The Clearing House
At the Center of Banking Since 1853

June 11, 2012

FinCEN
P.O. Box 39
Vienna, VA 22183

Re: RIN 1506-AB15—Advance Notice of Proposed Rulemaking on Customer Due Diligence Requirements for Financial Institutions

Dear Sirs and Mesdames:

The Clearing House Association L.L.C. ("The Clearing House")[1] is pleased to comment on FinCEN's advanced notice of proposed rulemaking ("ANPRM") requesting public comment on a proposal to "codify, clarify, consolidate, and strengthen existing CDD [customer due diligence] regulatory requirements and supervisory expectations, and establish a categorical requirement for financial institutions to identify beneficial ownership of their accountholders, subject to risk-based verification and pursuant to an alternative definition of beneficial ownership"[2] included in the ANPRM.

FinCEN believes that an effective CDD program should include four elements:

> (i) Conducting initial due diligence on customers, which includes identifying the customer, and verifying that customer's identity as appropriate on a risk basis, at the time of account opening;
>
> (ii) Understanding the purpose and intended nature of the account, and expected activity associated with the account for the purpose of assessing risk and identifying and reporting suspicious activity;
>
> (iii) Except as otherwise provided, identifying the beneficial owner(s) of all customers, and verifying the beneficial owner(s)' identity pursuant to a risk-based approach; and

---

[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs, and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the United States. See The Clearing House's web page at www.theclearinghouse.org for additional information.

[2] 77 Fed. Reg. 13,046 (Mar. 5, 2012).

The Clearing House Association L.L.C. : 450 West 33rd Street : New York, NY 10001
Phone 212.613.0100 : Fax 212.613.0184 : www.theclearinghouse.org

(iv) Conducting ongoing monitoring of the customer relationship and conducting additional CDD as appropriate, based on such monitoring and scrutiny, for the purposes of identifying and reporting suspicious activity.[3]

FinCEN states that with respect to the financial institutions that would be subject to the new CDD regime,[4] three of the CDD elements are already being done and would create no new or additional requirements. The proposal to expand the scope of the requirement to obtain beneficial ownership information is new.[5]

SUMMARY

1. The Clearing House supports clarifying customer due diligence standards in order to provide a uniform framework for compliance, examination, regulation, and enforcement across the financial-services industry. The Clearing House also supports efforts to develop a strategic plan for CDD and other FinCEN rules to allow covered institutions to integrate their compliance efforts more effectively into their on-going budget and planning processes.

2. FinCEN should adopt a three-tiered overall approach to CDD that provides for identification of the customer (the current customer identification program ("CIP") requirement), basic due diligence to categorize the risk level of the customer, and enhanced due diligence required for certain high-risk customers.

3. FinCEN should clarify that the first element of its proposed CDD rule would be identical to the current CIP requirement.

4. The Clearing House believes that financial institutions must have sufficient information about the customer and the account to be able to form a judgment about the customer's AML risk profile and generally understand the nature and purpose of the account, which need not necessarily be obtained from the customer and may be inherent in the nature of the product or service or the type of customer.

5. The Clearing House supports a reasonable expansion of the requirement to obtain information on the beneficial owners of accounts, but believes that it should be applied on the basis of risk rather than universally.

(a) In general, The Clearing House believes that FinCEN should not adopt a blanket requirement to obtain beneficial-ownership information for all accounts; any beneficial-owner-identification rule should be risk-based.

[3] *Id*. at 13,050.

[4] Banks, brokers or dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities. *Id*. at 13,046.

[5] *Id*. at 13,051.

(b) The Clearing House believes that entities that are exempt from CIP requirements should also be exempt from beneficial-ownership requirements and that specific other low-risk customers also be excluded from the requirement.

(c) FinCEN's proposed expanded definition of beneficial owner is confusing. If the customer is an individual or several individuals (family members, joint consumer accounts), the beneficial owner should be presumed to be the individuals named as the accountholder. If the customer is an entity, the rule should follow the current definition of beneficial owner.

(d) In the case of accounts opened or maintained by intermediaries, there is a wide variety of ownership arrangements that would be difficult to encompass within the proposed definition of beneficial ownership but are adequately addressed under the current definition.

(e) FinCEN's proposed verification requirement poses problems. The risk-based customer identification and special due diligence procedures that institutions have developed to comply with the regulations implementing sections 312 and 326 of the USA PATRIOT Act are adequate to provide both the institutions and the government with the information they need to deter money laundering or other criminal abuse of the account.

6. We strongly urge FinCEN to coordinate its AML efforts with the IRS's efforts to implement the Foreign Account Tax Compliance Act ("FATCA") in order to leverage the extensive work already done by U.S. financial institutions.

7. We urge FinCEN to publish for public comment a long-term strategic plan that includes anticipated regulatory requirements and that FinCEN and the regulatory agencies revise and publish for comment the *BSA Examination Manual*.

