed B-D SAR rule. However, certain futures activity that takes place through an entity that is dually registered appears to be covered, and the FIA is concerned that the rule has an unintended impact upon FCMs. By way of background, the SAR reporting rules affect FCMs in three different ways. Some FCMs are subsidiaries of bank holding companies, and as such are required to file SARs under the bank regulatory rule, 12 C.F.R. § 208.62.⁵ Other FCMs are dual registrants, meaning that the same entity is both an FCM and a registered broker-dealer (either as a fully registered or notice registered broker-dealer).⁶ Those entities are not currently required to file SARs, but often do so voluntarily. They will be indirectly subject to the reporting requirements under the proposed B-D SAR rule and will therefore be required to file SAR-BDs. There are still other FCMs that are freestanding, meaning that their sole business is as an FCM. They are not subject to any SAR reporting obligation, but often file SARs voluntarily.

Our comments are addressed first to the rule and then to the overall regulatory scheme. The FIA's primary concerns and recommendations are that: (i) the proposed rule does not explicitly cover futures transactions, but Treasury is apparently intending to apply the rule to such transactions; (ii) the safe harbor does not clearly apply to FCMs and does not extend to reparations proceedings; (iii) the proposed rule contains no exemptions for futures industry regulatory filings; and (iv) FCM subsidiaries of bank holding companies will be subject to duplicative reporting requirements.

On a broader point, Treasury's approach of adopting various rules applicable on a piecemeal basis to futures transactions and indirectly to FCMs have created a confusing regulatory scheme for FCMs. As you are aware, prior to the USA PATRIOT Act, although Treasury had the authority to do so, no implementing regulation had been adopted by Treasury with respect to FCMs under the BSA.⁷ FCMs have historically been covered by the Internal Revenue Service ("IRS") rule that requires certain cash transactions be reported to the IRS. It appears that FCMs will now be covered by both 26 U.S.C. § 6050I (the "IRS rule") and a new interim rule under the BSA adopted pursuant to section 365 of the USA PATRIOT Act⁸ which tracks that IRS rule (the "interim BSA

⁵ This provision is made applicable to bank holding companies and any nonbank subsidiaries thereof pursuant to 12 C.F.R. § 225.4(f).

⁶ FCMs may notice register as broker-dealers for the purpose of trading security futures products by filing an abbreviated registration form with the National Futures Association.

⁷ The BSA actually refers to a broker or dealer in securities or commodities. 31U.S.C. § 5312(a)(2)(H).

⁸ 31 U.S.C. § 5331, entitled "Reports Relating to Coins and Currency Received in Nonfinancial Trade or Business."

rule”).⁹ This new BSA rule requires a joint IRS/FinCEN filing to report the currency transactions formerly reported solely to the IRS. At the same time, Treasury has proposed rules under the BSA regulating futures transactions through broker-dealers but not FCMs under its proposed correspondent account rule.¹⁰ Application of the proposed B-D SAR rule to futures transactions but not to FCMs further complicates the regulatory scheme to which FCMs are subject.

Treasury needs to recognize the various types of FCMs and apply one anti-money laundering rule to them rather than subjecting them to a regulatory scheme where they are treated like broker-dealers for some purposes of the BSA, like banks for other purposes, and like non-bank financial institutions for cash reporting purposes. This combination of rules creates a wholly unworkable regulatory scheme for FCMs. As noted, FCMs are fully prepared to comply with their anti-money laundering obligations, but believe they should be permitted to do so under a consistent set of rules.

Finally, the FIA voices its concurrence with the Securities Industry Association ("SIA") and the comments submitted in its separate comment letter. In particular, the FIA shares the SIA's concerns regarding the differing penalties imposed for violating the bank SAR rule; the reporting threshold which does not take into account the suspicious transactions for which no suspect can be identified and will require reporting of many transactions banks are not required to report; and the overall scope of the rule being broader than the bank regulatory rule.

I. The Proposed B-D SAR Rule Does Not Cover Futures Transactions and Should Not Be Interpreted to Do So.

Although neither the proposed B-D SAR rule nor its preamble state this explicitly, it is the FIA's understanding from discussions with Treasury that the proposed rule is intended to apply to futures transactions. First, it is not clear how futures transactions are covered by the text of the rule. In addition, it does not appear appropriate for futures transactions to be addressed in a rule that is intended to apply only to broker-dealers.

The definition of "transaction" in the proposed rule is:

a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or security, purchase or redemption of any money order, payment or order for any money remittance or transfer, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected.¹¹

⁹ See 66 Fed. Reg. 67679-67684 (Dec. 31, 2001).

