

SCHWARTZ & BALLEN LLP

1990 M STREET, N.W. • SUITE 500
WASHINGTON, DC 20036-3465

(202) 776-0700

FACSIMILE
(202) 776-0720

schwartzandballen.com

MEMORANDUM

May 4, 2006

To Our Clients and Friends

Re: Suspicious Activity Reporting for Mutual Funds

The Financial Crimes Enforcement Network (“FinCEN”) has issued a final rule under the Bank Secrecy Act to require mutual funds¹ to report suspicious transactions to FinCEN. The rule imposes reporting requirements similar to those applicable to banks, thrift institutions and broker-dealers. The final rule is generally consistent with the rule FinCEN proposed in January 2003.² The final rule is effective June 5, 2006 and is applicable to transactions occurring after October 31, 2006.

FILING REQUIREMENTS

Mutual funds are required to report suspicious transactions relating to a possible violation of law or regulation to FinCEN on suspicious activity report form SAR-SF within 30 days after the mutual fund initially detects the suspicious transaction.³

A transaction is to be reported if it is conducted or attempted by, at or through a mutual fund, involves assets of at least \$5,000 and the mutual fund knows, suspects or has reason to suspect that the transaction (or a pattern of transactions):

- involves funds derived from illegal activity or is intended to hide or disguise assets derived from illegal activity in order to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation

¹ Under the rule a mutual fund is an open-end management investment company as described in section 3 of the Investment Company Act of 1940 that is registered, or is required to register, with the Securities and Exchange Commission. The rule also applies to insurance companies that issue variable insurance products funded by separate accounts that meet the definition of a mutual fund.

² See our memorandum of January 17, 2003 at

http://schwartzandballen.com/MemoDocs_2003/Mutual%20Funds%20-%20SAR%20%20_1-17-03_.pdf

³ In addition, in situations requiring immediate attention, such as terrorist financing or ongoing money laundering schemes, the final rule requires immediate notification by telephone to the appropriate law enforcement authorities.

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- is designed to evade the requirements of the Bank Secrecy Act or its regulations
- has no business or apparent lawful purpose, or is not the sort of transaction in which the customer would normally be expected to engage, and the mutual fund knows of no reasonable explanation for the transaction or
- involves use of the mutual fund to facilitate criminal activity

FinCEN encourages mutual funds to report suspicious transactions even when the rule does not explicitly require such reporting. Filing an SAR does not relieve the filer from complying with other reporting requirements of the Securities and Exchange Commission (“SEC”).

The final rule does not require reporting by affiliated persons of mutual funds although some affiliates may be subject to their own reporting rules. A mutual fund may contractually delegate performance of the reporting obligation to a service provider, but the mutual fund remains responsible for assuring compliance and must actively monitor the procedure for reporting suspicious transactions. If more than one mutual fund is involved in a particular transaction, they may file a single joint report.

A mutual fund is prohibited from notifying anyone involved in a suspicious transaction that it has been reported. The SAR or supporting documentation cannot be disclosed to anyone except where disclosure is requested by FinCEN, the SEC or another appropriate law enforcement or regulatory agency.

While sharing an SAR is generally not permitted, the final rule permits certain financial institutions to share information regarding the transaction (but not the SAR) with each other solely for the purpose of identifying and reporting activities that may involve money laundering or terrorist activity.

The rule reaffirms the protection accorded by law to a mutual fund and an employee, officer, director and agent that files an SAR from liability for any disclosure contained in the report.

A copy of the final rule can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.