American Bankers Association
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June 11, 2012

FinCEN
P. O. Box 39
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Re: Customer Due Diligence Requirements for Financial Institutions, FIN 1506-AB15

Dear Sir or Madam:

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the request by the Financial Crimes Enforcement Network (FinCEN) for comments on a wide range of questions related to the possible development of a customer due diligence (CDD) requirement. FinCEN's intent through this Advanced Notice of Proposed Rulemaking (ANPR) is to create a new regulation that would codify, clarify, consolidate and strengthen existing requirements and expectations. Perhaps more significant, the new regulation would establish a "categorical requirement" for financial institutions to identify beneficial ownership of accountholders. If and when a rule is adopted, it would apply to banks, brokers or dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities, although it is likely the requirements will be expanded to other financial institutions in the future.

ABA welcomes FinCEN starting this process with an advanced notice rather than beginning with a proposed rule. ABA believes that the area of customer due diligence has expanded far beyond the initial concepts associated with Bank Secrecy Act (BSA) record-keeping and reporting—and has done so without the kind of visible public debate that such an incursion into financial privacy warrants. The last time a "Know Your Customer" regulatory prescription as broad as the mandate being considered here was actively discussed by the citizens and businesses, whose interests are at stake, it was loudly denounced. In the interim, much has happened concerning financial crimes and national and global security such that today the perspectives of our citizens and businesses may have changed to some extent, but there has not been the national debate needed to identify the proper balance between privacy and security, where the lines should be drawn, who should bear the costs, what protections should be applied to the information reported, what accountability for the use and utility of BSA data should be instituted, and what is practical and feasible.

The expedited Congressional authorization of the USA PATRIOT Act regime of financial crime due diligence and reporting that we follow today was not accompanied by the kind of scrutiny that its expansive implementation merits even if the legitimacy of its extraordinary legislative motivation may be appropriate. Now a decade after the adoption of the cornerstone customer identification program (CIP) rule and the gradual aggregation of more specific risk-based enhancements to customer due diligence and the steps which FinCEN is preparing to take, it would be fitting to take stock of what we have done and what further expansion of customer due diligence means for our financial system and our society. Therefore, ABA welcomes the

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.

potential for further outreach and discussion by all interested parties on the impact and merits associated with this proposal. Enforcement actions alone do not demonstrate a gap in the regulatory regime.[2]

The policy aspirations that FinCEN cites for this inquiry into expanded CDD each has a second dimension to its assertion that warrants careful consideration:

- *"To promote greater efficiency in identifying and reporting illicit financial activity"* is another way of further shifting the unfunded mandate of financial surveillance from the government to the private sector and attenuating the appropriations check on the government's command of national resources for conducting such surveillance;

- *"To enhance financial transparency"* represents the expansion of government mandated financial surveillance by the private sector without the due process protections that would accompany direct government surveillance; and

- *"To comply with international standards for strengthened CDD"* suggests the need to adopt a consensus that may be nothing more than the result of like-minded law enforcement representatives whose well-meaning goals have never been subject to the sunshine of vigorous public debate in their respective countries.

Today our system of financial transactions is fast evolving into another realm of electronic information sharing. We are daily bombarded with reminders that our personal and business financial information is little more than a digital message or data entry in the electronic ether. We must all pause and ask ourselves whether our financial transactions and information are materially different from our telecommunications, our social media exchanges, our public activities, our medical records, and our water-cooler conversations and what those distinctions mean for the type of government accessed surveillance we wish to legitimize.

ABA believes that there has been no demonstration that a timetable for expanded CDD should proceed without every effort to conduct the outreach and thorough evaluation of what this expansion means for society and our personal freedoms. Accordingly, this ANPR should mark the beginning of such a national discussion. FinCEN's role here should be that of the independent gatekeeper of financial crime regulatory standards protecting the interest of all stakeholders in our financial privacy and security rather than the surrogate for enforcement interests alone. ABA and its members welcome the opportunity to facilitate that role and engage in the thorough evaluation that will – and must – continue.

