#33

October 11, 2002

FinCEN
Post Office Box 39
Vienna, VA 22183 Sent by mail and email to regcomments@fincen.treas.gov

Re: **Proposed Rule Implementing Section 312 on Anti-Money Laundering Due Diligence Policies, Procedures and Controls**

Dear Sir or Madam:

As key authors of Title 3 of the USA PATRIOT Act ("Patriot Act"), we appreciate this opportunity to offer formal comments on the proposed rule to implement Section 312 of the new law regarding requirements for U.S. financial institutions to exercise due diligence when opening and operating correspondent accounts for foreign financial institutions and private banking accounts for wealthy non-U.S. individuals. We strongly support the proposed rule with several strengthening changes and urge rejection of all suggestions to weaken it.

Last year, Osama bin Laden was quoted as boasting that his modern new recruits know the "cracks" in "Western financial systems" like they know the "lines in their hands." This chilling observation helped convince Congress to enact strong due diligence requirements in Section 312 – to seal the cracks that have been allowing terrorists and other criminals to misuse our financial systems, not only by sending criminal money through our banks, but also through our securities firms, money service businesses, credit card systems, and other financial institutions. Section 312's due diligence requirements lie at the heart of the law's attempt to end such abuses by requiring U.S. financial institutions, before opening their doors to foreign funds, to conduct sufficient research to assure themselves they are not allowing terrorist or other criminal funds into this country. In light of ongoing threats, it is essential that the regulations implementing these due diligence requirements help erect strong barriers to suspect funds.

We also strongly support the Treasury Department's commitment not to "create a competitive advantage for one type of financial institution over another when they perform the same or similar functions," and to resist requests for exemptions or special rules.

We would like to offer detailed comments on the following issues: (1) support for the proposed broad definition of "correspondent account"; (2) support for the proposed definition of "foreign financial institution"; (3) opposition to a proposed offshore bank exemption; (4) several comments on the proposed due diligence rules for private banking accounts; (5) general support for the proposed definition of "beneficial ownership interest" and against transferring private banking due diligence obligations to intermediaries; and (6) several comments on the proposed rules clarifying elements to be included in general and enhanced due diligence reviews.

(1) Definition of "Correspondent Account"

The Department recently reaffirmed a broad definition for "correspondent account" in the final regulations implementing Sections 313 and 319(b) of the law. The reasons for using the same approach in Section 312 are compelling, since the intent of Section 312 is to ensure that a broad spectrum of U.S. financial institutions use due diligence before allowing foreign funds into this country. The proposed definition directly complies with the legislative intent of the law and should not be narrowed, weakened, or complicated through the adoption of various exemptions being proposed in other comment letters.

Deputy Treasury Secretary Kenneth Dam has testified that "our financial system is only as secure as its most vulnerable point." That is why the Patriot Act expanded U.S. anti-money laundering safeguards to apply not only to banks, but throughout the U.S. financial system, to identify and seal all of the existing cracks in U.S. anti-money laundering controls. The definition of correspondent account is one of the basic building blocks of the law and plays a critical role if the law is to reach the many types of financial institutions in this country that could be misused by terrorists and other criminals.

The proposed rule relies on the actual text of the statutory definition in 31 U.S.C. 5318A(e)(1)(B), defining a correspondent account as "an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution." The proposed rule explains that it would encompass not only traditional banking accounts, but also any account used by a foreign financial institution to engage in securities or future transactions, funds transfers, or other financial transactions. This is exactly the broad reach contemplated in the statute.

A number of comment letters propose excluding certain types of transactions, accounts or financial institutions from the definition of correspondent account, often on the ground that they pose little risk of money laundering. But the intent of the statute is not to exempt low-risk accounts from due diligence reviews altogether, but to allow financial institutions to perform a risk assessment and then conduct a reasonable review. The law clearly authorizes low risk accounts to receive less due diligence review than high risk accounts. The statutory objective, however, is to require an appropriate level of due diligence, rather than no due diligence at all.

Two examples of exemptions suggested in various comment letters, both of which should be rejected, illustrate the dangers of exempting whole categories of accounts, transactions, or financial institutions from the coverage of Section 312.

(1) Foreign Financial Institution As Principal. Several comment letters suggest exempting from the definition of correspondent account all accounts in which the accountholder is a foreign financial institution acting as a principal in transactions involving such matters as foreign currency exchanges, derivatives, capital market transactions, overnight sweep accounts, escrow accounts, corporate trust accounts, pension funds, or loan or lease payments. These letters generally contend that these transactions are low risk, because they involve the foreign

financial institution itself rather than the institution's clients and, in some cases, already require a detailed analysis of the foreign financial institution's credit risk.

