



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

9 March, 2012

Via FedEx or Electronic Mail

Chief General Manager-in-Charge
Reserve Bank of India
Department of Banking Operations and Development
12th Floor
Shahid Bhagat Singh Marg
Fort, Mumbai – 400001, India

Shri Alok Nigam
Joint Secretary
Ministry of Finance
Department of Financial Services
Room No. 32, Jeevan Deep Building
Parliament Street
New Delhi – 110001, India

Mr. S. Ramann
Officer on Special Duty
Integrated Surveillance Department
Securities and Exchange Board of India
Email: ramanns@sebi.gov.in

Re: Know Your Customer (“KYC”) Requirements for U.S. Registered Investment Companies

Ladies and Gentlemen:

The Investment Company Institute (“ICI”)¹ is writing to express our concern about the KYC documentation requested by intermediaries registered with the Securities and Exchange Board of India (“SEBI”) from U.S. registered investment companies that are licensed to invest in India. We appreciate the efforts of SEBI and the Ministry of Finance (“MOF”) to fight money laundering and terrorist financing and to bring uniformity to the varied KYC approaches historically followed in the Indian financial sector.² However, the specific and detailed KYC information that SEBI registered intermediaries are now requiring from U.S. registered investment companies – including copies of passports and other personal information about directors of U.S. registered investment companies – is outside international norms, and presents serious compliance and privacy challenges without offering

¹ The Investment Company Institute is the national association of U.S. registered investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.98 trillion and serve over 90 million shareholders.

² See, e.g., Circular No. MIRSD/SE/Cir-21/2011 (5 Oct., 2011) (“October 5 Circular”).

any commensurate benefit. Accordingly, we urge the appropriate Indian authorities to provide clarification to SEBI registered intermediaries about their KYC obligations with respect to their U.S. registered investment company clients. As explained more fully below, we believe the KYC Form should not be interpreted to require U.S. registered investment companies to submit KYC information and forms for their directors; rather, SEBI and MOF could require KYC information only of individuals who are authorized signatories. We believe that such a clarification will still ensure that money laundering and terrorism risks are effectively and adequately addressed consistent with international standards.

Background and Issue

The Prevention of Money Laundering Act, 2002 (“PMLA”), including Rule 9 of the PMLA, imposes an obligation on Indian Financial Institutions to verify the identity of investors and to maintain records of transactions with investors. Since 2006, Indian Financial Institutions have been required to obtain the following minimum KYC information from their clients:

- (1) A power of attorney, as granted to the sub-custodian through the global custodian;
- (2) A license issued by the relevant statutory bodies or jurisdiction, where applicable, or a certified copy of constitutive documents (*e.g.*, a deed of trust or partnership agreement); and
- (3) A tax identification number in the name of the investor.³

On October 5, 2011, SEBI introduced uniform KYC standards that must be followed by all SEBI registered intermediaries effective January 1, 2012, including a “KYC Application Form for Non-Individuals” (the “KYC Form”) that must be completed by registered investment company clients of SEBI registered intermediaries. Since the effective date of these uniform KYC standards and the KYC Form, SEBI registered intermediaries have been requesting that U.S. registered investment companies provide highly sensitive and personal information, including copies of passports, about registered investment company directors.⁴ As discussed below, we believe that these requests are based on a misunderstanding of the unique role of U.S. registered investment company directors, and are not required by the KYC Form. In addition, such requests are well outside international norms and are inconsistent with Financial Action Task Force (“FATF”) standards for low-risk clients such as U.S. registered investment companies.

³ SEBI Circular ISD/CIR/RR/AML/1/06 (Jan. 18, 2006).

⁴ *See, e.g.*, October 5 Circular: KYC Form for Non-Individuals (General Instructions, Section A).

The KYC Form

First, SEBI registered intermediaries are requiring U.S. registered investment companies to provide personal information regarding their directors, even though the KYC Form on its face does not appear to require such information. U.S. registered investment companies invest in India as a SEBI-registered “foreign institutional investor” (“FII”) or FII sub-account. The KYC Form sets forth the following documentary requirements for FIIs: copy of SEBI registration certificate; and authorized signatories list with specimen signatures. The KYC Form does not require FIIs to provide identification documents for directors. This position makes sense in light of the fact that FIIs already are required to provide SEBI with identification information necessary to obtain a license to invest in India.