Overview of ABA Comments

In the preamble to the proposal, FinCEN points out that internal controls including CDD are the cornerstone of a Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program. While banks currently perform due diligence on their customers, FinCEN believes that "issuing an express CDD rule that requires financial institutions to perform CDD, including an obligation

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[2] It is important to draw a distinction between a problem at a single institution that was addressed and resolved by an enforcement action and a more systemic problem where problems are likely to be repeated because there is no regulatory requirement that will prevent the problem. It is also critical is to maintain the proper perspective on the need for a full-blown regulatory scheme by balancing enforcement actions against the industry's overall level of compliance.

to categorically obtain beneficial ownership information, may be necessary to protect the United States financial system."

While ABA strongly supports meaningful efforts to detect and deter money launderers and terrorists, we also believe it is critical to ensure that any new requirement be materially useful to that end, that it serves a demonstrated need. Already, there are too many steps in the BSA process that need to be reconsidered for their utility and whether or not they serve the ultimate goal of protecting the financial system. Adding new rules without a clear justification merely pile on to the burden and consume resources that could be better used and therefore can interfere with a successful BSA/AML effort. Before even considering moving forward, it is incumbent on FinCEN to demonstrate what weakness or gap in existing protocols must be addressed. Equally critical is to demonstrate how a new requirement complements and fits into the greater AML scheme.

Elements of CDD

According to the FinCEN proposal, an effective CDD program should include the following elements:

- Initial CDD through identifying and verifying the customer's identity at account opening
- Understanding the nature and purpose of the account
- Identifying and verifying the beneficial owners of the account on a risk-based approach
- Conducting ongoing monitoring

Customer Identification & Verification

The first step is essentially what financial institutions currently do to meet CIP requirements under section 326 of the USA Patriot Act. For individuals, CIP generally requires a bank to collect the person's name, date of birth, physical address and identification number. The bank then verifies the information on a risk-based approach, using documentary or non-documentary means; the riskier the account, the more in-depth analysis (diligence) required.

The CIP rule defines a customer as the ***holder*** of an account. Where the customer is not an individual, additional information *may* be collected if deemed appropriate using a risk-based approach to obtain information about the individuals who have authority over or who control the account. As specified in the 2010 *FFIEC BSA/AML Examination Manual* at page 55, "The CIP must address situations where, based on the risk assessment of a new account opened by a customer that is not an individual, the bank will obtain information about individuals with authority or control over such accounts, including signatories, *in order to verify the customer's identity. This verification method applies only when the bank cannot verify the customer's true identity using documentary or nondocumentary methods".* (Emphasis added). To a great extent, existing steps to comply with CIP for non-individuals would satisfy elements of what FinCEN is considering for the new rule, and it would seem that FinCEN believes this fact would help minimize the burden of the new proposal.

<u>*ABA Comments*</u>
ABA agrees that this is an appropriate first step in the CDD process and something that banks have been doing since before the Patriot Act was adopted. The real issue, though, is how this applies when a customer is not an individual. ABA believes that it is extremely important for

FinCEN to consider carefully the existing mandates under the CIP rules that have been in place for nearly ten years. Failing to build on the existing CIP mandate as set forth in the existing FinCEN rules undermines the premise that there is no additional burden involved in a new CDD rule.

At the outset, there is a very real question about the ability of financial institutions to verify the *bona fides* of a non-corporate or non-chartered entity. While FinCEN discusses efforts by the federal government to improve information to verify the validity of a corporate charter, there have been no efforts along the same lines to address other types of legal entities. And in some cases, there is nothing registered and possibly no underlying documentation for the entity itself. This underscores the importance of approaching the possible development of a formal CDD rule with a clear understanding of the many variations of entities that states have seen fit to create.

