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#18

July 1, 2002

Financial Crimes Enforcement Network
U.S. Department of the Treasury
Attn: Section 312 Regulations
P.O. Box 39
Vienna, Virginia 22183
regcomments@fincen.treas.gov

Re: Proposed Regulations under Section 312 of the USA PATRIOT Act

Ladies and Gentlemen:

The Institute of International Bankers appreciates this opportunity to comment on the regulations proposed by the Financial Crimes Enforcement Network ("FinCEN") under Section 312 of the USA PATRIOT Act of 2001. The Institute strongly supports the coordinated global effort to combat money laundering and to curtail the financing of terrorist activities. We also strongly support the policy objectives underlying the USA PATRIOT Act's provisions designed to further this global effort, including Section 312.

Section 312 requires certain U.S. financial institutions, including U.S. branches and agencies of international banks and U.S. bank and broker-dealer subsidiaries of international banks, to establish due diligence procedures for correspondent and private banking accounts provided to certain non-U.S. customers. These procedures are required to include enhanced due diligence for correspondent accounts in which the non-U.S. respondent is a foreign bank meeting certain criteria, and enhanced scrutiny for private banking accounts for senior foreign political figures and their family members and close associates.

In many respects, Section 312 reflects a fundamental principle underlying the anti-money laundering procedures already used by international banks for their correspondent banking and private banking activities—that institutions can and must make informed judgments regarding risks of money laundering and terrorist financing and implement customer due diligence procedures in accordance with those risk-based judgments. On the other hand, Section 312 creates a significant need for interpretive guidance and implementation by FinCEN, in view of the broad (and in many cases unclear) wording of the statutory language. The importance of FinCEN's guidance in this area is particularly important to avoid the risk that inflexible and

potentially overbroad rules will force financial institutions to divert resources away from higher priority anti-money laundering measures.

In this regard, the Institute of International Bankers has joined several leading U.S. trade organizations in a joint comment letter dated July 1, 2002 regarding FinCEN's proposed regulations under Section 312 (the "Joint Comment Letter"). The Joint Comment Letter raises many important issues that international banks share with domestic institutions, including appropriate deadlines for compliance under FinCEN's final regulations, the scope of certain key terms such as "correspondent account" and "foreign financial institution", difficulties associated with identifying a non-U.S. respondent bank's customers and persons authorized to direct transactions through a correspondent account, the need for clarification of the types of "publicly available information" that institutions will be required to review, the importance of affirming the ability to rely in appropriate circumstances on the due diligence procedures of intermediaries, including in the private banking context, and the definition of "beneficial ownership".

The issues discussed in the Joint Comment Letter take on even greater importance from the perspective of international banking organizations, since Section 312 and FinCEN's proposed regulations specifically target non-U.S. institutions. Section 312 affects international banks not only in their capacity as U.S. correspondents required to conduct due diligence and enhanced due diligence, but also in their capacity as non-U.S. respondents that potentially will be subject to the due diligence and enhanced due diligence performed by their U.S. correspondents. From this perspective, there is an additional policy rationale supporting the arguments made in the Joint Comment Letter. Not only would the suggestions raised in the Joint Comment Letter make FinCEN's proposed regulations more effective and tailored to actual money laundering risks, but the suggestions would help minimize the extent to which the proposed regulations discriminate against internationally headquartered banks or otherwise contravene the U.S. policy of national treatment for international banking organizations. Many international banks have implemented rigorous anti-money laundering controls that compare favorably with U.S. and international best practices, and many non-U.S. jurisdictions have adopted anti-money laundering measures that compare favorably with the post-USA PATRIOT Act legal framework in the United States.

As senior officials of the Treasury and Justice Departments have recognized, international cooperation is a critical component of the United States' efforts to combat international money laundering and terrorist financing. By minimizing discriminatory effects on international banking organizations, and by taking into account the existing money laundering programs that international banks have implemented on a global basis under their home country requirements, FinCEN will help promote international cooperation in this area.

This letter does not reiterate the positions expressed separately in the Joint Comment Letter. Instead, this letter addresses certain issues that arise under FinCEN's proposed regulations of particular importance to international banking organizations.