This suggestion, however, flatly contradicts the work of the U.S. Senate Permanent Subcommittee on Investigations which has shown that not all foreign financial institutions present low money laundering risks. The legislative history compiled in the Subcommittee's hearings and reports is replete with examples of high risk foreign financial institutions facilitating the transfer of criminal funds, including offshore institutions, institutions from jurisdictions with weak anti-money laundering controls, institutions with a history of misconduct, and institutions owned by persons with unknown or questionable backgrounds. Rather than exempting such accounts or transactions from Section 312 altogether, the Patriot Act instructs U.S. institutions to apply the level of due diligence that would be appropriate to guard against money laundering. The statute clearly allows reputable institutions from well-regulated jurisdictions, for example, to undergo less review than poorly known institutions from suspect jurisdictions. Accounts or transactions which already include a credit risk analysis would require little or no additional analysis to guard against money laundering. The regulations may also want to make it clear that a anti-money laundering review performed for a foreign financial institution for one type of account may be sufficient for other types of transactions as well. The law nowhere requires that a separate review be done for each type of account or transaction engaged in by the same entity.

(2) Money Service Businesses. Another comment letter, submitted by the Non-Bank Funds Transmitters Group, proposes exempting "foreign sales outlets" from Section 312, if they sell money remittance services, such as wire transfers, money orders, or travellers checks, under contract with a U.S. money service business (MSB). In effect, this letter seeks to free U.S. MSBs from any due diligence obligation to determine whether a foreign MSB with which it transacts business may be sending terrorist or criminal funds into the United States. Such an exemption would allow, for example, a U.S. MSB under contract with a money exchange house in a foreign country to receive regular and unlimited funds from that exchange house without any ongoing obligation to determine whether the foreign MSB has a history of money laundering convictions, engages in high risk transactions, or has a reputation as a front for terrorists. Clearly, the Patriot Act did not intend to exempt U.S. MSBs from this type of due diligence – just the opposite.

In attempting to justify its position, the letter reasons that U.S. MSBs do not really have correspondent accounts for their foreign outlets, because the U.S. MSBs do not directly accept funds from the foreign MSBs, but merely keep records of money transfers that actually take place through various bank accounts. But virtually every non-bank financial institution operates the same way – it transfers funds through international wire transfer systems into or out of various bank accounts, while keeping internal records of client-specific transfers and financial transactions. Essentially, the suggested approach seeks to limit the definition of "correspondent account" to accounts at banks, a limitation that the Patriot Act explicitly rejected.

The two proposals just described are not only contrary to the legislative intent of the law, they threaten to complicate and narrow its reach, and to introduce accounting and economic

distortions into U.S. financial markets, without any corresponding benefit in anti-money laundering protections or cost savings. Carving out specific types of accounts or transactions from the correspondent account definition would likely introduce distortions into U.S. financial markets, for example, by encouraging persons wanting to avoid anti-money laundering analysis to attempt to structure their activities to fit into the identified exceptions. Transactions that may be more properly characterized as loans, for example, may be structured as derivative transactions, if derivatives are deemed exempt from any anti-money laundering due diligence review. Transactions that would normally go through bank accounts might be sent through MSBs instead, if foreign MSB transfers were to be exempted from the law.

The guiding principle behind Section 312's due diligence requirement is to ensure that a wide spectrum of U.S. financial institutions understand their foreign financial institution clients prior to entering into a business relationship with them. Given the ongoing terrorist and criminal threats that the Patriot Act attempts to address and the ongoing need to seal the cracks in the U.S. financial system that allow criminal funds into this country, the proposed broad definition of "correspondent account" continues to be the correct approach.

(2) Definition of "Foreign Financial Institution"

The proposed rule requests comments on its definition of "foreign financial institution" which is defined to cover any foreign bank or other person organized under foreign law which "if organized in the United States, would be required to establish an anti-money laundering program." The definition encompasses foreign banks, MSBs, hawalas, securities firms, commodity brokers, insurance companies, casinos, and credit card operators. The proposed definition, again, captures exactly the broad reach contemplated in the statute.

Some comment letters seek assistance from the Department to determine whether certain categories of foreign financial institutions in specific countries are included within the definition, given differences in terminology, licensing and regulatory regimes. Guidance in this area could help ensure a comprehensive and even-handed application of the law, in light of the Department's ongoing policy against creating a competitive advantage for one type of financial institution over another when they perform the same or similar functions.

