PATRIOT Act Section 312 NPRM Comment file

On June 12, 2002, the representatives of the financial services industry listed below met with representatives of the Treasury Department to present their views on the issues set forth in the attached memorandum regarding Treasury's Notice of Proposed Rulemaking under PATRIOT Act Section 312. The Treasury representatives included General Counsel David Aufhauser, Deputy General Counsel George Wolfe, Deputy Assistant Secretary Julie Myers, and representatives of Domestic Finance, Office of General Counsel, and FinCEN. Following the presentation the Treasury representatives thanked the financial services industry representatives for their comments.

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Treasury/FinCEN Proposed Rule under Section 312 of the USA PATRIOT ACT
#3a

Issues of Primary Significance Jointly Identified by Leading Financial Institution Trade Associations[1]

1. Timing of Implementation of Proposed Rule.

   Issue:

   - Broad scope and retroactive application (*i.e.*, to existing accounts) of Proposed Rule render compliance by July 23, 2002 impossible.[2]

   Proposal:

   - Prospective application of the Proposed Rule to new correspondent accounts should become effective in two stages:

     - 30 days after publication of the Final Rule in the *Federal Register* with regard to correspondent accounts established for foreign banks subject to enhanced due diligence under proposed 31 C.F.R. § 103.176(c); and

     - 90 days after publication of the Final Rule in the *Federal Register* with regard to correspondent accounts established for all other "foreign financial institutions".

   - Retroactive application of the Proposed Rule to existing correspondent accounts should begin to become effective 180 days after publication of the Final Rule in the *Federal Register* with regard to correspondent accounts maintained for "foreign financial institutions." U.S. financial institutions should review existing accounts on a risk-focused basis, *i.e.*, with priority given to those believed to create higher risk of money laundering.

2. Scope of the Proposed Rule.

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[1] These trade associations are: the American Bankers Association; the Bankers Association for Finance and Trade; the Financial Services Roundtable; the Futures Industry Association; the Institute of International Bankers; the Investment Company Institute; The New York Clearing House Association L.L.C.; the Securities Industry Association; and the Swiss Bankers Association.

[2] The Proposed Rule under Section 352 of the Act that was issued on April 23, 2002 provided that compliance with the Act would be achieved if anti-money laundering programs were implemented within 90 days after publication of the Final Rule in the *Federal Register*, even though the Act by its terms required that such programs be implemented by April 24, 2002.

- Broad definitions of "correspondent account," "foreign financial institution" and "covered financial institution" work together to expand significantly the scope of the due diligence and enhanced due diligence requirements.

- Definition of "Correspondent Account"

  Issue:
  - Definition is overly broad and includes virtually every relationship with a foreign financial institution (see below).

- Definition of "Covered Financial Institution"

  Issue:
  - Includes foreign branches of insured depository institutions.

  Proposal:
  - The definition should not extend to the foreign branches of insured depository institutions for the following reasons:

    - The Act clearly limits the Section 312 due diligence requirements to correspondent accounts and private banking accounts established or maintained *in the United States*. Foreign branches of insured banks are therefore not included within this definition.

    - Drives transactions to foreign institutions prior to entry of funds into the U.S., depriving the U.S. of access to information about sources of funds and putting U.S. banks at a significant competitive disadvantage.

- Definition of "Foreign Financial Institution"

  Issues:
  - The definition of "foreign financial institution" is too broad.

  - U.S. financial institutions have not traditionally tracked such a broad range of foreign entities.

  - Difficult to apply definitional concepts tailored for U.S. financial institutions to foreign entities, especially where these foreign entities are not regulated.

  Proposals:
  - The trade associations suggest alternative approaches:

    - Limit the definition. For example, the definition could be limited to "foreign banks;" for other "foreign financial institutions" that present a significant money laundering concern, Treasury could use its broad

authority under Section 311 to apply special measures to those institutions; or

- Provide covered financial institutions with the flexibility to conduct due diligence on a risk-focused basis, *e.g.*, based on the geographic location of the "foreign financial institutions.

3. Enhanced Due Diligence Requirements for Correspondent Accounts.

- Requirement to review a foreign bank's anti-money laundering program and consider the extent to which it is reasonably designed to detect and prevent money laundering.

  Issue:

  - Could be read to require covered financial institutions to audit the foreign bank's anti-money laundering program in order to make a judgment about the adequacy and implementation of the foreign bank's program. It may be difficult to reach such a judgment absent substantial familiarity with various conditions in the foreign bank's home country jurisdiction.

  Proposal:

  - Clarify that this requirement does not imply an obligation to audit the foreign bank's implementation of its anti-money laundering program, as such an obligation would be exceedingly burdensome, if not impossible, to comply with.

- Requirement to identify persons with authority to direct transactions through the correspondent account.

  Issue:

  - As a practical matter, this would be impossible to accomplish, unless this is directed at payable through accounts.

  Proposal:

  - Draw a clear distinction between payable through accounts and correspondent accounts and clarify that this requirement is directed at payable through accounts. (In the case of a payable through account, the foreign bank's customer can direct transactions through the foreign bank's correspondent account with a U.S. financial institution (*e.g.*, by way of check-writing privileges). In the case of a correspondent account, only the foreign bank can direct transactions through the correspondent account.)

