PRESENTATION OF
JOSEPH R. ALEXANDER
SENIOR VICE PRESIDENT, DEPUTY GENERAL COUNSEL, AND SECRETARY
THE CLEARING HOUSE ASSOCIATION L.L.C.
BEFORE THE
FINANCIAL CRIMES ENFORCEMENT NETWORK
U.S. DEPARTMENT OF THE TREASURY
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INTRODUCTION

My name is Joseph R. Alexander, and I am Senior Vice President, Deputy General Counsel, and Secretary of The Clearing House Association and its affiliate, The Clearing House Payments Company. I appreciate the opportunity to appear before you today to discuss the views of The Clearing House and its member banks on FinCEN's proposal to codify and strengthen regulatory requirements and supervisory expectations regarding customer due diligence policies and procedures for financial institutions.

The Clearing House was established in 1853, making it the oldest banking association in the United States. We are a nonpartisan advocacy organization representing our member banks on a variety of legal, legislative, and regulatory issues, and our members include the largest U.S. banking organizations and several leading non-U.S. banks. Our members include significant global banks, with extensive payments and correspondent-banking operations. The Payments Company provides payment, clearing, and settlement services to our member banks and other financial institutions. The Payments Company clears almost $2 trillion and 63 million transactions in automated clearing house, funds transfer, and check image payments every day.

The Clearing House has been involved with anti-money laundering and related issues for over 20 years. We have a very active Anti-Money Laundering Committee consisting of senior AML compliance and other officers of our member banks, and over the years we've been actively engaged with FinCEN on a number of issues ranging from

the travel rule to cross-border funds transfers, cover payments, and correspondent banking.

I'd like to begin by stressing The Clearing House's continuing strong support for robust, effective anti-money laundering rules that work to protect the financial system and the public from the serious harm caused by money launderers and terrorists. In this regard, we support FinCEN's efforts to clarify and codify financial institutions' customer due diligence responsibilities, which we believe could provide a clear, uniform framework for regulation, compliance, examination, and enforcement across the financial-services industry.

We support an overall customer due diligence program for financial institutions that has three main elements:

1. Identification of all customers—the same as the current Customer Identification Program ("CIP") requirement.
2. Basic due diligence applied to all customers to obtain sufficient information to allow the bank to categorize a customer's apparent AML risk. A financial institution may decide that the customer's apparent AML risk is such that it should obtain additional information from the customer to determine its actual or inherent AML risk.
3. Enhanced due diligence applied to certain customers that are high risk for money laundering or terrorist financing.

It is also vitally important that FinCEN provide sufficient time for financial institutions to implement any changes required by a new customer due diligence rule. Given the need to change procedures and technology and to train personnel in the new procedures, institutions will need 18 to 24 months following the announcement of the final rule to complete their compliance efforts.

BENEFICIAL OWNERSHIP

The most significant change that FinCEN's proposal presents would be to impose for the first time a requirement to obtain—and in some cases verify—beneficial-ownership information for all customers other than those specifically exempted from the

requirement. Because of the importance of this aspect of the proposal, the rest of my statement will be centered on these aspects of FinCEN's proposal.

The Clearing House supports a reasonable expansion of the requirement to obtain beneficial ownership information, but we have reservations about several aspects of the proposal.

Definition of Beneficial Owner

We believe that the definition of *beneficial owner* is crucial. If this isn't right, the information obtained will not be useful for banks, regulators, or law-enforcement agencies. There are multiple possible definitions of beneficial owner that are useful to financial institutions and law-enforcement agencies depending on the circumstances, and FinCEN has proposed a new definition that is intended to be applied concurrently with the definitions existing under its current regulations. The new definition is intended to bring in a range of additional persons that FinCEN believes should be covered but are not encompassed by the existing definitions. Unfortunately, we believe that this new definition is confusing and would be difficult to implement; moreover, it may not actually get the information about the persons law-enforcement and other regulators are really interested in.

Accordingly, the first step toward rationalizing the definition of beneficial owner is for FinCEN and its law-enforcement and regulatory partners to determine the purpose of the new beneficial-owner rule: How will identifying the beneficial owner assist financial institutions in their AML compliance? How will this information be useful to law-enforcement agencies? Based on this analysis, FinCEN should identify which persons or relationships should be covered under the beneficial-ownership umbrella. Once FinCEN has identified the purpose of a beneficial-ownership rule to the public, it should work with the industry and other knowledgeable interested parties to develop a definition of beneficial ownership that works and that clearly identifies both the situations in which a beneficial owner must be identified and the person that should be identified.