1. Enhanced Due Diligence for Foreign Banks Operating Under an Offshore Banking License

Under Section 312, certain enhanced due diligence procedures are required for U.S. correspondent accounts that are requested or maintained by, or on behalf of, a "foreign bank operating – (i) under an offshore banking license." Although the USA PATRIOT Act defines "offshore banking license", it does not define what it means to be "operating under" such a license. As we have argued to Treasury, the Institute believes the better interpretation of Section 312 and its legislative history is that enhanced due diligence should apply to non-U.S. banks that are established under an offshore banking license (i.e., offshore banks), but not to offices with offshore licenses (including offshore booking locations) operated by banks that are organized under conventional banking licenses.[1]

Recognizing that FinCEN has proposed a different interpretation of Section 312, the Institute strongly supports the exception that the proposed regulations create for offshore branches of a foreign bank where the Federal Reserve Board has made a determination that the foreign bank's home country provides comprehensive consolidated supervision ("CCS").[2] FinCEN's proposed exception (the "CCS Exception") is consistent with the principle that anti-money laundering measures should be risk-focused, and it expressly acknowledges the importance of a foreign bank's home country anti-money laundering regulation in assessing those risks. At the same time, the Institute would suggest a number of clarifications and technical improvements to the CCS Exception.

First, the principle underlying the CCS Exception for branches of a foreign bank extends equally to bank subsidiaries of the foreign bank and to the foreign bank itself. Thus, a correspondent account maintained by an offshore bank subsidiary of a foreign bank that would qualify for the CCS Exception, or a correspondent account maintained by a foreign bank that operates under an offshore banking license but that would itself qualify for the CCS Exception, should similarly be eligible for the CCS Exception. Although the existing formulation of the CCS Exception in the proposed regulations would cover most of the offshore operations of international banks that are subject to comprehensive consolidated supervision (i.e., offshore booking locations), there are significant numbers of other offshore operations that would not be included.

Including not only offshore branches but also offshore bank subsidiaries and the foreign banks themselves is fully consistent with the policy underlying the CCS Exception. The CCS Exception recognizes that, where the Federal Reserve Board has determined that a jurisdiction's supervisory authorities exercise CCS over banking organizations based in that jurisdiction, an

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[1] See Letter, dated Dec. 17, 2001, from the Institute of International Bankers to Ms. Francine J. Kerner, U.S. Department of the Treasury.

[2] See 67 Fed. Reg. 37736, 37743 (May 30, 2002) (proposed 31 C.F.R. § 103.176(c)(1)(ii)).

offshore branch of such a foreign banking organization should not necessarily be subject to enhanced due diligence under Section 312.[3] The underlying policy supporting the CCS Exception is that the relevant home country anti-money laundering controls should be sufficient to allow a U.S. institution to conclude that it can apply its normal due diligence procedures in lieu of the prescribed enhanced due diligence procedures. Because the basic concept of CCS depends on the home country supervisors' authority over the bank itself, its subsidiaries and its offices, all such entities should be equally eligible for the CCS Exception if the foreign bank meets the relevant criteria.

Indeed, the Federal Reserve Board's Regulation K, which enumerates the factors the Federal Reserve Board considers in making a CCS determination, provides that the Federal Reserve Board shall consider the home country supervisors' authority not only over the foreign bank's branches outside the home country, but also over the foreign bank itself and over the foreign bank's subsidiaries.[4] In this regard, the Federal Reserve Board's Regulation K implements international bank supervisory standards originally articulated in the 1983 Basle Concordat published by the Basle Committee on Banking Supervision (and consistently reaffirmed in subsequent Basle Committee pronouncements).[5]

A CCS determination by the Federal Reserve Board thus has the same meaning for non-U.S. bank subsidiaries of the foreign bank and for the foreign bank itself as it does for non-U.S. branches of the foreign bank. Consequently, the Institute would respectfully suggest that all such entities should be eligible for the CCS Exception in FinCEN's final regulations under Section 312 (so long as the foreign bank meets the criteria for the CCS Exception). Included in the suggested revisions to the wording of the CCS Exception in Annex A are revisions designed to reflect this technical change.

Second, there are two types of CCS determinations that the Federal Reserve Board can make under the International Banking Act of 1978, as amended (the "IBA"). The first and more common determination is the one paraphrased in the text of the CCS Exception in FinCEN's proposed regulations.[6] In addition, however, the Federal Reserve Board may approve a foreign bank's application under the IBA if it determines that the home country supervisor is actively working to establish arrangements for the consolidated supervision of the applicant bank and all

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[3] Of course, there may be circumstances in which a U.S. institution may elect to apply due diligence procedures comparable to the enhanced due diligence procedures specified in the proposed regulations even when not required to do so.