- Requirement that a covered financial institution identify its foreign respondent bank's bank customers.

  Issue:

  - May be difficult, if not impossible, to obtain this information. Foreign banks may be reluctant to provide this information for competitive and other reasons, *e.g.*, providing the information may violate foreign privacy or data

protection laws. Also, may result in jurisdictions (including, Russia, Israel, Egypt and the Philippines) being effectively precluded from direct participation in the U.S. financial system.

Proposal:

- Adopt an approach that would require covered financial institutions to request the names and addresses of their foreign respondent banks' bank customers, and if such information is not obtained, to take such action (including closing the account or determining not to open the account) as Treasury may direct by rule or regulation.
- Could exclude "correspondent accounts" that do not involve transactions on behalf of third parties, *e.g.*, where a foreign bank is trading for its own account using proprietary funds.
- Clarify that this is not a continuous obligation, but that information should be updated periodically.
- Essential to clarify that covered financial institutions have no due diligence obligations with regard to their foreign respondent bank's bank customers.

- Requirement to identify the owners of a privately held foreign bank.

  Issue:

  - 5% threshold in definition of "owner" renders this requirement too onerous.

  Proposal:

  - Adopt definition of "owner" used in certification included in Proposed Rule under Sections 313 and 319(b).

4. The Concept of "Publicly Available Information."

Issue:

- This concept is highly important because it is used to delineate a U.S. financial institution's due diligence obligations throughout the Proposed Rule. Meaning and scope of this concept unclear and should be clarified in each of the following instances:

  - Definition of "senior foreign political figure" (" . . . a person who is widely and publicly known . . . to maintain a close personal or professional relationship . . .").

  - Correspondent account due diligence requirement to consider publicly available information from U.S. governmental agencies and multilateral organizations with respect to supervision and regulation.

  - General requirement in the Preamble that covered financial institutions should avail themselves of public information about jurisdictions in which their foreign financial institution customers are organized or licensed.

- Correspondent account due diligence requirement to review public information to ascertain whether the foreign financial institution has been the subject of a criminal or regulatory action relating to money laundering.

- Private banking account due diligence requirement to determine whether a nominal holder or holder of a beneficial ownership interest may be a senior foreign political figure ("[r]easonable steps . . . should generally include some review of public information, including information available on databases on the Internet.").

- Enhanced due diligence requirements for private banking accounts (" . . . if a private banking customer is from a jurisdiction where it is well known through publicly available sources . . . that political figures have been implicated . . .").

Proposal:

- "Publicly available information" could be limited to sources specifically identified or made available to U.S. financial institutions by Treasury. Recognition should be given to usage of a "reasonableness" test and to industry efforts to create private sector repositories of relevant data and U.S. financial institutions should be allowed to meet their statutory and regulatory obligations by availing themselves of these repositories.

5. Due Diligence for Private Banking Accounts.

Issue:

- Proposed Rule provides no guidance on obtaining beneficial ownership and source of funds information for private banking accounts established by intermediaries on behalf of foreign individuals.

Proposal:

- Recognize the developing industry practice to rely on representations and warranties from intermediaries subject to robust anti-money laundering regimes in their home country jurisdictions with regard to due diligence rather than obtaining the identities of and performing due diligence on beneficial owners.

- This proposal relates not only to private banking, but to the numerous other situations in which the "intermediary" issue arises throughout the Act.

Issue:

- Definition of "beneficial ownership interest."

Proposal:

- Final Rule could more closely follow an approach similar to paragraph 1.2.2 of the Wolfsberg Principles, as more fully explained in Wolfsberg's "frequently asked questions with regard to beneficial ownership" (see attached).

6. Definition of "Correspondent Account"

Issues:

- As stated above, the definition includes virtually every relationship with a foreign financial institution.

- Significant problems created by overly broad definition:

    - Competitive considerations.
    - Disperses focus.
    - Cost of implementation.
    - Not compelled by statute.

Proposals:

- Trade associations previously proposed various definitions (or carve-outs). Common among the proposed definitions is an attempt to identify those accounts/transactions where the risk of money laundering is not meaningful. This should also be the focus of the Final Rule.

    - In keeping with the risk-based approach that underlies the Proposed Rule, the risk of money laundering is greatest with regard to those accounts through which payments to/from third parties are made/received.

    - In the following situations involving accounts/transactions with foreign banks, the risk of money laundering is not material:

        - Where a foreign bank is the counterparty, *i.e.*, acting as principal (*e.g.*, foreign exchange, derivatives and other capital markets transactions, and extensions of credit).

        - Where the foreign bank engages only in occasional/ isolated transactions with the covered financial institution (*e.g.*, overnight CDs).

        - Where the covered financial institution's relationship or account with the foreign bank is established for a specific purpose and funds are received/disbursed under limited defined circumstances to identified third parties as set forth in an agreement with the foreign bank (*e.g.*, escrow, corporate trust, paying agency and custody).

- Where the account is for investment of funds that is subject to a regulatory scheme (*e.g.*, investment of funds of regulated pension or retirement plans).

- Where the account is held by a foreign bank that is itself subject to a robust anti-money laundering regime.