



December 14, 2017

*Via Electronic Mail*

The Honorable Joseph M. Otting  
Comptroller of the Currency  
Office of the Comptroller of the Currency  
400 7th Street SW  
Washington, DC 20219

The Honorable Janet Yellen, Chair  
The Honorable Randal Quarles, Vice Chair for Supervision  
Board of Governors of the Federal Reserve System  
20th Street & Constitution Avenue NW  
Washington, DC 20551

The Honorable Martin J. Gruenberg  
Chairman  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429

Re: Appropriate Implementation of FinCEN's Customer Due Diligence Rule

Ladies and Gentlemen:

The Clearing House Association L.L.C.<sup>1</sup> is writing to identify concerns with the federal banking agencies' implementation of FinCEN's 2016 customer due diligence ("CDD") rule.<sup>2</sup> In light of these concerns, we respectfully request that you conform your examination procedures

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<sup>1</sup> The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system.

<sup>2</sup> See 81 Fed. Reg. 29,398 (May 11, 2016). We note that while this letter focuses on TCH's concerns with the federal banking agencies' approach to examining financial institutions for compliance with FinCEN's CDD rule, we have broader concerns with their approach to BSA/AML exams at banks, which we intend to address further with the agencies in the future.

and activities to that rule as adopted, and that any proposed deviations from that rule be adopted in conformance with the Administrative Procedure Act.

The Bank Secrecy Act grants the Secretary of the Treasury exclusive authority to issue implementing regulations.<sup>3</sup> In 2014, the Secretary delegated that authority to FinCEN.<sup>4</sup>

On May 11, 2016, FinCEN adopted a final CDD rule. That rule establishes explicit customer due diligence requirements including a requirement that financial institutions identify and verify the identity of beneficial owners of legal entity customers, subject to certain exemptions and exclusions. In this rule, FinCEN defines a “beneficial owner” to include one who owns “25 percent or more of the equity interests of a legal entity customer.”<sup>5</sup> In setting this 25 percent threshold, FinCEN expressly noted, “[a]s a general matter, FinCEN does not expect covered financial institutions’ compliance with this regulatory requirement to be assessed against a lower threshold.”<sup>6</sup> Indeed, in adopting the final rule, FinCEN explained why it had rejected a lower, 10 percent threshold, stating:

As some proponents of the 10 percent threshold noted, this lower threshold would make it more difficult for illicit actors to structure ownership interests to evade the reporting threshold. However, it would also require financial institutions to identify and verify as many as eleven beneficial owners (including the control prong). In FinCEN’s assessment, the incremental benefit of this approach does not outweigh the burdens associated with having to collect and verify the identities of more than twice as many beneficial owners in some circumstances. Furthermore, the proposed 25 percent threshold is consistent with that of many foreign jurisdictions (including EU member states) and with the FATF standard...<sup>7</sup>

Nonetheless, public reports indicate that the federal banking agencies intend to enforce a 10 percent threshold in “high risk” cases and that examiners have communicated as much to banks. According to a recent media report, “regulators shared the game-changing revelation that this linchpin figure [i.e., the 25 percent threshold] applies only to low-risk accounts and that higher-risk business may require a lower threshold, and they did so not in an explanatory

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<sup>3</sup> 31 U.S.C. 5318(a)(2) and (h)(2).

<sup>4</sup> See Treasury Order 108-01 (July 1, 2014).

<sup>5</sup> 31 CFR 1010.230(d)(1).

<sup>6</sup> See 81 Fed. Reg. at 29,410. FinCEN stated that a financial institution could decide to collect such information at a lower ownership threshold. However, FinCEN explains numerous times in the supplemental information of the final rule that consistent with the risk-based approach, a *financial institution* may determine that collection of beneficial ownership information at an ownership level lower than 25 percent based on the institution’s – and notably not its prudential regulator’s – determination that such collection is warranted at a lower level. For example, FinCEN states that “the 25 percent threshold is the baseline regulatory benchmark, but . . . covered *financial institutions* may establish a lower percentage threshold for beneficial ownership (*i.e.*, one that regards owners of less than 25 percent of equity interests as beneficial owners) based on *their own assessment of risk* in appropriate circumstances.” See *id.* (emphasis added).