[4] See 12 C.F.R. § 211.24(c)(1)(ii).

[5] See "Principles for the Supervision of Banks' Foreign Establishments" (May 1983); see also, e.g., "Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments" (July 1992); "The Supervision of Cross-Border Banking" (Oct. 1996).

[6] Compare 67 Fed. Reg. at 37743 (proposed 31 C.F.R. § 103.176(c)(1)(ii)) with 12 C.F.R. § 211.24(c)(1)(i).

other factors are consistent with approval.[7] In making such a determination, the Federal Reserve Board is required to consider whether the foreign bank has adopted and implemented procedures to combat money laundering. The Federal Reserve Board is also permitted to take into account whether the home country supervisor is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering.[8] The statutory and regulatory criteria for both types of CCS determinations by the Federal Reserve Board are similar from the perspective of evaluating money laundering risks, and both types of CCS determinations should be sufficient to qualify a foreign bank and its subsidiaries and offices for the CCS Exception. Included in the suggested revisions to the wording of the CCS Exception in Annex A are revisions to reflect this technical change.[9]

Third, in certain respects the list of jurisdictions that will qualify for the CCS Exception will be arbitrarily defined by the home jurisdictions of foreign banking organizations that have filed recent applications with the Federal Reserve Board under the BHCA or the IBA. If no foreign banking organization from a particular jurisdiction has sought to establish a U.S. banking operation since 1991 (the year in which the CCS requirement was enacted), the Federal Reserve Board would have no reason to make a CCS determination regarding that jurisdiction. Because the due diligence procedures under Section 312 apply globally to all non-U.S. respondent banks, regardless of whether they have U.S. operations, there are many foreign banks from jurisdictions that could qualify for a CCS determination that would be unnecessarily subject to the prescribed enhanced due diligence requirements. To the extent that such requirements are inconsistent with the U.S. correspondent's money laundering risk assessment for the foreign bank, this will unnecessarily divert resources away from other anti-money laundering measures where those resources could be more effectively used.

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7 See 12 U.S.C. § 3105(d)(6)(A); 12 C.F.R. § 211.24(c)(1)(iii)(A).

8 See 12 U.S.C. § 3105(d)(6)(B); 12 C.F.R. § 211.24(c)(1)(iii)(B).

9 Indeed, it may be that both CCS determinations were intended to be included within the proposed wording of the CCS Exception, in which case the proposed language changes in Annex A would simply make that intention more clear. In the preamble to FinCEN's proposed regulations, Korea is cited as a jurisdiction as to which the Federal Reserve Board has made a CCS determination. See 67 Fed. Reg. at 37740 n. 9. To our knowledge, the most recent CCS determinations that the Federal Reserve Board has made for Korea are under the "actively working to establish arrangements for consolidated supervision" standard. See, e.g., Kookmin Bank, 87 Fed. Res. Bull. 787 (2001).

As of June 27, 2002, it appears that expressly including both types of CCS determinations would add two jurisdictions to the list of jurisdictions in footnote 9 to the preamble to the proposed regulations: Colombia (see Banco de Bogota S.A., 87 Fed. Res. Bull. 552 (2001)) and Peru (see Banco de Credito, 87 Fed. Res. Bull. 708 (2001)). Although this second type of CCS determination has also been made with respect to Egypt, Egypt would not necessarily qualify for the CCS Exception as worded in the proposed rule because Egypt has been designated by the Financial Action Task Force as a non-cooperative country. See Financial Action Task Force, "Non-Cooperative Countries and Territories," Updated as of June 21, 2002. But see text accompanying n. 11 infra.

By way of illustration, the following members of the Financial Action Task Force have not been subject to a CCS determination by the Federal Reserve Board: Denmark, Finland, Iceland, Luxembourg, New Zealand, Norway, Singapore and Sweden. The Institute believes that most, if not all, of these jurisdictions would easily meet the Federal Reserve Board's criteria for a CCS determination, but the Federal Reserve Board has not been called upon to make such a determination simply because of historical accident. In order to treat foreign banks from such jurisdictions consistently and fairly under Section 312 and FinCEN's regulations, it is important to create a reasonable mechanism for Treasury to add to the list of jurisdictions that would otherwise qualify for the CCS Exception to include such jurisdictions.