Even if a U.S. registered investment company is viewed as a “Corporate” entity under the KYC Form,⁵ the documentary KYC requirements with respect to individuals apply only to “whole time directors/two directors in charge of day to day operations.” Given the structure of U.S. registered investment companies and the role of their boards of directors, U.S. registered investment companies do not have individuals who serve on the board of directors who fall within the definition of a “whole time director” or “director in charge of day to day operations.” We understand that a “whole time director” of a company is an individual who devotes the whole of his or her time and attention to the affairs of the company – such that, for example, he or she may not be employed by another company. By this standard, directors of U.S. registered investment companies are neither “whole time directors” nor “directors in charge of day to day operations” of the investment companies they oversee. Under U.S. law, registered investment company directors serve in an oversight role,⁶ and are not directly involved in the day-to-day management or investment operations of registered investment companies. By way of example, registered investment company directors do not, in their capacity as director, place trades on behalf of the fund or dispose of assets in fund accounts. While registered investment company directors have oversight responsibilities under U.S. law, the registered investment company’s

⁵ U.S. registered investment companies are typically organized under U.S. law as corporations or business trusts.

⁶ The board of directors of a U.S. registered investment company reviews and, where applicable, approves policies developed by the fund’s investment adviser and other service providers with respect to fund investments and oversees those entities’ performance of their duties. The boards of registered investment companies oversee management but are not, and are not expected to be, technical experts. See IDC Task Force Report, *Board Oversight of Derivatives* (July 2008) at 8 (describing the board’s oversight responsibilities), available at http://www.idc.org/pdf/ppr_08_derivatives.pdf; Letter from the Independent Directors Council to Elizabeth Murphy, Securities and Exchange Commission, November 7, 2011 at 2 (describing board oversight of derivatives use by registered investment companies) available at <http://www.ici.org/pdf/25627.pdf>; *Proxy Disclosure Enhancements*, Release IC-29092 (Dec. 16, 2009) at 43 (Securities and Exchange Commission agreed that “risk oversight” instead of “risk management” is a more appropriate description of the board’s responsibilities) available at <http://www.sec.gov/rules/final/2009/33-9089.pdf>.

investment manager, pursuant to a contract with the registered investment company, is more directly responsible for conducting the day-to-day operations of the fund. It is perhaps for this reason that SEBI does not require detailed KYC information about registered investment company directors when approving FII or sub-account licenses for U.S. registered investment companies.⁷

In light of the foregoing, we believe that, under a plain reading of the KYC Form, the requirement to provide personal information does not apply to FIIs, which would include U.S. registered investment companies. Further, assuming a U.S. registered investment company falls within the “Corporate” classification under the KYC Form, the KYC Form’s requirements should be interpreted by SEBI registered intermediaries in a way that does not treat directors of U.S. registered investment companies as “whole time directors” or “directors in charge of day to day operations.”

International Norms / FATF Standards

Importantly, our interpretation of the KYC Form is consistent with international anti-money laundering and counter-terrorist financing (“AML/CTF”) standards. Both the United States and India are FATF members, and have committed to implementing FATF’s *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (the “FATF Recommendations”).⁸ After a multi-year review of its AML/CTF standards, on February 17, 2012 FATF released new FATF Recommendations with the goal of significantly enhancing the “customer due diligence” obligations of financial institutions in FATF-member jurisdictions. Nevertheless, even the new FATF Recommendations specifically contemplate the use of “simplified customer due diligence measures” in circumstances “where the risk of money laundering or terrorist financing may be lower.”⁹ The new FATF Recommendations list several examples of “potentially lower risk situations,” including cases where a customer is a financial institution “subject to requirements to combat money laundering and terrorist financing consistent with the FATF Recommendations, [has] effectively implemented those requirements, and [is] effectively supervised or monitored in accordance with the Recommendations to ensure compliance with those requirements.”¹⁰

⁷ Like regulated funds authorized for public sale in many other jurisdictions (*i.e.*, “broad-based funds”), interests in U.S. registered investment companies may be publicly offered and represent a pro-rata interest in the assets of the fund which is professionally managed by an investment adviser.

⁸ Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (February 2012), available at <http://www.fatf-gafi.org/dataoecd/49/29/49684543.pdf>.