DETAILED COMMENTS

1. The Clearing House supports clarifying customer due diligence standards in order to provide a uniform framework for compliance, examination, regulation, and enforcement across the financial-services industry. The Clearing House also supports efforts to develop a strategic plan for CDD and other FinCEN rules to allow covered institutions to integrate their compliance efforts more effectively into their on-going budget and planning processes.

The Clearing House supports having a CDD rule that will clarify financial institutions' CDD responsibilities, giving both institutions and their regulators and examiners a clear picture of their compliance responsibilities. This will have a number of advantages for the banks and other financial institutions that must meet regulatory

expectations that have not been codified in any regulation, policy statement, or examination guidance. By gathering all of the regulatory expectations in a comprehensive CDD regulation, FinCEN will give financial institutions, regulators, law-enforcement officers, and examiners clarity about what institutions are expected to do and allow them to develop appropriate compliance programs in conformance with the applicable rules.

It is critical to note that any change in CDD standards has a direct effect on how a financial institution brings new customers on board, and therefore has major technological implications for every financial institution, not only with regard to anti-money laundering ("AML") information technology ("IT") systems, but may also require changes in core banking platforms and customer-relationship systems in each line of business. Such technology enhancements are extremely complex and require significant advance planning to operate effectively.

The Clearing House also supports applying the comprehensive CDD regulation to all financial institutions that are subject to FinCEN's regulations, including money-services businesses and insurance companies.[6] As long as the CDD standards are specifically tailored to the money-laundering and terrorist-financing risks posed by each line of business and individual institution, application to all such institutions will create a level playing field for all financial institutions.

2. FinCEN should adopt a three-tiered overall approach to CDD that provides for identification of the customer (the current customer identification program ("CIP") requirement), basic due diligence to categorize the risk level of the customer, and enhanced due diligence required for certain high-risk customers.

Rather than formulating a unified CDD rule to cover all aspects of an institution's relationship with its customers, The Clearing House believes that it would be more logical for FinCEN to provide for a progressive, risk-based regulation that would consist of the following elements:

1. Customer identification, which would be identical to the current CIP rules.

2. Basic due diligence, which would apply to all customers and consist of collecting sufficient information to enable the institution to conduct a risk analysis of the customer to categorize the level of risk the customer presents to the institution. Based on the risk rating the institution assigns to the customer, the institution would determine what additional information on the customer would be needed by line-of-business and customer category and the level of on-going transaction or account

---

[6] *Id*. at 13,046.

monitoring that would be appropriate and whether the customer should be moved to the next step of due diligence.

3. Enhanced due diligence would be required for certain customers considered to be high risk for money laundering and terrorist financing. Within this category, EDD standards should be established in accordance with a risk-based analysis for different lines of business and customer types. For example, credit-only, cash-intensive customers will have a very different profile from cash-intensive customers that use demand deposit accounts to make payments; similarly, investment banking clients will have very different profiles from money services businesses, using products and services, such as deposit accounts. Consideration must also be given to the method of customer on-boarding, whether the customer is dealing with a relationship manager or is a mass-market customer, and whether a customer is being on-boarded through a trusted intermediary.

This risk-based approach has been advocated by bank supervisory agencies, FinCEN, and by other federal functional regulators. A risk-based approach permits financial institutions to continue to focus on those customers and combinations of customers and products that pose the highest money-laundering or terrorist-financing risk to a particular bank. The approach is also now integrated into the new FATF Recommendations published in February.[7]

3. FinCEN should clarify that the first element of its proposed CDD rule would be identical to the current CIP requirement.

The first element of the proposed CDD requirement is described as "[c]onducting initial due diligence on customers, which includes identifying the customer, and verifying that customer's identity as appropriate on a risk basis, at the time of account opening."[8] FinCEN references the current rules requiring institutions to develop customer identification programs ("CIP") and says that the identification portion of this element would be satisfied by compliance with the existing CIP rules, and thus there will be no new or additional regulatory requirement.[9] But the ANPRM goes on to state that certain bank customers are exempt from the CIP requirement (generally government agencies, regulated financial institutions, and publicly traded companies), but that these customers would not be exempt from the other elements of the CDD requirement and, moreover, the person identified as the customer for CIP purposes would not necessarily

[7] Financial Action Task Force, *The FATF Recommendations: International Standards on Combating Money laundering and the Financing of Terrorism & Proliferation* (2012) ("FATF 2012 Recommendations").

[8] 77 Fed Reg. at 13,050.

[9] *Id*.

be the same person identified as the beneficial owner for purposes of the proposed requirement that institutions obtain beneficial owner information.

The Clearing House believes that this section of the proposal should be clarified by eliminating any confusing language, such as "initial due diligence" and referring to it simply as customer identification. FinCEN should state clearly that this step is identical to the current CIP requirement and that any institution with a CIP requirement that is in compliance with that requirement would also be in compliance with this aspect of the CDD requirement. Such institutions may rely on their current CIP procedures, but would need to comply with any enhancements made to general CDD or EDD requirements, as applicable.