We would therefore respectfully suggest that FinCEN add language to Section 103.176 providing that Treasury may, after consultation with the Federal Reserve Board, determine by regulation or order that a foreign bank or jurisdiction may be exempted from enhanced due diligence procedures under Section 312 (or subject to modified enhanced due diligence requirements). Suggested language to this effect is included in Annex A.

Fourth, it would be helpful for institutions interpreting FinCEN's regulations under Section 312 if FinCEN would clarify in the preamble to the final regulations that the CCS Exception is not meant to imply that a foreign bank that maintains an offshore branch would otherwise be subject to enhanced due diligence for all correspondent accounts maintained by the foreign bank's global operations. As we understand the CCS Exception, it was meant only to imply that the particular offshore branch of a foreign bank that actually maintains the correspondent account would otherwise be subject to enhanced due diligence.[10] The need for this clarification arises in part from the lack of clarity in the scope of "foreign bank … operating under an offshore banking license," discussed above, combined with the addition of the CCS Exception as it is worded in the proposed regulations. The suggested modifications to the language of the CCS Exception in Annex A would help clarify this issue as well.

2. Enhanced Due Diligence for Foreign Banks Operating Under a Banking License Issued by a Non-Cooperative Country or Territory

Under the proposed wording of the CCS Exception, countries and territories that are designated as non-cooperative with international anti-money laundering efforts ("NCCTs") by international organizations such as the Financial Action Task Force ("FATF") would not be eligible for the CCS Exception, even if the Federal Reserve Board has made a recent CCS determination with respect to that jurisdiction. Recognizing that determinations by FATF represent considered judgments by a leading multilateral organization, the Institute would respectfully submit that the Federal Reserve Board's CCS determination should nevertheless be

[10] See 67 Fed. Reg. at 37740 ("Correspondent accounts for a branch of a foreign bank operating under an offshore branch license would not be subject to the additional requirements … if ….").

accorded great weight under FinCEN's regulations under Section 312. The Institute would therefore suggest that the proposed qualification on the CCS Exception that a jurisdiction not be an NCCT be removed from the language of the CCS Exception. (This would leave in place the qualification that the jurisdiction not be one as to which the Treasury Secretary has imposed so-called "special measures" under Section 311.) In addition, based on the same reasoning, the CCS Exception should apply not only to offshore operations in NCCTs but also to traditional banking operations in NCCTs. For example, a Russian bank subsidiary or branch of a major U.K. banking organization should be equally eligible for the CCS Exception as an offshore booking location in Grand Cayman of the same U.K. banking organization.

As of June 27, 2002, there is one country on the FATF list of NCCTs as to which the Federal Reserve Board has made a CCS determination. The Federal Reserve Board made a determination in 2000 that Egypt is actively working toward CCS.[11] In this regard, we note that FATF's recent report revising its list of NCCTs noted the favorable development that Egypt has adopted an anti-money laundering law, but indicated that FATF has not yet reviewed the new legislation in detail.[12] Thus, as a result of our proposed change to the CCS Exception, banks chartered in Egypt and their branches and bank subsidiaries would not necessarily be subject to enhanced due diligence.

The suggested language in Annex A reflects the deletion of the requirement that the CCS jurisdiction not be a designated NCCT and changes the placement of the CCS Exception so that it modifies not only the offshore banking license prong of the enhanced due diligence test but also the NCCT prong.

3. Information Regarding Owners of a Foreign Bank That is Subject to Enhanced Due Diligence

Under Section 312 and FinCEN's proposed regulations, the prescribed enhanced due diligence procedures applicable to foreign banks that meet the relevant criteria include identifying the owners of such foreign banks unless their shares are publicly traded. In our Joint Comment Letter we address separately FinCEN's proposed definition of owner, suggesting that FinCEN adopt a definition for purposes of Section 312 that is comparable to the definition that the Treasury Department proposed for purposes of Sections 313 and 319(b) of the USA PATRIOT Act. In this regard, we would add that the Institute continues to support the ability of a U.S. institution to rely on ownership information reported by a foreign bank to the Federal Reserve Board on the foreign bank's Annual Report on Form FR Y-7. Just as such information should be viewed as sufficient for purposes of Section 319(b), it should be viewed as sufficient to satisfy a U.S. institution's enhanced due diligence obligations under Section 312.