It may be that the key concern is not to identify the person who has legal title to the account, but the person who exercises control over the account. The legal owner may be a passive owner or a person with a contingent interest in the account but no present

ability to control the account. If control is FinCEN's key concern, then the definition of *beneficial owner* currently set out in section 1010.605(a) of FinCEN's rules[1] works well and would not seem to be improved by the proposed definition. If it is important to identify the owner of an entity that has a bank account, then the definition of owner in section 1010.605(j)[2] would also work well with only minor modifications.

We are also particularly concerned with FinCEN's treatment of intermediary accounts in its notice. For example, FinCEN states:

> there may be instances in which 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 those customers could pose a money laundering risk through their ability to access the financial system through that account relationship.

As we pointed out in our comment letter, banks open correspondent accounts with other financial institutions for their own business purposes, which will often include making payments for their customers as well as making payments for their own account, with all of these transactions being paid out of one account. The balance in a correspondent account is a debt that the financial institution owes to its correspondent customer; the correspondent customer's customers do not have a claim against the U.S. 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. FinCEN's concern about the customer's customers presenting a money laundering risk is best addressed the way it is currently addressed: through risk-based due diligence on the correspondent, as currently required under regulations implementing section 312 of the USA PATRIOT Act. The U.S. bank's assessment of its correspondent customer's own AML controls and whether the

[1] "*Beneficial owner* of an account means an 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."

[2] The term *owner* means any person who, directly or indirectly:

> (i) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities or other voting interests of a foreign bank; or
> (ii) Controls in any manner the election of a majority of the directors (or individuals exercising similar functions) of a foreign bank.

correspondent's home country has adequate AML regulations, and the U.S. bank's risk-based due diligence and monitoring of transactions affecting the account, are more effective to address potential money laundering risks posed by correspondent relationships than the legal fiction of treating the balance in the account as property of someone other than the correspondent customer.

We have similar concerns with some of the other intermediary account relationships. For example we believe that for private banking accounts, the current definition, which emphasizes the person who has control over the account rather than simple entitlement to the balance or other assets in the account, works well. For nominee accounts, where a covered financial institution is itself the nominee, the institution should have information on the persons for whom it is acting. On the other hand, where a financial institution holds an account for a nominee, the institution should be able to regard the nominee as its customer and should not be required to inquire as to the persons on whose behalf the nominee is working unless the account or the customer is regarded as high risk.

Exceptions to the Requirement to Obtain Beneficial Ownership Information

A blanket requirement to obtain beneficial ownership information in all cases is likely to be counterproductive in that it would require covered institutions to track down the beneficial owners of all customers regardless of risk, detracting from their ability to focus their attention on truly high-risk customers. With this in mind, we believe that FinCEN should exempt from the revised rule entities that are exempt under the current CIP requirements. In addition, our comment letter recommended additional exemptions that were based in part on the list of entities that would be exempted from S. 1483, Senators Levin and Grassley's bill to require those who form corporations to disclose the beneficial owners of those companies.

Verification of Beneficial Ownership Information.

FinCEN has proposed that covered institutions verify the identity of the beneficial owners "pursuant to a risk-based approach." We believe that verification should be required only when an institution's due diligence on an entity customer indicates that, in the bank's judgment, the customer presents a high risk of money laundering or terrorist financing.

FinCEN notes that *verification* can mean two different things (i) verifying the *existence* of the person identified as the beneficial owner, or (ii) verifying that person's *status* as a beneficial owner. As we pointed out in our comment letter, there is no reasonable or practical

way for an institution to conclusively prove that X actually is a beneficial owner of the customer. There are no official registries of corporate beneficial ownership in the United States, and while some foreign countries do have corporate registries, they are rarely if ever complete, often list corporate officers or registered agents rather than beneficial owners, and are almost never updated after the initial filing. Without reliable, readily available databases of corporate ownership, there is no practical way for an institution to obtain sufficient information to allow it to form a reasonable belief that a given person is a beneficial owner of a corporate customer. 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. 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 institution refusing to open the account, filing a Suspicious Activity Report, or may ultimately closing of the account, it one has been opened.

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Once again, I appreciate the opportunity to present our views to FinCEN and hope that my comments have been helpful. We are ready to work with FinCEN as it works through these issues. I look forward to any questions you may have.