(3) Unfounded Offshore Bank Exemption

Section 312 requires U.S. financial institutions to conduct due diligence reviews for all accounts opened or operated for foreign financial institutions. It also identifies three categories of foreign banks for which U.S. financial institutions must exercise "enhanced due diligence" because of the foreign banks' high risk of being involved in money laundering. One of the three categories identified in the law is foreign banks operating under an offshore banking license.

In Section 103.176(c)(1), the proposed rule creates an unfounded exemption to Section 312's bright line rule requiring U.S. financial institutions to exercise enhanced due diligence before opening or operating correspondent accounts for offshore banks. The proposed exemption seeks to free U.S. financial institutions from the obligation to exercise enhanced due

diligence for any offshore bank which is not located in a suspect jurisdiction and which is a branch of a foreign bank which has been "found" or chartered in a jurisdiction in which the Federal Reserve has determined that one or more foreign banks are "subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in that jurisdiction." This exemption has no statutory basis, no foundation in the legislative history, contradicts clear legislative intent, and should be removed.

Offshore banks carry some of the highest money laundering risks in the world. As defined in the Patriot Act, offshore banks have licenses which bar them from transacting banking activities with the citizens of their own licensing jurisdiction or bar them from transacting business using the local currency of the licensing jurisdiction. Because of these restrictions, they are particularly dependent upon correspondent accounts in other countries to transact business.

Since, by design, offshore banks operate in the international arena outside their licensing jurisdiction, they have long been a focus of the international financial community for their detrimental impact on international anti-money laundering and tax enforcement efforts. Nearly all of the foreign banks investigated by the Permanent Subcommittee on Investigations[1] held offshore licenses and were associated with millions of dollars in suspect funds, drug trafficking, financial fraud, tax evasion, and other misconduct. Additional evidence has emerged since the September 11th tragedy documenting links between a few offshore banks and terrorist funds.

Offshore banks pose high money laundering risks for a variety of reasons. The Subcommittee staff report found that a foreign jurisdiction has significantly less incentive to oversee and regulate banks that are required to transact business with non-citizens. The report also found that offshore banking is largely a money-making enterprise for the governments of small countries, and the less demands made by the government on bank owners, the more attractive the country becomes as a licensing locale. The report found that offshore banks "often rely on these reverse incentives to minimize oversight of their operations, and become vehicles for money laundering, tax evasion, and suspect funds."

In addition to the history of misconduct and poor oversight associated with offshore banks, there appears to be no compelling economic justification to favor a banking license which shields the licensing jurisdiction's own citizens from the financial institutions created by their government. Virtually no well-regulated country issues offshore banking licenses, and smaller jurisdictions like the Channel Islands have long demonstrated that a sophisticated and profitable banking industry can flourish without them. Offshore banks also typically operate in jurisdictions with strict secrecy laws that can impede international law enforcement, foster tax evasion and other criminal misconduct, and generate unfair competition for financial institutions operating under laws requiring greater transparency. The proposed rule offers no explanation, in light of these policy considerations, for an exemption favoring banks that choose to open

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[1]See "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg.107-84 (March 1, 2, and 6, 2001), summarizing three days of hearings held by the Subcommittee and a Subcommittee staff report, "Correspondent Banking: A Gateway for Money Laundering," reprinted in the hearing record beginning at page 273.

offshore branches in secrecy jurisdictions.

Congress enacted in the Patriot Act a bright line rule requiring U.S. financial institutions to employ tougher due diligence standards when reviewing offshore banks than other types of foreign financial institutions. This bright line rule does not forbid U.S. financial institutions from opening accounts for offshore banks, as Section 313 does for shell banks, but it does require them to use greater caution when dealing with entities that have a history of money laundering abuses and often operate with poor regulatory oversight and under strict secrecy laws. The tougher due diligence standards required for offshore banks consists, at a minimum, of three elements: identifying each of the owners of the offshore bank (if it is not publicly traded); identifying what other banks, if any, are "nested correspondents" utilizing the offshore bank's U.S. accounts; and conducting "enhanced scrutiny" of the offshore bank's accounts to guard against money laundering and report any suspicious transactions. The proposed exemption would, in effect, relieve U.S. financial institutions of these three obligations.

