SwissBanking

FinCEN
P.O. Box 39
Vienna, Virginia 22183

Basel, 28 June 2002
L.162/HU/mg

Section 312 Regulations

Dear Sir or Madam:

The Swiss Bankers Association (the "SBA")[1] appreciates this opportunity to comment on the regulations proposed by the Department of the Treasury ("Treasury") and the Financial Crimes Enforcement Network ("FinCEN") on May 30, 2002, to implement Section 312 of the USA PATRIOT Act of 2001 (the "Act").

The SBA supports the Act's requirements that covered financial institutions conduct due diligence for correspondent and foreign private banking accounts. These and other requirements of the Act are consistent with the recommendations of the Financial Action Task Force ("FATF") with respect to combating money laundering and other financial crimes, including terrorist financing. Switzerland has also implemented FATF's recommendations and has long been recognized as having one of the most robust anti-money laundering systems in the world, including "know your customer" due diligence requirements for all customers, not only foreign correspondent banks and foreign private banking customers.[2] Switzerland's two largest banks also are

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[1] The Swiss Bankers Association represents approximately 400 banks, including non-Swiss banks, with operations in Switzerland. Several members of the SBA have substantial operations in the United States through branches, agencies and affiliates.

[2] U.S. government officials have testified to the cooperation of Swiss authorities in the fight against money laundering. See, Testimony of Michael Chertoff, Senate Banking Committee Hearing on the 2001 National Money Laundering Strategy (September 26, 2001). More recently, on June 12, following a meeting with Switzerland's Justice Minister, Attorney General John Ashcroft commended the Swiss banking system for being in the forefront of international efforts to stop the funding of terrorism: "The Swiss banking system is well known as an example to the world [...] The world needs to take note of the way in which Switzerland operates to support law enforcement, while protecting the interests of the individual." *Ashcroft Praises Switzerland's Anti-Terror Role*, Swissinfo, Jun. 12, 2002.

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founding members of the Wolfsberg group of international banks, a leader in developing principles on due diligence in private banking and other measures to protect financial institutions from being used by those who commit financial crime.

The SBA is a signatory to the joint comment letter on the proposed regulations that is being submitted separately by leading financial institution trade associations and strongly supports each of the points expressed therein. There are four aspects of the proposed regulations that are of particular significance to our members on which we would like to comment separately. They are: (A) the treatment of bank subsidiaries of foreign banks located in offshore jurisdictions under the enhanced due diligence provisions of the proposed rule; (B) clarification of the treatment to be accorded to branches located in "noncooperative" jurisdictions; (C) the scope of due diligence to be performed with respect to beneficial ownership interests in the context of private banking accounts; and (D) reliance on intermediaries in conducting due diligence, particularly in private banking relationships. Each of these issues is addressed below.

A. Treatment of Bank Subsidiaries Operating in Offshore Jurisdictions.

As proposed, the regulations generally would require enhanced due diligence for any correspondent account maintained for a foreign bank that operates under "an offshore banking license," defined as "a license to conduct banking activities that prohibits the licensed entity from conducting activities with the citizens of, or in the local currency of, the jurisdiction that issued the license." The proposed regulation would exempt from this requirement any "branch" of a foreign bank that is chartered in a jurisdiction that the Board of Governors of the Federal Reserve System (the "Board") has determined subjects its banks to "comprehensive supervision or regulation on a consolidated basis" ("CCS").[3] The SBA supports this exemption as consistent with the overall risk-based focus that underlies the proposed regulations. It appropriately focuses the enhanced due diligence requirements on correspondent account relationships with offshore branches of institutions that are not already subject to global anti-money laundering requirements by their home countries.

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[3] Excluded from the exemption is any foreign bank from a country that has been designated by FATF or another intergovernmental body as "noncooperative" with international anti-money laundering principles or that the Treasury has identified as requiring special measures.