4. The Clearing House believes that financial institutions must have sufficient information about the customer and the account to be able to form a judgment about the customer's AML risk profile and generally understand the nature and purpose of the account, which need not necessarily be obtained from the customer and may be inherent in the nature of the product or service or the type of customer.

The second element of the proposed CDD requirement is "[u]nderstanding the purpose and intended nature of the account, and expected activity associated with the account for the purpose of assessing risk and identifying and reporting suspicious activity."[10] FinCEN believes that each financial institution must already "understand the nature and purposes of an account in order to assess risk and satisfy its obligation to detect and report suspicious activity," thus it does not believe that the proposed CDD requirement will impose new or additional requirements on financial institutions.[11]

While banks and other financial institutions do seek to understand the nature of their relationship with the customer and to determine the risk that the customer presents to the institution, this may not in all cases require asking the customer about what the customer believes is the nature and purpose of the account. In many cases, institutions are able to anticipate the level of activity in the account because this will be inherent in the nature of the product or service being offered and the type of customer using the account.

Financial products and services vary from static to dynamic. The nature of a certificate of deposit or time deposit, for example, is static. By virtue of enrolling a customer in that product an institution understands very well the nature and purpose of the account and—without asking—understands its expected activity (holding idle funds until needed). Term-loan facilities to operating companies are another example of a static account; simply by virtue of the product and knowing the reason for the loan and the purpose of the operating company, an institution will know the nature of the

[10] *Id*.

[11] *Id*. at 13,051.

account and the expected activity (borrowing money for a particular purpose and repaying it as scheduled). The same is true for interest-rate swaps tied to loan facilities.

Checking accounts are an example of a dynamic product, with deposits made, checks paid, and other debits and credits posted to the account. But even here, for most customers, understanding the product enables an institution to understand the account's nature and purpose and with that understanding the institution also effectively understands the purpose and expected activity of the account. For example, when a consumer opens a typical checking account, the bank will anticipate that the activity may include payroll deposits and paying bills. A significant departure from that pattern will be picked up by the bank's monitoring system, which will alert the bank that further investigation may be needed.

Revolving lines of credit to operating companies with an annual clean up may be considered dynamic, but also demonstrate that by knowing the product and the customer, an institution will have an understanding of the nature, purpose, and expected activity of the account without further documentation than is currently included in the usual credit file.

The proposed CDD elements do not acknowledge that the nature of the product rather than the "purpose and nature of the account" often is all that an institution requires to understand the three matters suggested by FinCEN or that expected activity is not something that needs to be discussed with the customer to be understood by an institution. In many cases, an institution's relationship with the customer would become unnecessarily complicated by any discussion with the customer to determine the expected activity of the account. Indeed, a customer intent on laundering money through the account will most likely try to manage the account activities to match the institution's expectations, so getting expected usage from such a customer may not be particularly useful in identifying suspicious activity.

We agree that an institution must have sufficient knowledge about a customer's intended account and product usage to enable it to appropriately score the customer's risk. We also believe that understanding the nature of a customer's relationship with the institution and the general purpose of the account are important to enable an institution to determine whether or not the transactions that are occurring in the account are consistent with the institution's understanding of the customer's business or the financial situation of the specific customer or class of customer, particularly when assessing potentially suspicious activity that has been identified through monitoring or other trigger event. This information is usually key to making an assessment of whether or not the activity is normal and expected for that customer or class of customer or whether the activity cannot be explained after examining the available facts, and, therefore, whether a Suspicious Activity Report should be filed.

The type of information and level of detail of that information collected in an account profile will vary widely depending on what kind of account is being established

and the nature of the products and services being offered. For example, it would not be customary to develop a detailed transaction profile, unless the institution anticipates that the customer will be using high-risk products such as wholesale banknotes and remote deposit capture. Even in these cases, the detail of the transaction profile developed will vary depending on the specifics of the relationship with the customer. Also, the means of using that information will vary depending on the type of monitoring system that the institution has implemented and the process for using the CDD information in the investigative process.

We would also note if the new regulations do not build on existing structures, they risk losing the gains that they have made thus far in combating money laundering and terrorist financing. Financial institutions have spent years building systems to identify possible money laundering and terrorist-financing activity, and have learned much from this experience. If they are now to be required to change the method of monitoring, then much of that experience may become irrelevant and the progress that has been made could be lost.

The Clearing House believes that any CDD rule should explicitly recognize that one size does not fit all situations and should expressly permit institutions to categorize accounts and customers based on their assessment of risks posed by the particular customer and product involved. One line of demarcation could be between mass-market retail accounts (e.g., consumer checking accounts and related overdraft facilities, consumer loans, and credit cards) and managed account in which a relationship manager is assigned to the customer.

Any CDD rule should recognize that institutions will differ based on their customer bases, lines of business, and the kinds of products and services they offer. Institutions should, therefore, be given considerable latitude in determining the appropriate level of CDD and designing monitoring systems to discover suspicious activity. Rules should also encourage financial institutions to gather information that is needed to identify those customers that present the highest risk for money laundering, terrorist activity, or other criminal activity, so that monitoring resources can be focused on them rather than on lower risk customers.