The proposed rule does not explain why it seeks to relieve U.S. financial institutions of these obligations for the specified subset of offshore banks, but one possible reason is an assumption that, because they are branches of other banks, these offshore banks are no longer at high risk of money laundering. This reasoning, however, is contrary to the conclusion reached by Congress, and fails to take into account information contained in the staff report issued by the Permanent Subcommittee on Investigations describing foreign banks that have raised significant money laundering concerns despite functioning as branches or affiliates of banks in well-regulated jurisdictions.

For example, one case history featured in the Subcommittee staff report, at pages 474-93, involved British Bank of Latin America (BBLA), an offshore Bahamian bank that was closely affiliated with Lloyds TSB Bank in the United Kingdom and Banco Anglo S.A., a large Colombian bank that was also a Lloyds affiliate. The report found that BBLA closed its doors in 2000, after having been named in two major U.S. money laundering stings as a repository of illegal drug money from the Black Market Peso Exchange in Colombia; firing an employee suspected of being involved in money laundering, and identifying an additional 85 suspicious transactions beyond those identified in the two sting operations. The report also noted BBLA's extensive correspondent activities, stating that "a constant stream of large money transfers among BBLA and a handful of Lloyds affiliates, including Lloyds banks in Belgium, Colombia, Panama, the United Kingdom and the United States ... involving millions of dollars moving on almost a daily basis among the Lloyds group, were the most significant category of transactions on BBLA's account statements."

The report notes that BBLA regularly told its U.S. correspondent banks that its association with the two Lloyds banks had made BBLA "subject to the supervision in varying degrees of Bahamas, Colombia and the Bank of England." In other words, BBLA won the confidence of its U.S. correspondents in part by claiming it was subject to consolidated supervision. At the same time, however, the report disclosed that BBLA had "never undergone a bank examination or even a site visit by bank regulators" from any country in 19 years of operation. Consolidated supervision in theory did not translate into any additional supervision in

fact.

The staff report found the BBLA case history demonstrated that an offshore bank's affiliation with a major bank in a well-regulated jurisdiction is no guarantee that the offshore bank will receive careful oversight from either the parent entity or the parent entity's bank regulators. To the contrary, BBLA showed that the money laundering risks associated with offshore banks even apply to offshore banks integrated into a well-regulated bank's network of affiliates. Given the BBLA case history and other money laundering abuses documented in the report in connection with offshore banks, the legislative record provides no justification for freeing U.S. financial institutions from the statutory obligation to conduct enhanced due diligence reviews when opening or operating an account for an offshore bank.

In addition to the lack of any legislative foundation, the proposed exemption raises a number of interpretative issues. Key terms are undefined. For example, the exemption applies to "branches" of foreign banks, but does not define that term. Since the provision necessarily applies to foreign branches outside of the United States, the definition will presumably vary with the laws in the relevant foreign jurisdiction. BBLA, for example, might or might not qualify as a branch of Lloyds under Bahamian, Colombian or British law. In addition, the proposed exemption applies to branches of foreign banks that are "found" in certain jurisdictions, without explaining what it means for a foreign bank to be "found" but not chartered in that jurisdiction. An obvious interpretative question is whether an offshore bank would qualify for the exemption if it has a representative sales office in a well-regulated jurisdiction, even if that office is limited to advertising the offshore bank's services and would not itself subject the offshore bank to a bank examination.

The proposed rule offers no explanation or justification for exempting this class of offshore banks from the enhanced due diligence requirement in the law, and no data on how many offshore banks would qualify for exemption under its provisions. Moreover, a number of comment letters from offshore banks and others propose extending the exemption further, to offshore bank subsidiaries or to countries "actively working" toward consolidated supervision. All of these suggestions fly in the face of the legislative judgement that all offshore banks warrant enhanced due diligence procedures at U.S. financial institutions. This bright line rule was legislated by Congress based upon a detailed legislative record, and the Treasury Department has no legal basis to overturn it. The proposed exemption should be eliminated.

(4) Private Banking Due Diligence

The proposed rule **addresses** due diligence requirements related to private banking accounts for non-U.S. citizens in Section 103.178. The importance of these due diligence reviews was recently reinforced by revelations of alleged money laundering abuses by the former President of Nicaragua[2] who has apparently been charged with corruptly transferring at least

[2] See, for example, "Former President's 'Hidden Treasure' Appalls Nicaragua: Successor Pursues Corruption Charges," Washington Post (9/12/02).

$100 million out of his country during six years in office using, in part, U.S. bank accounts. We have several comments on various aspects of the proposed rule.