The SBA respectfully recommends that this exemption be clarified to include any banking subsidiary of a parent foreign bank that is from a jurisdiction that the Board has found to apply CCS, that otherwise will come within the definition of "offshore banking license." The rationale for exempting branches licensed in offshore jurisdictions applies equally to subsidiaries chartered in such jurisdictions. The Board's CCS determination relates to the supervision and regulation that is applied by a home country regulator to an entire banking organization, including its branches and subsidiaries.[4] In both cases, subjecting such operations to enhanced due diligence would impose a significant cost on legitimate banking business that does not present a high risk of money laundering. The difference in legal status between an offshore branch and an offshore subsidiary is irrelevant for purposes of CCS and to the application of the enhanced due diligence requirements. Indeed, the Swiss Federal Banking Commission, the Swiss banking supervisor, examines such offshore branches <u>and</u> subsidiaries of Swiss banks and requires, that such branches <u>and</u> subsidiaries adhere to equivalent anti-money laundering standards to those that apply to the Swiss parent banks.

B. Clarification of the Treatment of Branches Operating in Noncooperative Jurisdictions

Section 103.76(c)(2) of the proposed regulations requires enhanced due diligence for any bank "licensed" by a country that has been designated as non-cooperative with international money laundering principles by an intergovernmental group or organization such as FATF. In this context, it is not clear whether the term "licensed" is intended to refer only to the jurisdiction in which the head office of the foreign bank is chartered or also to the host jurisdiction in which the branch of a foreign bank is licensed to operate. We assume the intent of the Act and the proposed regulation is to apply enhanced due diligence to every bank headquartered in a country that FATF has listed as non-cooperative. We further assume that neither the Act nor the proposed rule is intended to impose enhanced due diligence on a correspondent account maintained by a branch operating in a FATF-listed country, if the bank is headquartered in a jurisdiction that has not been listed by FATF as non-cooperative. The SBA respectfully requests clarification that foreign bank branches licensed by a host country that is on the FATF list be excluded from enhanced due diligence if the foreign bank is chartered in a country that is not on the FATF list and that the Board has determined subjects its banks to CCS.

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[4] <u>See</u> 12 C.F.R. § 211.24(c)(1)(ii).

C. Scope of Due Diligence to Determine Beneficial Ownership

The SBA also recommends that Treasury provide further clarification regarding the conduct of due diligence in the case of beneficial ownership interests in private banking accounts. In this regard, paragraph 1.2.2 of the Wolfsberg principles is particularly instructive and we respectfully request that such an approach be recognized as a means of fulfilling an institution's obligation to perform due diligence on beneficial owners. Such an approach is more risk-based than that set forth in the proposed rule, which is based on a strict definition of beneficial ownership. Unlike the proposal, which, for example, requires enhanced due diligence for any noncontingent legal interest in an account that is equal to or exceeds the lesser of $1 million or 5 percent of the corpus or income of an account, paragraph 1.2.2 provides that beneficial ownership should be examined according to the following principles:

- Natural persons: when the account is in the name of an individual, the private banker must establish whether the client is acting on his/her own behalf. If doubt exists, the bank will establish the capacity in which and on whose behalf the accountholder is acting.
- Legal entities: where the client is a company, such as a private investment company, the private banker will understand the structure of the company sufficiently to determine the provider of funds, principal owner(s) of the shares and those who have control over the funds, e.g. the directors and those with the power to give direction to the directors of the company. With regard to other shareholders the private banker will make a reasonable judgment as to the need for further due diligence. This principle applies regardless of whether the share capital is in registered or bearer form.
- Trusts: where the client is a trustee, the private banker will understand the structure of the trust sufficiently to determine the provider of funds (e.g. settlor) those who have control over the funds (e.g. trustees) and any persons or entities who have the power to remove the trustees. The private banker will make a reasonable judgment as to the need for further due diligence. ·
- Unincorporated associations: the above principles apply to unincorporated associations.