5. The Clearing House supports a reasonable expansion of the requirement to obtain information on the beneficial owners of accounts, but believes that it should be applied on the basis of risk rather than universally.

(a) In general, The Clearing House believes that FinCEN should not adopt a blanket requirement to obtain beneficial-ownership information for all accounts; any beneficial-owner-identification rule should be risk-based.

The Clearing House supports a reasonable expansion of the requirement to obtain information on the beneficial owners of accounts, but does not believe that a

universal requirement is necessary, useful, or practical. This position is supported by FATF Recommendation 1, which states in part that

> [c]ountries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk based measures throughout the FATF Recommendations. Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions.[12]

Moreover, FATF Recommendation 10, which sets out recommended CDD measures, also has a beneficial-ownership component, but as in Recommendation 1, the recommendation is subject to a risk-based approach.[13]

The Clearing House believes that FinCEN should not adopt a blanket requirement to obtain beneficial-ownership information for all accounts; it should be applied under a risk-based approach. In any event, any beneficial-owner-identification rule should have broad exceptions.

(b) The Clearing House believes that entities that are exempt from CIP requirements should also be exempt from beneficial-ownership requirements and that specific other low-risk customers also be excluded from the requirement.

FinCEN has requested comment on whether the entities that are exempt under the CIP rules[14] should also be exempt from the beneficial-ownership requirement.[15] The Clearing House agrees that entities exempt from CIP requirements should also be exempt under the beneficial-ownership rules, but we believe that the exemption should be expanded to cover the kinds of customers set out below.

We recommend that FinCEN exclude the following entities from beneficial-ownership-identification requirements. Most of these organizations are regulated

---

[12] FATF 2012 Recommendations at 11.

[13] *Id*. at 15.

[14] Generally, government entities, regulated financial institutions, and publicly traded firms. *See* 31 C.F.R. § 1020.100(c)(2), *id*. § 1020.315(b)(2)–(b)(4).

[15] 77 Fed. Reg. at 13,052.

entities, either in the United States or a foreign country,[16] and therefore present minimal risk for money-laundering or terrorist-financing activity. In all cases, if monitoring raises anything suspicious about the account or the customer, or in the case of another trigger event, such as the receipt of a subpoena or section 314(a) or (b) request, additional due diligence requirements could come into play, including, if necessary, identifying the beneficial owners of the account holder.

a. publicly traded companies;

b. government agencies, departments, subdivisions, instrumentalities, multi-state authorities (e.g., the Port Authority of New York and New Jersey), and international organizations (e.g., the World Bank, IMF, United Nations);

c. regulated depository institutions, including banks, thrift institutions, and credit unions;

d. registered financial-institution holding companies;

e. registered brokers and dealers;

f. registered exchanges and clearing agencies;

g. registered investment companies and investment advisers;

h. regulated insurance companies;

i. entities (such as futures commission merchants, introducing brokers, commodity pool operators, or commodity trading advisors) registered with the Commodity Futures Trading Commission or similar foreign agency;

j. registered public accounting firms;

k. public utilities;

l. charities or nonprofit entities that are described in section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code or similar foreign laws;

[16] It may be appropriate to limit the exclusions in this list to the United States and foreign countries that have a low AML risk rating. For example, entities from countries that FATF has listed as high-risk or non-cooperative jurisdictions, see http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/ would not be excluded from a beneficial-ownership identification requirement.

m. financial market utilities designated under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act or similar entities regulated under standards developed by the Committee on Payment and Settlement Systems of the Bank for International Settlements or the International Organization of Securities Commissions;

n corporations, partnerships, and other business organizations that provide products or services to customers, as opposed to shell companies or holding companies that are not exempt under another provision; and

o. any corporation or limited liability company formed and owned by an entity described in *a* through *n*, above or any joint venture of two or more of the above entities.

We recommend that for any of the above exceptions a bank should be able to rely on the statement of its customer that it fits into one of the exceptions, unless it is clear from other information in an institution's possession that the exception does not apply.

Any requirement to obtain beneficial-ownership information should apply to new customers, with retroactive application only to existing customers that are judged to be high risk. For example, a financial institution could be required to get beneficial ownership information on an existing customer if monitoring or some other trigger event indicates a problem.

(c) FinCEN's proposed expanded definition of beneficial owner is confusing. If the customer is an individual or several individuals (family members, joint consumer accounts), the beneficial owner should be presumed to be the individuals named as accountholders. If the customer is an entity, the rule should follow the current definition of beneficial owner.

Once it has been determined that a financial institution must obtain beneficial-ownership information on a customer, the next step for the regulation is to determine who that beneficial owner is, and on this point FinCEN proposes to expand the definition. FinCEN notes that for the current, limited circumstances in which institutions are required to identify beneficial owners, the rules define the beneficial owner as the individual who is able directly or indirectly "to control, manage or direct the account."[17] FinCEN has suggested expanding this definition to the following:

(1) Either:

[17] 77 Fed Reg. at 13,051, quoting 31 C.F.R. § 1010.605(a).