¹⁰ See 66 Fed. Reg. 67459-67476 (Dec. 28, 2001) ("correspondent account rule").

¹¹ Security is defined as "any instrument or interest described in section 3(a)(10) of the Securities Exchange Act of 1934 [15 U.S.C. § 78c(a)(10)]."

Nothing in this definition describes activity that pertains specifically to futures transactions. In contrast, Treasury's rule relating to correspondent accounts refers specifically to "futures accounts or transactions". This clear statement that futures transactions are covered is missing from the proposed B-D SAR rule and the FIA is unclear how Treasury intends to apply this definition to futures transactions. Treasury's interpretation that this rule includes futures transactions also raises a concern that Treasury may intend to apply this section to other types of activity that are not clearly covered by this definition.

FIA's understanding is that Treasury is relying on the fact that some broker-dealers are dually registered as FCMs, and that as a result, both securities and futures transactions take place at the same institution. However, this approach ignores the fact that the institution acts as a broker-dealer when it conducts securities transactions and as an FCM when it conducts futures transactions. It appears that Treasury, in interpreting the B-D SAR rule to apply to futures transactions, intends to cover all activity at a broker-dealer, even if that broker-dealer is acting not as a broker-dealer but in its capacity as an FCM.

Finally, the B-D SAR rule is proposed pursuant to the requirement of the USA PATRIOT Act that Treasury issue a rule requiring broker-dealers to report suspicious activity.¹² Separately, section 356(b) allows for Treasury to also issue a rule pertaining to FCMs, but Treasury has not yet chosen to do so. As noted above, the B-D SAR rule does not explicitly apply to FCMs. By applying the rule to all activity at a broker-dealer, Treasury is reaching beyond its stated rule and regulating an entire industry that was not put on notice that it was to be regulated. The FIA therefore requests that Treasury refrain from extending the application of the rule to futures transactions and thereby FCMs. Instead, Treasury should issue a rule under section 356(b) covering FCMs. This would allow the futures industry an appropriate time period for comment on the implications of any proposed rule.

II. The Safe Harbor Does Not Appear to Apply to Futures Commission Merchants and Does Not Address Reparations Proceedings.

The FIA is concerned that since the regulations as written address only broker-dealers, if futures transactions are subject to the proposed rule, the FCMs involved in futures transactions will not be covered by the terms of the safe harbor. The safe harbor in the B-D SAR rule only states that "broker-dealers" shall not be liable for disclosures made in a SAR-BD. While FCMs may be protected under the safe harbor for voluntary filings,¹³ if it is Treasury's intention to extend the proposed rule to futures transactions, and therefore to FCMs, then the rule should be revised to reflect that FCMs are protected by the safe harbor.

Furthermore, the safe harbor does not extend to reparations proceedings. The proposed rule extends the safe harbor to arbitration proceedings, which are a widely used alternative to

¹² USA PATRIOT Act § 356.

¹³ The Act itself is clear that all financial institutions are covered by the safe harbor for voluntary reporting. In section 351, it amends 31 U.S.C. § 5318(g)(3) to state that "[a]ny financial institution that makes a voluntary disclosure of any possible violation of law or regulation to a government agency or makes a disclosure pursuant to this subsection . . ." is covered by the safe harbor. As such, the Act is broader than the proposed rule as drafted.

litigation employed in the broker-dealer industry and the futures industry. If the proposed rule is extended to apply in any way to futures transactions involving potential claimants, reparations proceedings—a government provided alternative to arbitration in the futures industry—should also be covered by the safe harbor.

III. The Proposed Rule Contains No Exemptions for Activity Reported to Self-Regulatory Organizations.

The proposed rule appropriately provides reporting exemptions for securities transactions reported by a broker-dealer to a self-regulatory organization (“SRO”) such as the National Association of Securities Dealers (“NASD”) or the New York Stock Exchange (“NYSE”). The rule specifically provides that if a transaction is reported to the NASD on Forms U-4 or U-5 or the NYSE on a Form RE-3, the transaction need not be reported to FinCEN on a SAR. Those forms are used, among other things, to report certain incidents that fall under NYSE Rule 351.

No similar exemptions are provided for activity by employees of the FCM. If the rule is extended to cover futures transactions, the rule should similarly provide that transactions reported to SROs in the futures industry are exempted from being reported on a SAR. Specifically, FCMs file Forms 7-R and 8-R with the National Futures Association (“NFA”) to register their associated persons, floor brokers and floor traders. These forms serve the same function as forms U-4 and U-5 in the securities industry. Updates to registration for FCMs are done through filing a Form 3-R. The filing of any of these forms should provide an exemption from filing a SAR to FCMs. If the activity is otherwise reported to an SRO through one of these forms, a SAR should not also have to be filed.