Further, the SBA respectfully requests that Treasury clarify the scope of the proposed rule's requirements to identify the holders of beneficial ownership interests in companies. As the proposed definition of "beneficial ownership interest" reflects, investors in certain categories of companies, such as mutual funds and publicly traded companies, would generally be exempt from identification or due diligence.[5] Consistent with this approach, we assume that the Treasury did not intend that such investment vehicles be included within the definition of "private banking." The determination of whether information is needed on beneficial owners in other, more specialized investment vehicles, such as hedge funds, should be risk-based and turn on factors such as the number of investors in the fund, the reputation of the manager of the fund and whether the manager meets the test (discussed below) to be relied upon as an intermediary performing due diligence.

D. Reliance on Intermediaries

No one country can prevent money laundering or terrorist financing on a global basis. In recognition of this reality, the countries that are members of FATF, for more than a decade, have been implementing harmonized and uniform anti-money laundering requirements for financial institutions and other intermediaries in their jurisdictions. FATF has also taken a leading role in recommending additional measures to prevent terrorist financing. In this context, there is a growing recognition in industry practice and regulatory guidance that banks and other financial institutions may, in appropriate circumstances, rely on the due diligence performed by other intermediaries in the financial system. This recognition is particularly important in the context of determining the beneficial owners in the context of relationships where the financial institution's customer is often another financial intermediary that collectively manages the assets of several entities and/or individuals. Such recognition of, and reliance upon, the due diligence performed by a financial intermediary avoids the need for financial institutions to "know their customer's customer," particularly under circumstances where the risk of money laundering is low because the intermediary itself is well regulated. It also avoids difficulties that could otherwise be encountered due to restrictions that might apply to the transfer of customer-specific information across borders.

With respect to the application of due diligence to financial intermediary-asset managers , the proposed regulations contain no explicit recognition of the developing industry practice to rely on representations and warranties from intermediaries that are subject to adequate supervision and robust anti-money

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[5] In his Senate floor statement on the Act, Senator Carl Levin(D-MI) stated that "no one wants financial institutions to record the names of the stockholders of publicly traded companies. No one wants financial institutions to identify the beneficiaries of widely held mutual funds." 147 Cong. Rec. S11036 (daily ed. Oct. 25, 2001).

laundering regimes in their home country jurisdictions.[6] Rather, in this context, the regulations contain a technical legal definition of “beneficial ownership interest” in the context of private banking relationships that is intended to provide a standard point at which a financial institution would be required to make inquiries concerning the ultimate beneficial owner of an account. The SBA requests that Treasury clarify that accounts held by financial intermediary-asset managers are not encompassed by the definition of private banking relationships and incorporate a more risk-based approach in the final rule that would enable covered financial institutions to determine when it is appropriate to rely on due diligence performed by intermediaries based on the bank’s due diligence on the intermediary, and the level of supervision applied to the intermediary.[6]

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The SBA thanks Treasury and FinCEN for the opportunity to comment on the proposed regulations. If you need any additional information concerning issues addressed in this letter, please contact our U.S. counsel Thomas J. Delaney or Marc R. Cohen at Shaw Pittman LLP (telephone 202-663-8000).

Sincerely,
Swiss Bankers Association

Urs P. Roth   Andreas Hubschmid

[6] Switzerland in particular has rigorous know your customer requirements for private banking accounts combined with strict legal obligations to protect the privacy of customers. The banks report suspicious activities to Swiss legal authorities that can share customer information with legal authorities in other countries through well-established mechanisms for multilateral sharing of information. It would create serious conflicts with their obligations under Swiss law if Swiss banks were required to provide customer information to covered financial institutions in the United States.

[6] *See, e.g.,* § 2.2.3 and 2.2.4 of the guidelines provided by the Basel Committee on Banking Supervision, *Customer Due Diligence for Banks* (Oct. 2001); and § 1.2.3 of the *Global Anti-Money Laundering Guidelines for Private Banking: Wolfsberg AML Principles* (Oct. 2000).