First, although Section 312 specifically requires U.S. financial institutions that open private banking accounts for a senior foreign political figure to "conduct enhanced scrutiny" of those accounts using policies, procedures, and controls "reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption," the proposed Section 103.178(c)(2) leaves out the requirement to "conduct enhanced scrutiny" of the accounts. Since ongoing monitoring of private banking accounts is essential to detecting and reporting suspicious transactions, and the statutory language could not be more specific, this statutory requirement needs to be added to the proposed rule.

Second, a few comment letters raise questions about whether the proposed definition of private banking accounts will encompass accounts at non-bank financial institutions such as securities firms and commodity brokers. The clear legislative intent of the law is that they do. Securities firms clearly maintain accounts equivalent to the private banking accounts maintained by depository institutions. These accounts are geared to wealthy individuals, they offer liaison services to manage client wealth, and they offer services vulnerable to money laundering abuses, including the quick movement of significant sums across international lines. Law enforcement cases, such as the pending criminal action against the former president of Ukraine, demonstrate that wealthy foreign individuals can use U.S. securities accounts as well as U.S. bank accounts to launder illegal funds, and the intent of the Patriot Act is to apply the same preventative due diligence requirements to both types of accounts.

Third, several comment letters have raised questions regarding the $1 million threshold which defines which private banking accounts are subject to Section 312's due diligence requirements. The law included this threshold to make it clear that the due diligence obligations are intended to apply only to accounts with significant sums. However, some financial institutions apparently believe that if they establish programs for high net worth clients that allow a minimum deposit of, perhaps, $500,000, then they can evade all due diligence requirements for these accounts even if the accounts customarily contain more than $1 million. To prevent circumvention of the law's intent to require due diligence reviews of private banking accounts with at least $1 million, the proposed rule should specify that Section 312 will be triggered if the relevant account meets or exceeds the designated threshold three times in a calendar year.

Fourth, several comment letters raise issues related to whether private banking accounts located outside of the United States are subject to Section 312's due diligence requirements, if U.S. based personnel play a limited role in establishing, managing or administering the accounts. The clear legislative intent of Congress was to cover accounts in which U.S. based personnel play a role in opening and handling the accounts on a routine basis. The private banking hearing and staff report[3] of the Permanent Subcommittee on Investigations provide numerous examples of private banking accounts that were physically located in a U.S. bank's overseas offices, such

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[3] See "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428, and related staff report reprinted beginning at page 872 (November 9-10, 1999).

as the United Kingdom, France, or Cayman Islands, but were solicited and managed on a **routine** basis by bank personnel based in New York. The Subcommittee's work also exposed significant oversight problems that arose when the personnel who opened or managed a private banking account were in a different country than the personnel who reviewed the actual account statements for suspicious activity. The statutory language is designed to address this due diligence problem by requiring U.S. financial institutions to develop policies, procedures, and controls to ensure that U.S. employees working on private banking accounts – no matter where the accounts are physically housed – conduct appropriate due diligence reviews and scrutinize those accounts to detect and report suspicious transactions.

Some comment letters have suggested exempting private banking accounts that are solicited or administered by a foreign sales representative office located in the United States, if the accounts themselves are housed in a non-U.S. jurisdiction. Some of the letters suggest that these private banking accounts are managed on a day-to-day basis in the non-U.S. location, and the U.S. based employee in the foreign sales office plays a minimal role in either referring or administering them. While such facts are possible, foreign sales representative offices that sell private banking services to U.S. residents typically are responsible for opening the accounts and providing ongoing liaison services to arrange deposits, wire transfers, credit facilities, or other private banking products or services. Such sales offices compete directly with U.S. private banks, and should be subject to the same due diligence requirements. Foreign private banking operations that maintain U.S. sales offices do not merit a wholesale exemption from the law.

(5) Definition of "Beneficial Ownership Interest"

The proposed rule requests comments on its proposed definition of "beneficial ownership interest." This term and closely related terms are used in two key sections of Title 3 of the Patriot Act: (1) Section 312 which requires U.S. financial institutions considering private banking accounts for non-U.S. persons to determine the "identity of the nominal and beneficial owners" of the account "as needed to guard against money laundering and report any suspicious transactions"; and (2) Section 311 which authorizes the Treasury Department, as a possible special measure under that section, to require U.S. financial institutions to maintain records or report information on the "identity of the beneficial owner of the funds involved in any transaction" or on the "beneficial ownership of any account opened or maintained in the United States by a foreign person ... or a representative of such a foreign person." The term is also used in Section 356 requiring a report and recommendations on whether personal holding companies with five or fewer participants should have to disclose their "beneficial owners" to U.S. financial institutions when opening accounts.