The fact that no such exemptions are provided in the rule supports the FIA’s position that the rule should not apply to futures transactions at all. The rule was designed for broker-dealers, and application of the rule to futures transactions impacts FCMs and the futures industry in ways that were clearly not contemplated in the drafting of the rule. Due to the many issues raised, futures transactions should not be covered by the rule at all, and instead a separate rule specifically intended to regulate futures transactions at FCMs should be promulgated.

IV. Subsidiaries of Bank Holding Companies Will be Subject to Duplicative Reporting Requirements.

FCMs that are subsidiaries of bank holding companies are currently subject to the bank regulatory rule, requiring them to file SARs. Broker-dealer subsidiaries of bank holding companies are also subject to this rule. In the proposed rule Treasury states its expectation that “when this proposed rule becomes effective, the federal bank supervisors will amend or repeal, as appropriate, any duplicative suspicious activity reporting requirements for broker-dealers.” This statement does not address the duplicative reporting requirements which will be imposed on FCM subsidiaries of bank holding companies by virtue of this rule. Therefore, if futures transactions are covered by the proposed rule, such transactions at FCMs that are subsidiaries of bank holding companies will be required to be reported under both the bank regulatory rule and the broker-dealer rule.

V. A Separate Rule Regulating SAR Filing for FCMs Should Be Proposed.

The anti-money laundering regulatory scheme to which FCMs are subject is already very confusing. The application of the proposed rule to FCMs only increases that confusion and should be avoided, and instead a separate SAR rule specifically tailored to FCMs and futures transactions should be issued.

If the proposed B-D SAR rule is adopted as proposed, FCMs will be subject to three different sets of regulations: the IRS/BSA 8300 rule; the correspondent account rule as it applies to broker-dealers and the B-D SAR rule. Moreover, the B-D SAR rules will be applicable to FCMs in three different ways. Broker-dealers dually registered as FCMs will be required to file SAR-BDs under the proposed rule for futures transactions. Subsidiaries of bank holding companies must file SARs pursuant to the bank rule. On the other hand, freestanding FCMs will not be required to file SARs under any rule, unless and until Treasury issues a separate rule under section 356(b) of the USA PATRIOT Act.

Thus, as it has developed, although FCMs are heavily regulated financial institutions, they do not seem to fit squarely into any anti-money laundering regulatory scheme. The regulatory structure to which FCMs are subject should be clarified rather than further confused. As such, instead of subjecting futures transactions and indirectly FCMs to the proposed rule, a separate rule for FCMs should be issued to require reporting for futures transactions.

VI. The Interim BSA Rule Should Be Clarified to Explain Why FCMs Are Covered By the Rule.

Section 365 of the USA PATRIOT Act creates a reporting scheme under the BSA which mirrors the IRS rule, so the same transactions reported to the IRS on a Form 8300 are now to be reported to FinCEN. This allows FinCEN access to the information previously held by the IRS in confidence. The report is to be made on a joint IRS/FinCEN form. In the interim BSA rule, Treasury provides an example of a transaction reportable under the rule. For the example it uses a futures transaction conducted at an FCM. This example illustrates Treasury's intent to apply this interim BSA rule to FCMs.

Application of the interim BSA rule to FCMs is confusing because the rule specifies that currency received in a "designated reporting transaction" must be reported. A designated reporting transaction is a "retail sale (or receipt of funds by a broker or other intermediary in connection with a retail sale) of (A) A consumer durable, (B) A collectible, or (C) A travel or entertainment activity." 31

103.30 (c)(1)(B)(i). Futures transactions are not retail sales of any of those items. Treasury should clarify why FCMs are covered by the interim BSA rule.

Summary

The proposed B-D SAR rule's applicability to futures transactions is not explicit. This lack of clarity has made it very difficult for the futures industry to provide comment on the proposed rule. If the industry cannot be sure what Treasury is attempting to cover, it cannot submit meaningful

comment. The already-confusing regulatory scheme to which FCMs are subject should not be complicated further. Instead, Treasury should wait until it issues a rule under section 356(b) of the USA PATRIOT Act to regulate FCMs and futures transactions. It would then be able to formulate a rule tailored to the industry, upon which the industry would be given sufficient notice to comment.

Similarly, obligations of FCMs under the interim BSA rule should be clarified to explain why FCMs fall under the rule.

We thank you for the opportunity to comment on the proposed B-D SAR rule, and we hope the above issues and concerns will be carefully considered by the Department in the formulation of an appropriate yet workable regulation. If you wish to receive additional information related to our comments, please feel free to contact us.

Sincerely,

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