While FinCEN discusses Treasury's efforts involving legislation on legal entities, most of those efforts to date have focused solely on corporate charters. For example, the *Incorporation Transparency and Law Enforcement Assistance Act* (S 1483 introduced by Senator Carl Levin (D-MI) and its companion bill in the House of Representatives, HR 3416 introduced by Representative Carolyn Maloney (D-NY)) would impose requirements on states regarding *corporate* charters.[3] And yet, that is only one type of legal entity. There are closely held corporations, partnerships, limited partnerships, personal trusts, corporate trusts, revocable and irrevocable trusts, pensions, retirement plans and a myriad of other entities. Each is a creature of different statutory mandates at the state level, and they run the gamut from very informal undocumented structures to highly formalized entities. And, within each type of legal entity there are many variations among the states. Therefore, ABA believes and strongly urges FinCEN to create a chart or outline of the many different entities that exist and then indicate the perceived risks for each type of entity and the appropriate steps that should be taken. Otherwise, the expectations are too vague to be workable and may not reflect actual levels of risk. Clearly, with the great spectrum of varying legal entities, one-size-fits-all approach cannot begin to work.

For example, in many states, consumers take advantage of a payable-on-death or POD account. Briefly, these provide a simple mechanism to pass along assets after death to an appropriate beneficiary. They are usually small dollar accounts, often set up by a grandparent to pass along a small sum of money to a grandchild. Technically, these are a form of trust, and yet the only documentation for these accounts is the title on the bank's records. This one example raises a number of questions that FinCEN will need to address in any guidance on beneficial ownership.

First, it underscores the problem associated with confusing beneficiary and beneficial ownership. It is not unusual for the beneficiary of a POD account not even to know of the existence of the funds until the account owner dies. Moreover, until the grantor dies, the beneficiary has no right to the funds under most state laws. It is the grantor who controls the funds, and yet the account operates like many other consumer accounts. For the most part, these POD accounts are even lower risk than a normal checking account from an AML perspective. However, in crafting a final rule, FinCEN would not only need to address how these and other types of informal trust accounts should be handled, but also consider the many different state laws that affect control and ownership of such accounts. This also emphasizes

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[3] ABA has not taken a position on possible federal mandates that would require states to collect and make this information available. While it should provide useful information, the costs and inherent expectations for how this information would be used must be further explored by all parties.

the need to address how documentation and charter – or lack thereof – and registration and licensing – or lack thereof – comes into play.

ABA believes that any rule must clearly delineate the distinction between beneficiary and beneficial owner. Otherwise, there will be even more confusion about expectations, and instead of clarity the rule will have the opposite effect. ABA expects that FinCEN only wants information about those individuals who have the authority over a legal entity or sufficient ownership interest in a legal entity to exert influence over that entity and that other owners are irrelevant. If that is the case, then the final rule should clearly articulate the parameters of what is expected since doing so will help guide supervisory expectations and financial institutions' compliance efforts. In turn, FinCEN should articulate what level of ownership triggers or serves as a mandatory threshold as a bright-line test for ownership, including how that differs for different types of legal entities.

This raises another question related to the failure to clearly distinguish the difference between a beneficiary and a beneficial owner when a trust is the customer. It is not unusual for estate planning purposes for a grantor of a trust to set up an account that will go to grandchildren or other designated individuals who have yet to be born. This underscores the irrelevance of identifying a beneficiary of an account who has no interest in the funds or control over them and who may not even be aware of them. Equally problematic is the unknown beneficiary who presents a different challenge that the final rule would need to address: how to deal with the beneficiary who has yet to be born. How can a financial institution conduct CIP on someone who does not exist?

ABA recommends that good BSA/AML policy should focus on the following: when a customer of a financial institution is not a biological person (i.e., not an individual), the focus should be who has the authority to control the funds in the account? When that person is a beneficiary he or she may have no knowledge or authority over the funds and so his or her role is irrelevant as a general rule. For a corporation or other legal entity, it is the authorized signer who controls the funds – and it is that person who is the person of interest.

This, though, needs additional refinement to achieve the goal FinCEN aims to address. For example, there are five possible variations of what constitutes a beneficial owner: it could be the legal owner of the account (the individual who holds title); second, it could the legal owner of the entity (the owner of sufficient shares); third, it could the person who controls the account (the person authorized by the entity's charter); fourth, it could be the person who controls the entity, such as the Board, the CEO or COO; and finally, it could be the person who "owns" the funds. Fundamentally, this underscores the flaws inherent in a proscriptive approach and the necessity of taking care to ensure that flexibility and the risk-based approach are maintained.