<sup>7</sup> *Id.*

document, but via a nine-minute discussion at a conference in Las Vegas.”<sup>8</sup> The article further reports that “an OCC examiner provided the first hint that regulators might be inclined to demand risk-based thresholds. . . . [O]ne of the largest U.S. banks recently expressed interest in relaxing its 10 percent threshold to 25 percent but was rebuffed by the examiner who demanded it explain how its financial crime risks had changed in a way that warranted the move.”<sup>9</sup>

If true, this supervisory practice raises serious legal concerns. First, no rational basis has been asserted for rejecting the reasoned judgment of FinCEN in this area. Second, the federal banking agencies have no independent regulatory authority under the Bank Secrecy Act.<sup>10</sup> Third, while the agencies do retain general safety and soundness authority under the Federal Deposit Insurance Act, we are aware of no argument that the failure to collect beneficial ownership information for owners of 10-25 percent of a client company constitutes an unsafe and unsound banking practice that imperils the safety and soundness of a bank; nor can we imagine any such argument.

Finally, even if such an argument were imagined, it should be published for notice and comment pursuant to the Administrative Procedure Act rather than conveyed through a series of informal announcements or MRAs, with the latter ostensibly constituting confidential supervisory information and thus being immune to public appeal.<sup>11</sup> Such a process would not only comport with the law and allow aggrieved parties to comment and even file legal challenge, but also would yield a better policy. Furthermore, it would require the agencies to identify, and the public to assess, the statutory basis of the policy articulated. This process is, of course, precisely the one that FinCEN followed in establishing the beneficial ownership requirement from which the federal banking agencies now appear to deviate.

While this letter focuses only on the beneficial ownership reporting threshold, we are concerned that your agencies are also varying FinCEN’s CDD rule in other ways, either on a systemic or idiosyncratic basis. Any deviation from FinCEN’s rule raises the same concerns articulated above.

For the foregoing reasons, we strongly urge each of your agencies to adopt examination guidance making clear that FinCEN’s CDD rule is the only operative requirement in this area. If

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<sup>8</sup> See, e.g., Brett Wolf, *U.S. regulators: 25 percent beneficial ownership collection threshold only a “starting point,”* Regulatory Intelligence (Sept. 26, 2017).

<sup>9</sup> *Id.*

<sup>10</sup> We note that other potential AML-related sources of statutory authority do not apply here. For example, while some have suggested that the federal banking agencies might impose this requirement under the customer identification provisions of section 326 of the USA PATRIOT Act, section 326 expressly requires any regulations issued thereunder by a federal banking agency to be done *jointly with FinCEN*. Similarly, section 8(s) of the FDI Act only grants the agencies with authority to “prescrib[e] regulations requiring [banks] to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions with the [BSA]”; while regulations thereunder may establish procedural expectations for compliance with the BSA, they cannot interpret the BSA itself.

<sup>11</sup> We note that the GAO has recently concluded, in two separate instances, that guidance constituted a “rule” under the APA and was therefore subject to the Congressional Review Act. Therefore, any final rule or policy statement must also be submitted to Congress under the Congressional Review Act before it may take effect.

any additional standards are viewed as necessary in order to avoid unsafe and unsound practices, they should be adopted through a notice-and-comment rulemaking process under the APA and pursuant to legal authority actually granted to the agencies by law.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'G. Baer', with a long horizontal flourish extending to the right.

Gregory Baer  
President  
The Clearing House Association L.L.C.

cc: Sigal Mandelker, Under Secretary for Terrorism and Financial Intelligence  
(U.S. Department of the Treasury)

Kenneth Blanco, Director  
(Financial Crimes Enforcement Network)

Morris Morgan  
Karen Solomon  
(Office of the Comptroller of the Currency)

Michael Gibson  
Mark Van Der Weide  
(Board of Governors of the Federal Reserve System)

Doreen Eberley  
Charles Yi  
(Federal Deposit Insurance Corporation)