(a) Each of the individual(s) who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, owns more than 25 percent of the equity interests in the entity; or

(b) If there is no individual who satisfies (a), then the individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, has at least as great an equity interest in the entity as any other individual, and

(2) The individual with greater responsibility than any other individual for managing or directing the regular affairs of the entity.[18]

We respectfully submit that the proposed rule is very confusing. Is a person a beneficial owner only if he or she meets (1) and (2), or if different persons fit both (1) and (2), are both or neither beneficial owners? For example, a limited liability company may have ten members each of whom has an equal 10% membership interest in the company, and the members may hire a nonmember to be the company's manager. In this case, who is the beneficial owner of that LLC? Because no member has a 25% interest, none of the members meets (1)(a), but they all would meet (1)(b). If (2) is intended as an independent element, then the manager would be the beneficial owner, but the use of the conjunctive *and* to connect (1) and (2) indicates that a beneficial owner must meet both (1) *and* (2), in which case there is no beneficial owner of the LLC because no one who meets (1)(b) also meets (2). The proposed language could also be read to mean that because all of the members meet (1)(b) and the manager meets (2), all of the members *and* the manager are beneficial owners of the accountholder for purposes of the rule, a result that would seem to defeat the purpose of the proposed rule.

Another ambiguity involves FinCEN's use of the concept of the person "who has greater responsibility than other individual for managing or directing the regular affairs of the entity." Is this the party who pursuant to resolutions or other organizational documents is responsible at a high level for determining to initiate funds transfers, write checks, etc., or is this the person who may fulfill a clerical function but who has actual responsibility to initiate funds transfers, stamp signatures on checks, etc., in execution of company directives?

Third, in the absence any of public database that lists beneficial owners, institutions are dependent on information submitted by the person opening the account on behalf of the entity. Information from this source, however, is not subject to independent verification. In general, if the customer is honest, the information will be accurate. If, however, the customer and its representative are dishonest and intent on

[18] *Id*. at 13,052.

using the account to launder money, the beneficial-ownership information provided by the customer may be completely false, and the institution will not have an objective way to reliably evaluate the accuracy of the information at the time the account it opened.

For most entities, the institution will have to know that the entity exists and that the person with authority over the account has been authorized by the appropriate corporate authority to direct the account (e.g., sign checks, initiate funds transfers) and will attempt to understand other aspects of the customer's ownership structure if the customer's risk rating warrants it.

We believe that a beneficial-ownership rule should consist of a few very simple propositions. Once it is determined that beneficial-ownership information is required, the next question to ask is whether the customer is an individual or an entity. If the customer is an individual or several individuals (family members, joint consumer accounts), the beneficial owner should be presumed to be the individuals named as accountholders. If the customer is an entity, the rule should follow the current definition of beneficial owner.[19]

(d) In the case of accounts opened or maintained by intermediaries, there is a wide variety of ownership arrangements that would be difficult to encompass within the proposed definition of beneficial ownership but are adequately addressed under the current definition.

FinCEN also seeks comment on alternative definitions of beneficial owner to encompass the persons who own assets in the account (rather than the person who owns the account holder). In most cases, however there is no need for an additional definition.

(1) Correspondent banking customers. Correspondent banks should not be regarded as intermediaries in the sense that the account balance is held to be the asset of the customer's customers or that the customer's customers are held to be the beneficial owners of the account balance. FinCEN states that

> obtaining information about the beneficial owners of assets in an account may be warranted instead, such as where a legal entity (e.g. a foreign or regulated or unregulated domestic financial institution) opens an account for the benefit of its customers (as opposed to for its own benefit), as

[19] "[A]n individual who has a level of control over, or entitlement to, the funds or assets in the account that, as a practical matter, enables the individual, directly or indirectly, to control, manage or direct the account. The ability to fund the account or the entitlement to the funds of the account alone, however, without any corresponding authority to control, manage or direct the account (such as in the case of a minor child beneficiary), does not cause the individual to be a beneficial owner." 31 C.F.R. § 1010.605(a).

> those customers could pose a money laundering risk through their ability to access the financial system through that account relationship[20]

This, however, misses the point. Banks open correspondent accounts with other financial institutions for their own business purposes, which will often include making payments for their customers and making payments for their own account, with all of these transactions being paid out of one account. The balance in a correspondent account is always a debt that the financial institution owes to its correspondent customer; the correspondent customer's customers never have any claim against the bank for any balance in the account, even if the account is used to execute payments or provide other services for those customer's customers.[21] There may be a legitimate concern that the correspondent customer is providing services for money launderers or terrorists, but that concern is best handled through transaction monitoring of the sort banks already do in compliance with existing OFAC and FinCEN regulations, such as those implementing section 312 of the USA PATRIOT Act.[22]

The specific risks associated with payable-through accounts are already addressed in FinCEN regulations, which require institutions to ascertain "the sources and beneficial owner of funds or other assets in the payable-through account."[23] It should be noted, however, that few banks offer these kinds of payable-through accounts any longer.