The definition of beneficial ownership is critical to the successful implementation of the anti-money laundering safeguards in the law since it serves as a key mechanism to require U.S. financial institutions to take reasonable steps to determine who is the true holder of the accounts they open and manage. Money launderers frequently attempt to hide their identity behind shell corporations, trusts, or intermediaries such as trustees, attorneys, or investment personnel. Others attempt to avoid scrutiny by having another person named as the accountholder, while serving as a secondary signatory on an account. Some use even more exotic means to hide their

identity, such as by opening an account in the name of a closely held investment company, hedge fund, or unincorporated association.

The proposed definition requires financial institutions to determine, for each account, the identity of not only the persons who have legal authority to "fund, direct, or management the account," but also the persons who have a "legal entitlement to all or any part of the corpus or income" in the account. The proposed definition exempts persons with the lesser of $1 million or a 5% interest in the corpus or income in the account, so that persons with an immaterial interest do not have to be reviewed. By requiring financial institutions to inquire into both categories of persons, those who direct an account and those who are entitled to the corpus or income in an account, the proposed definition correctly intends to compel U.S. financial institutions to do more than obtain the name of the nominal accountholder. The U.S. financial institution needs to find out who really has a stake in the funds they have been asked to handle.

The proposed definition should be further strengthened, however, by adding a new sentence at the end of 103.175(b): "Any list of persons holding a beneficial ownership interest in an account must, where appropriate (other than for a publicly traded corporation, widely held mutual fund, or similar entity), identify the natural individuals associated with a listed corporation, trust, attorney, or other intermediary." Right now, the proposed definition does not convey any obligation on the part of U.S. financial institutions to identify natural individuals and not just legal entities as the beneficial owners of an account. Naming individuals, in addition to corporations or trusts serving as the holders of beneficial interests, is particularly important for private banking accounts. Naming natural individuals might also be critical under Section 311 where, for example, the Department may be attempting to track financial transactions related to a known terrorist.

Several comment letters suggest there may be practical difficulties in implementing the proposed definition and identifying relevant beneficial owners. Countries such as Switzerland, however, have long required Swiss banks to identify the beneficial owners of their accounts, and have shown that naming beneficial owners is not only practical, but very valuable to anti-money laundering efforts, particularly for private banking accounts held on behalf of political figures. The proposed rule may want to consider adopting the Swiss approach of creating an official form for identifying an account's beneficial owners, requiring banks to have individuals sign that form as part of the account opening documentation, and then treating it as legally conclusive evidence of ownership; this approach has apparently been very effective in accurately identifying the real owners of funds in an account.

Several comment letters urge the Department to allow U.S. financial institutions to forego identifying and conducting their own due diligence review of the beneficial owners of a private banking account in favor of relying on so-called "intermediaries" with "robust anti-money laundering regimes in their home country jurisdictions." The letters seem to suggest that an intermediary serving as a private banking accountholder could be called upon to identify the beneficial owners of the account, perform the required due diligence reviews, and vouch for the legitimacy of the owners, and the U.S. financial institution may rely on the intermediary's efforts without performing any due diligence of its own with respect to the beneficial owners.

The suggestion that U.S. financial institutions delegate their due diligence obligations to intermediaries, however, runs counter to years of U.S. anti-money laundering practice requiring U.S. banks to know their clients, and is particularly ill suited to private banking accounts which typically involve a few wealthy individuals and their families. It is also an approach that the United States has condemned in other countries and has been working to end. Liechtenstein, for example, was originally included in the Financial Action Task Force (FATF) list of noncooperative jurisdictions in part because its banks had tens of thousands of accounts in which the banks allegedly had little or no information about the beneficial owners. Instead, Liechtenstein banks had routinely relied on intermediaries such as attorneys to identify the account's beneficial owners and vouch for their legitimacy. The United States, among other countries, insisted that Liechtenstein's banks abandon this practice of relying on intermediaries and instead open accounts only after identifying and conducting their own due diligence reviews of the beneficial owners. Liechtenstein agreed to do so in connection with a number of reforms it undertook at FATF's request; it is still under international scrutiny to determine whether its banks have actually ended their reliance on intermediaries to conduct due diligence reviews.