⁹ See Interpretive Notes #16-17 to FATF Recommendation 10.

¹⁰ *Id.*

We believe that U.S. registered investment companies clearly meet the FATF standard for simplified customer due diligence. U.S. registered investment companies are some of the most highly regulated and scrutinized financial institutions in the world. They are required to register with the U.S. Securities and Exchange Commission (“SEC”), maintain detailed books and records, and submit to regular inspections from U.S. government authorities.¹¹ U.S. registered investment companies also are required to make periodic filings with the SEC that disclose, among other things, the identity of, and certain biographical information about, their directors and officers. Finally, U.S. mutual funds are required to implement an anti-money laundering program that includes customer identification and verification requirements, suspicious activity reporting, and other AML/CFT measures required by U.S. law, and are regulated by both the SEC and the U.S. Financial Crimes Enforcement Network for compliance with these AML/CFT measures.¹²

Request for Clarification

In light of the foregoing, we respectfully request that SEBI and/or MOF confirm that U.S. registered investment companies are not required to submit personal KYC information, including copies of passports and residential addresses, for registered investment company directors. As noted above, the KYC Form appears to contemplate that U.S. registered investment companies comply with the requirements for FIIs, which do not include obtaining copies of passports from registered investment company directors. Moreover, even if U.S. registered investment companies are required to provide the information required for corporate entities, directors of U.S. registered investment companies serve in an oversight role such that they are neither “whole time directors” nor “directors in charge of day-to-day operations.” Accordingly, the KYC Form should not be interpreted to require U.S. registered investment companies to submit KYC information and forms for their directors.

As an alternative, SEBI and MOF could require KYC information only of individuals who are authorized signatories of U.S. registered investment companies, meaning those individuals designated by the FII investing in India. Importantly, we understand that this approach would be consistent with the Indian KYC obligations of individuals associated with foreign broad-based investment funds that do not have boards of directors. We do not believe that there is a compelling reason to treat U.S. registered investment companies in a manner different from other broad-based investment funds,

¹¹ Registered investment companies in the United States are subject to SEC regulation under the Investment Company Act of 1940, the Securities Act of 1933, and other federal securities laws, and are also required to comply with detailed regulations issued by the U.S. Internal Revenue Service. In addition, all investment advisers to U.S. registered investment companies are required to be registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940.

¹² 31 U.S.C. § 5318(h). U.S. financial institutions, including U.S. mutual funds, are required to implement an anti-money laundering program reasonably designed to prevent the firm from being used for money laundering or terrorist financing purposes.

simply because U.S. registered investment companies have boards of directors with limited oversight responsibilities. Allowing a more flexible KYC approach would mean foreign broad-based funds would be treated similarly, and would ensure AML/CFT risks are effectively addressed consistent with international standards. In any case, we stress that maintaining the confidentiality of the KYC information provided is of paramount importance.¹³

We note that SEBI has previously endorsed a more flexible, risk-based approach for determining the level of KYC documentation required in appropriate circumstances. For example, with respect to the acceptance of clients, SEBI guidelines provide that the documentation required and other information to be collected “in respect of different classes of clients depend[s] on perceived risk.”¹⁴ SEBI has also stated that the “type and amount of identification information and documents that intermediaries should obtain necessarily depend[s] on the risk category of a particular customer.”¹⁵ Accordingly, we believe there is both international and local precedent for allowing SEBI registered intermediaries to follow the KYC approach outlined above for lower risk, highly regulated clients such as U.S. registered investment companies.

We appreciate your consideration of our request for clarification about the KYC requirements for U.S. registered investment companies. If you have questions or require additional information, you can reach me at (202) 326-5813 or solson@ici.org or Eva Mykolenko at (202) 326-5837 or emykolenko@ici.org.

Very truly yours,

/s/ Susan M. Olson

Susan M. Olson
Senior Counsel – International Affairs

cc: Mr. Alan Cox, Assistant Director, Office of Outreach Resources
Financial Crimes Enforcement Network, U.S. Department of Treasury

Mr. Ethiopis Tafara, Director, Office of International Affairs
U.S. Securities and Exchange Commission

¹³ See Interpretive Note #6 to Recommendation 26.

¹⁴ SEBI, AML Guidelines, *available at* <http://www.sebi.gov.in/guide/antimoney.pdf>.

¹⁵ *Id.*