(2) Introducing and managing or institutional intermediaries. With an introducing intermediary, the intermediary introduces the client to the financial institution and the broker's client becomes the client of the institution. In these cases the institution will obtain the same kind of information on the accountholder (including, where appropriate, beneficial-ownership information) that it would be required to obtain if the client came to the institution without the involvement of the intermediary.[24]

A managing intermediary is typically an entity, such as a professional asset manager that might play several roles. For example, it could have its own account at the institution from which it manages its customers' assets without the customers having any direct relationship with the institution. It could also open an account for its customers that the asset manager has authority over, or it may arrange accounts for its customers at the institution. The amount of due diligence the institution is required to

[20] 77 Fed. Reg. at 13,052.

[21] *Cf., Grain Traders, Inc. v. Citibank, N.A.*, 160 F.3d 97 (2d Cir. 1998).

[22] 31 U.S.C. § 5318; 31 C.F.R. § 1010.610

[23] 31 C.F.R. § 1010.610(b)(1)(iii)(A).

[24] *See* Wolfsberg Group, *The Wolfsberg Group AML Principles: Frequently Asked Questions with Respect to Intermediaries* at 3 (2003), available at http://www.wolfsberg-principles.com/pdf/Intermediaries_FAQs_(2004).pdf ("Wolfsberg FAQs"). (We note that the Wolfsberg Group is in the process of updating its FAQs and that a revised version will appear on its web page shortly. We do not, however, expect substantial changes from the current version.)

do on the intermediary and the intermediary's customers will depend entirely on the circumstances.

Where the intermediary has an account with the institution and there is no relationship between the intermediary's customers and the institution, the situation is akin to a correspondent banking account, and the institution should not be required to treat the intermediary's customers as its own or to obtain beneficial-ownership information on those customers. If, however, the intermediary's customer becomes a customer of the institution, then the situation is akin to an introducing intermediary, and the institution ought to get the necessary information on the intermediary's customer that it would be required to obtain if the intermediary were not involved.[25]

(3) Trusts. A trust is a legal entity in which a person (the "settlor") supplies the funds or other assets that constitute the corpus of the trust, the legal owner of the trust is the trustee, and funds are managed by the trustee for the benefit of the beneficiaries of the trust. Clearly, the legal owner of the trust is the trustee. Nonetheless, the trustee neither supplied the funds for the trust nor has any beneficial interest in the income or principal.

There are different kinds of trusts (e.g., corporate trusts, testamentary trusts, revocable trusts, etc.), and the rules appropriate for the one kind may not be appropriate for another. For example a wealthy individual who sets up trusts for his heirs as part of an estate plan and who has the power to change trustees and to revoke the trust and determine how the trust will be managed would appear to be the person with the strongest beneficial interest in the corpus of the trust despite the fact that there is a separate named trustee who is the legal owner of the trust. On the other hand, a financial institution that acts as trustee for corporate bondholders presents a completely different set of issues. In this case, it may make sense to regard the issuer as the beneficial owner and apply the exemption for publicly traded corporations suggested in the previous section.

In any of these cases, the current definition of beneficial owner that is used for certain private-banking and payable-through accounts (i.e., the individual who has the ability to control or direct the account) seems better suited for trusts than the new one that FinCEN has proposed.

(4) Nominees. Nominees are persons or organizations in whose name a security is registered though true ownership is held by another party. There are legitimate reasons to use the nominee form of ownership, for example where shares are held by a broker in street name (i.e., in the name of the broker, who keeps the shares in custody) because it makes transferring the securities easier than having to register in the customer's name and physically transfer certificates.

[25] *Id*. at 4-5.

The persons on whose behalf some nominees act are disclosed while others are not, and financial institutions may themselves be nominees. Where a financial institution is the nominee, the institution should have information on the person on whose behalf it is acting. Where an institution holds an account for a nominee, the institution should be able to regard the nominee as the owner of the account and should not be under any duty to inquire as to the person on whose behalf the nominee is acting unless the account or customer is considered high risk.

This approach is consistent with that taken by FATF in clause (b) below:

> [c]ountries should take measures to prevent the misuse of nominee shares and nominee directors, for example by applying one or more of the following mechanisms: (a) requiring nominee shareholders and directors to disclose the identity of their nominator to the company and to any relevant registry, and for this information to be included in the relevant register; or (b) requiring nominee shareholders and directors to be licensed, for their nominee status to be recorded in company registries, and for them to maintain information identifying their nominator, and make this information available to the competent authorities upon request.[26]

The Clearing House believes that nominee arrangements often serve valid business purposes and that nominators should be accorded privacy unless there is an overriding law-enforcement need for the information. In any case, nominee shareholders should not be required to disclose the identity of their nominators. Rather the fact of nomination should be disclosed and law-enforcement inquiries should be directed to the nominees. Accordingly, The Clearing House is of the view that the application of beneficial ownership concepts to nominees should be consistent with FATF's clause (b) and the approach outlined in clause (a) should not be implemented, whether directly or indirectly by virtue of a definition of beneficial ownership.