In support of their recommendation, some of the comment letters reference the Wolfsberg Principles on anti-money laundering guidance for private banking, noting that the Principles discuss private banking accounts held in the name of attorneys, trustees, money managers, and other intermediaries. They recommend that the United States recognize "developing international practice to rely on representations and warranties" by intermediaries. But the Wolfsberg Principles do not advocate private banks' transferring their due diligence obligations to third parties; to the contrary, they repeatedly direct their adherents to identify the beneficial owners of their private banking accounts and conduct sufficient due diligence to guard against money laundering. The Principles flatly state, for example, "Beneficial ownership must be established for all accounts." They direct private banks to "accept only those clients whose source of wealth and funds can be reasonably established to be legitimate," and state that the "primary responsibility for this lies with the private banker who sponsors the client for acceptance." While the Principles do reference private banking accounts held in the name of money managers, no such provision is included in the Patriot Act. Moreover, in the United States, accounts opened in the name of a money manager are typically treated as correspondent accounts, rather than private banking accounts. Of course, if U.S. financial institutions were to be excused from conducting their own due diligence for private banking accounts held in the name of a money manager, this exception could lead to numerous such accounts and a wholly new effort by U.S. private banks to transfer their due diligence obligations to a money manager which may or may not be a U.S. entity subject to U.S. law and oversight.

Private banking accounts, as defined in the Patriot Act, are accounts set up for wealthy non-U.S. individuals, and are fundamentally different than investment company accounts set up to benefit numerous unrelated parties. Distinctions can and should be made regarding the due diligence obligations applicable to private banking accounts, investment company accounts involving numerous individuals, and personal investment company accounts that may fall somewhere inbetween. In each instance, the U.S. financial institution needs to determine whether the accountholders are non-U.S. individuals or foreign financial institutions subject to

Section 312, identify the account's beneficial owners, analyze the money laundering risks, and apply an appropriate level of due diligence to guard against money laundering. The Department should reject requests by U.S. financial institutions to transfer their due diligence obligations to third parties simply by naming an intermediary as the nominal accountholder of a private banking account.

(6) Appropriate Due Diligence

Finally, we would like to comment on the proposed rule's guidance on the general and enhanced due diligence programs that U.S. financial institutions are expected to establish to guard against money laundering in their foreign correspondent and private banking accounts.

The proposed rule sets out 5 procedures that must be part of a U.S. financial institution's due diligence program for correspondent accounts involving a foreign financial institution. They are: (1) determining whether the accountholder is a high risk foreign bank requiring enhanced due diligence; (2) assessing whether the account presents a significant risk of money laundering; (3) considering information from the U.S. government and multinational organizations about the foreign financial institution; (4) reviewing regulatory guidance regarding the foreign financial institution or foreign correspondent accounts generally; and (5) reviewing public information to determine whether the foreign financial institution has been the subject of any criminal action or to a regulatory action related to money laundering. The proposed rule also specifies three elements that must, at a minimum, be included in any enhanced due diligence review directed toward three categories of high risk foreign banks: (1) identifying the foreign bank's owners, if the bank is not publicly traded; (2) identifying the foreign bank's nested correspondents; and (3) conducting enhanced scrutiny of the account, including reviewing documentation on the foreign bank's anti-money laundering program and, "when appropriate," monitoring transactions, obtaining information about the persons who can direct transactions through the account, and the sources and beneficial ownership of funds of such persons in the account.

While the proposed rule generally conforms with the statute, several changes are needed to strengthen it. First, the proposed rule needs to be reworded to better incorporate the principle that due diligence programs are to be risk-based. Secondly, the proposed rule is currently structured in such a way that it implies that U.S. financial institutions never have to apply enhanced due diligence procedures to any foreign financial institution other than the specified categories of high risk foreign banks. While it is true that these are the only foreign financial institutions for which enhanced due diligence procedures are mandatory, Section 312 also suggests using enhanced due diligence procedures for other categories of financial institutions as needed.

The relevant statutory language in 18 U.S.C. 5318(i)(1) requires U.S. financial institutions to "establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering." To better implement this statutory language, Section 103.176(a)(2) could be revised to read as follows:

"(2) Assessing the extent to which the foreign financial institution presents money laundering risks, based on any relevant factors, and, the appropriate due diligence procedures, including enhanced due diligence where necessary, to be applied to any accounts opened for such institution to guard against money laundering and detect and report suspicious activities;".

This language would make it clear that the due diligence program for correspondent accounts is to include an assessment of the money laundering risk and of the appropriate due diligence procedures to be applied to the foreign financial institution.