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[11] See National Bank of Egypt, 86 Fed. Res. Bull. 344 (2000); see also n. 9 supra.

[12] See FATF, "Review to Identify Non-Cooperative Countries or Territories: Increasing the World-Wide Effectiveness of Anti-Money Laundering Measures" (June 21, 2002).

4. Definition of "Beneficial Ownership" for Purposes of Private Banking Due Diligence

As noted above, the Institute supports the arguments made in the Joint Comment Letter regarding the scope of the definition of "beneficial ownership interest" in the proposed rule, which the Institute believes is overly broad and insufficiently tailored to what are different types of analysis for different types of private banking accounts and clients. In this regard, we would add that the international best practices adopted by major international and U.S. private banks for anti-money laundering efforts in the private banking context establish a more nuanced and risk-based approach to the identification of beneficial owners, which we believe would serve as a more useful model for FinCEN's regulations under Section 312. These best practices, known as the "Wolfsberg AML Principles", set forth guidelines for identifying and conducting due diligence on beneficial owners of private banking accounts where the private banking client is a natural person, legal entity, trust or unincorporated association, recognizing that the beneficial ownership analysis necessarily differs depending on the type of account involved.[13] Treasury officials have often referred to the value of building on industry best practices as FinCEN implements the USA PATRIOT Act, and this is an area where the Institute believes that international best practices are particularly relevant and helpful in that effort.

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Please contact the Institute if we can provide further assistance.

Sincerely,

Lawrence R. Uhlick
Executive Director and
General Counsel

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[13] See "Global Anti-Money Laundering Guidelines for Private Banking (Wolfsberg AML Principles)" at Section 1.2.2; see also "Frequently Asked Questions With Regard to Beneficial Ownership" (both available at http://www.wolfsberg-principles.com).

ANNEX A

Suggested Revisions to Proposed 31 C.F.R. § 103.175-176

31 C.F.R. § 103.175

- Add definitions of "Federal Reserve Board" (the Board of Governors of the Federal Reserve System), "IBA" (the International Banking Act of 1978, as amended) and the "BHCA" (the Bank Holding Company Act of 1956, as amended).

31 C.F.R. § 103.176

- Amend 31 C.F.R. § 103.176(c) as follows:

(c) *Foreign banks to be accorded enhanced due diligence.* ~~The~~**Except as described in paragraph (d) of this section, the** due diligence program elements of paragraph (b) of this section are required for any correspondent account maintained for a foreign bank that operates under:

(1) An offshore banking license~~, other than a branch of a foreign bank if such foreign bank:~~**;**

~~(i) Does not fall within paragraph (c)(2) or (3) of this section; and~~

~~(ii) Has been found or is chartered in a jurisdiction where one or more foreign banks have been found, by the Board of Governors of the Federal Reserve System under the Banking Holding Company Act or the International Banking Act, to be subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in that jurisdiction;~~

(2) A license issued by a foreign country that has been designated by an intergovernmental group or organization to which the United States belongs as noncooperative with international anti-money laundering principles or procedures and with which designation the U.S. representative concurs; or

(3) A license issued by a foreign country that Treasury has identified (by regulation or other public issuance) as warranting special measures due to money laundering concerns.

(d) *Exceptions for certain foreign banks*. The due diligence program elements of paragraph (b) of this section are not required for a correspondent account maintained for:

(1) A foreign bank, or any office or bank subsidiary of such foreign bank, if the foreign bank:

(i) Does not fall within paragraph (c)(3) of this section; and

(ii) Is chartered in a jurisdiction:

(A) Where one or more foreign banks have been found, by the Federal Reserve Board under the BHCA or the IBA, to be subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in that jurisdiction; or

(B) Where the Federal Reserve Board has determined under the IBA that the appropriate supervisors are working to establish arrangements for consolidated supervision; or

(2) A foreign bank, or any office or bank subsidiary of such foreign bank, to the extent that Treasury has determined by regulation or order, after consultation with the Federal Reserve Board, that the foreign bank or the jurisdiction in which the foreign bank is chartered does not require the due diligence program elements of paragraph (b) of this section.