(6) Foundations (other than tax-exempt foundations). A financial institution should understand the nature of the foundation, who supplies the funds, and who manages the foundation.

(7) Omnibus accounts. Omnibus accounts are widely used in the financial-services industry, with banks and broker-dealers often opening omnibus accounts for financial intermediaries. Intermediaries may then establish subaccounts either at the institution or on the intermediary's own books to facilitate trades. Typically, the institution never knows the identity of the intermediary's customers, and the assets in the subaccounts change on a minute-by-minute basis. In these cases, the intermediary should be regarded as the owner of the subaccounts, and any law-enforcement inquiries should be directed to the intermediary.

---

[26] FATF 2012 Recommendations at 86.

(e) FinCEN's proposed verification requirement poses problems. The risk-based customer identification and special due diligence procedures that institutions have developed to comply with the regulations implementing sections 312 and 326 of the USA PATRIOT Act are adequate to provide both the institutions and the government with the information they need to deter money laundering.

The third element of FinCEN's proposed CDD program would be "identifying the beneficial owner(s) of all customers, and verifying the beneficial owner(s)' identity pursuant to a risk-based approach."[27] In discussing this element in detail, FinCEN states that

> in general, the individual opening the account on behalf of a legal entity customer will identify its beneficial owner, and that covered financial institutions will generally be able to rely upon the beneficial ownership information presented by the customer, absent information that indicates reason to question the veracity of the information or an elevated risk of money laundering or terrorist financing.[28]

FinCEN notes that in this context, *verification* can have two possible meanings: (i) "verifying the identity of the individual identified by the customer as the beneficial owner of the account, i.e., verifying the *existence* of the identified beneficial owner";[29] or (ii) verifying "that the individual identified by the customer as the beneficial owner, is indeed the beneficial owner of the customer, i.e., to verify the *status* of the identified individual."[30] In either case, FinCEN states that the verification "procedures would need to be reasonable and practicable, and sufficient to form a reasonable belief that the financial institution knows the identity or status, as the case may be, of the beneficial owner."[31]

There are problems with verifying the status of an individual as owner of an entity. If a customer's representative informs a financial institution that X is a beneficial owner of the customer, there is no reasonable or practical way for the institution to conclusively prove that X actually is a beneficial owner of the customer during the customer on-boarding process and even after-the-fact verification presents substantial difficulties. There are no registries of corporate ownership in the United States, and while some—by no means all—foreign countries do have corporate registries, they are rarely if ever complete, often list corporate officers or registered agents rather than

---

[27] 77 Fed. Reg. at 13,050.

[28] *Id*. at 13,053.

[29] *Id*.

[30] *Id.* (emphasis added).

[31] *Id.*

beneficial owners, and are almost never updated after the initial filing. Without reliable, readily available databases of corporate ownership, there is no reasonable or practical way for financial institutions to obtain sufficient information—independent of the information that the customer provides—to form a reasonable belief that a given person is a beneficial owner of a corporate customer. Because of this we believe that financial institutions should not be required to verify the status of a person as a beneficial owner of a legal-entity customer except in very rare high-risk cases. We also question the utility of verifying the identity of the person identified as a beneficial owner in most cases because identification of that person's identity would still not establish that the purported owner is actually the beneficial owner.

Our suggestion is that in opening an account for a non-exempt legal entity, a financial institution should obtain from the person opening the account the names of the entity's beneficial owners but that the institution be permitted to rely on the representative's statement about the customer's beneficial owners and not be required to verify either the identity or status of those owners, unless the institution's risk-based procedures provide otherwise. The bank will then apply its CIP and risk-based CDD procedures or EDD procedures, as required.[32] If these procedures turn up information that calls into question the beneficial-ownership information obtained during the account-opening process, this will prompt further investigation by the institution and may result in the filing of a Suspicious Activity Report and may ultimately result in the closing of the account.

We agree with FinCEN that any identification "procedures would need to be reasonable and practicable." In practical terms, we believe that the customer identification and special due diligence procedures that institutions already do under the regulations implementing sections 312 and 326 of the USA PATRIOT Act[33] are adequate to provide both the institutions and the government with the information they need to deter money laundering from those accounts.

6. We strongly urge FinCEN to coordinate its AML efforts with the IRS's efforts to implement the Foreign Account Tax Compliance Act ("FATCA") in order to leverage the extensive work already done by U.S. financial institutions.

FinCEN points out that enhanced CDD "is also fundamentally important in facilitating tax reporting, investigations and compliance"[34] citing, among other things, tax reporting requirements under FATCA, which requires foreign financial institutions to identify U.S. account holders, including foreign entities with significant U.S. ownership, to report certain information about those accounts to the IRS. In many cases,

[32] For example, an institution may choose to verify the beneficial owner of an off-shore personal investment company doing business with the private-banking department but may not verify the beneficial owner of a large corporate entity doing business with the corporate department.

[33] 31 U.S.C. § 5318(i), (l); 31 C.F.R. §§ 1020.220, 1020.610, 1020.620.