Second, the proposed rule would be strengthened by adding a sixth mandatory due diligence procedure requiring U.S. financial institutions to "conduct appropriate monitoring of the transactions in correspondent accounts opened for foreign financial institutions to detect and report suspicious transactions." As currently structured, the proposed rule implies that the only foreign financial accounts that have to be monitored for suspicious transactions are accounts opened for the three specified categories of high-risk foreign banks. But an offshore brokerage account with a high velocity of transactions involving millions of dollars also needs to be monitored. The Patriot Act, in fact, seeks to subject all foreign financial institutions to appropriate levels of oversight to guard against terrorists and other criminals using these financial accounts against us.

Third, some comment letters assert that foreign banks subjected to the proposed enhanced due diligence procedures may refuse to provide the required information, perhaps claiming they are barred by local law from doing so. These comment letters seem to recommend eliminating the requirements. This suggestion is not only contrary to the statute, but ill advised. The proposed rule requires U.S. financial institutions to obtain only two types of information: the bank's owners and the bank's correspondents. While ownership information is not publicly available in many offshore jurisdictions, no jurisdiction we are aware of bars a bank from voluntarily disclosing its owners. Moreover, most banks advertise their correspondent relationships, rather than keep them confidential, to let clients know how to transfer funds to them internationally. The Bankers Almanac, for example, a widely used, on-line, compendium of bank information, includes long lists of correspondents for most of the listed banks. Bank ownership and correspondent information are not trade secrets, and obtaining this information is critical to an accurate money laundering assessment of a high risk foreign bank.

Fourth, we have a few comments on the wording of the proposed provisions. Section 103.176(a)(3) should be strengthened by requiring U.S. financial institutions to consider information from a foreign financial institution's own in-country regulator. With respect to enhanced due diligence procedures for the high risk foreign banks, Section 103.176(b)(1)(i) on monitoring transactions should be incorporated into (b)(1) and applied to all such foreign bank accounts – not only "when appropriate." Transaction monitoring is the essence of "enhanced scrutiny," and there can be no enhanced scrutiny without monitoring an account's actual transactions. In addition, Section 103.176(b)(1) might benefit from a new subsection (iii) requiring a U.S. financial institution to obtain from the high risk foreign bank information on its major lines of business, the nature of its clientele, and a copy of its last audited financial

statement. As shown in the Subcommittee's correspondent banking staff report, this basic information can be used to uncover sham banks with few assets, banking services, or clients.

Finally, Section 103.176(b)(1)(ii), addressing enhanced due diligence procedures for the three categories of high risk foreign banks, needs to be clarified. Several comment letters question whether this section is intended to require U.S. financial institutions to conduct due diligence reviews of the individual clients of the covered foreign banks. We believe Section 312, which requires U.S. financial institutions to apply "appropriate" due diligence to guard against money laundering, requires U.S. financial institutions to focus their reviews on their own client, the foreign bank, not the clients of their client. However, that review, depending upon the nature of the foreign bank, the number and nature of its clients, and other relevant factors, may necessitate some degree of inquiry into the bank's own customers. But that review would not require a U.S. financial institution to conduct systematic, comprehensive, detailed, or ongoing due diligence reviews of the clients of its client. For example, in the case of a small, closely held, offshore bank, the due diligence review by the U.S. financial institution should include evaluating the number of clients the bank has and, if that number is small, identifying and evaluating the major clients likely to be using the U.S. account. In the case of a client that is a large foreign bank in a non-cooperative jurisdiction, while the U.S. financial institution should not be required to review the bank's individual clients, it should have to evaluate the general nature of the bank's clientele, ask whether a few clients dominate the bank's business, and, if appropriate, identify and evaluate those clients. The U.S. financial institution would then have to factor that information into its money laundering risk analysis and into the design of appropriate ongoing due diligence procedures.

Some comment letters suggest that the proposed rule should explicitly authorize U.S. financial institutions to rely on the foreign bank, sometimes referred to as an "intermediary," to conduct anti-money laundering reviews of the foreign bank's own customers and explicitly free U.S. banks from any obligation to examine such customers. Others want this authorization for not only high risk foreign bank accounts, but also all foreign financial institution accounts, and all private banking accounts as well. But it would be illogical for U.S. financial institutions to treat the clients of a large foreign bank, one type of intermediary, representing thousands of customers, in the same way as an attorney, another type of intermediary, representing a single, unnamed individual. In the case of the intermediary representing a single individual, for example, a reasonable due diligence effort would require the U.S. financial institution to identify and evaluate the unnamed individual to guard against money laundering through the relevant correspondent or private banking account.

Thank you for this opportunity to comment on the proposed rule.

Sincerely,

Charles E.Grassley John Kerry Carl Levin

CL:ejb