[34] 77 Fed. Reg. at 13,048.

implementing these provisions will require the cooperation of foreign governments, and FinCEN believes that requiring U.S. institutions to obtain similar beneficial-ownership information will "put the United States in a better position to work with foreign governments to combat offshore tax evasion and other financial crimes."[35]

There are, however, a number of problems that arise from using an AML rule to bootstrap foreign banks' tax compliance. In the first place, there is a disconnect between the definition of *beneficial owner* for AML purposes and for tax purposes. Regulators and law-enforcement agencies concerned with money laundering and terrorist financing are concerned with the source of funds in an account; tax authorities are concerned with who gets paid. Thus the different authorities will often be interested in different persons when looking for beneficial owners.

Secondly, many Clearing House member banks are global institutions that are required to comply with U.S. CDD regulations but will also be required to file FATCA reports to the IRS as foreign financial institutions. Moreover, if the IRS is successful in its efforts to sign tax treaties with foreign tax authorities that call for FATCA reciprocity, then U.S. financial institutions will also be required to identify foreign taxpayers under the FATCA regime.

Another problem is that while FATCA rules generally attempt to rely on the AML/CDD practices of financial institutions in a number of areas, FATCA generally layers on additional requirements, some of which are quite burdensome for both financial institutions and their customers. Instead of achieving synergies, the end result is really a supplanting of the AML CDD and CIP existing practices. For example, under the proposed FATCA regulations, an institution will be required to periodically re-solicit customer identification (such as a passport or driver's license) from every one of its post-FATCA new accounts. Apart from the enormous costs involved in fulfilling these labor-intensive requirements, we cannot overemphasize how disruptive it is to customer relations generally to continuously seek customer identification documentation. This is contrary to the current CIP rule, and as emphasized earlier in this letter, it is absolutely fundamental that institutions be able to rely on their existing CIP programs. We therefore, strongly urge FinCEN and the IRS to coordinate their efforts in order to leverage the extensive work already done by U.S. financial institutions.

7. We urge FinCEN to publish for public comment a long-term strategic plan that includes anticipated regulatory requirements and that FinCEN and the regulatory agencies revise and publish for comment the *BSA Examination Manual*.

We would also urge FinCEN to begin publishing for public comment long-term strategic plans that include anticipated regulatory requirements for several years into

[35] *Id*. at 13,049.

the future.[36] One of our concerns is that without these kinds of strategic plans, financial institutions are unable to plan appropriately for possible future requirements. Especially with FinCEN, regulators, and law-enforcement agencies communicating their AML expectations to institutions through one-off enforcement actions, institutions are often faced with improvising *ad hoc* responses to new requirements with very short time frames for implementation. We think the better approach, one that would benefit law-enforcement agencies and regulators, as well as financial institutions, would be to move in the direction of long-term planning to enable banks and other financial institutions to build systems that make sense, are integrated, and otherwise create a more holistic approach to compliance and reporting while allowing them to integrate the compliance cost more effectively into the budgeting process. For instance, to implement regulations based upon the ANPRM, each financial institution will have to write new procedures, potentially change documentary intake to non-documentary for customers for CIP, create new systems or jerry-rig existing systems to fit the new requirements, develop new audit functions, and change or jettison risk assessments. To do this effectively, strategic—not tactical—reaction would produce a better result. This is particularly true if FinCEN is moving toward requiring the monitoring of relationships instead of accounts. This move alone requires an integration of systems that is beyond the current systems' capacity of most financial institutions.

In order to move in this direction, we also suggest that FinCEN and the regulatory agencies regularly combine all of their supervisory expectations regarding AML and OFAC responsibilities into an updated *BSA Examination Manual* and that this manual be published for public comment.

CONCLUSION

We understand that the ANPRM is the first step in the process of codifying and clarifying the CDD rules. Following the close of the comment period, FinCEN and its partners in the regulatory and law-enforcement communities will consider the issues raised by the commenters and then begin the process of consulting with the affected financial institutions and their trade associations leading to the development of a more specific notice of proposed rulemaking for another round of public comments. The Clearing House and its member banks appreciate this process, which allows them to begin considering the very complex issues proposed. We would be pleased to arrange for meetings with our member banks to discuss these issues in detail so that the regulatory process can be fully informed.

* * * * *

[36] FinCEN has published strategic plans in the past and recently published its plan for 2012–2016. This plan, however, does not specify the regulations that FinCEN plans to issue over the next few years.

We hope these comments are helpful. We would be pleased to help arrange meetings between FinCEN and experts of our member banks so that we can assist FinCEN in devising a reasonable CDD rule that achieves its goals while not unduly burdening financial institutions. If you have any questions about any of the matters discussed in this letter, please contact me at joe.alexander@theclearinghouse.org or 212-612-9234.

Very truly yours,

Joseph R. Alexander
Senior Vice President, Deputy
General Counsel, and Secretary

cc: The Honorable David Cohen
U.S. Department of the Treasury

Jamel El-Hindi
Financial Crimes Enforcement Center