While many banks do conduct some level of due diligence on the authorized signer, the real question that FinCEN should address with beneficial owners is the risk-level presented by the account. If AML/CFT compliance is truly risk-based, then before going beyond the customer level, the risk should be taken into account to determine what level of added diligence is needed beyond identifying who is authorized as a signer.

This raises another key point that FinCEN has not taken into account in the ANPR. One of the most important factors in the discussion of beneficial ownership is that no matter what the legal entity may be, from a relatively simple trust like a POD to a multi-national corporation traded on stock exchanges around the globe, the entity is a creature of law. In other words, governmental authorities create these entities. Therefore, it is the government – not the private sector – that

has the ultimate control over the entity. While a private sector financial institution may request information from a legal entity about its ownership and control, where there are no registries to which a financial institution can turn to verify simply, inexpensively and efficiently the information, the validity of the information provided is questionable at best. When the Financial Action Task Force sets forth these requirements, there is an expectation that governmental authorities have a responsibility to do their part. Therefore, to expect the private sector to collect this information is not likely to accomplish FinCEN's goal.

Verification of the information is a vital component. Some of the pending legislation that has been introduced over the years has focused on the corporate charter as a solution. As proposed, state chartering authorities would be required to collect and maintain current information about the corporation. However, ABA believes that there may be another solution that should be seriously explored. While the federal proposals to-date have focused on state authorities, which raises questions about constitutionality, ABA believes there could be a simpler approach that would avoid that problem. It would rely on another part of the Department of the Treasury. The Internal Revenue Service (IRS) collects a great deal of data and information from all taxpayers. Furthermore, given its Congressional authority, it can do so under penalty of perjury. A simple solution would be require that the IRS collect data on the owners and managers of any legal entity and then make that information available to law enforcement. While such a solution would likely involve statutory change, allowing the IRS to collect the needed information for law enforcement would provide a mechanism to ensure the information is available and up-to-date, it would have a government agency collecting the needed information that has the authority to ensure its accuracy, it would avoid questions of federal authority over state government officials, it would collect all the necessary information in one location for law enforcement officials, and it would collect the data on the entities that are most likely to have sufficient assets to present AML risk. By looking to the IRS, law enforcement would have a ready source for accurate, up-to-date information and the privacy of those affected would be preserved.

Similarly, and related to the fact that these are entities created by governmental authorities, corresponding laws and regulations also come into play that FinCEN must not overlook. For example, in the many different levels and types of trust that have existed for centuries, there is a corresponding fiduciary responsibility that applies. Similarly, when a corporation is publicly traded, there are many laws and requirements involved, including extensive oversight by the Securities and Exchange Commission, auditors and other public authorities. FinCEN must acknowledge these other controls that effectively eliminate or minimize the AML risk associated with particular legal entities that in turn affects the level of diligence needed.

Nature & Purpose of an Account

According to FinCEN, financial institutions want to understand a customer's needs in order to serve the customer well. More important, BSA requires each bank to understand enough about a customer to detect when a transaction or series of transactions are out of the ordinary and possibly suspicious. FinCEN is considering formalizing this element in a new CDD rule, but based on the premise that banks already do this, FinCEN does not believe this step would be a new or additional requirement.

ABA Comments

While it is not uncommon for a financial institution to seek to understand the needs of customers in order to serve their needs, and while financial institutions have spent countless sums to

develop and upgrade monitoring systems to detect anomalies that may warrant further investigation, FinCEN is not correct in suggesting that adding this to a new CDD rule would not add new requirements.

By formalizing the requirements, FinCEN would add a new layer of expectations for examiners and auditors to review. All too often, no matter what may be stated in formal guidance, examiners identify new guidance as a new regulatory expectation: if FinCEN has formalized something, then the bank should create formal policies and procedures in response. In other words, since the regulators have issued something, there must be an official and documented response by all financial institutions. When interagency guidance on beneficial ownership was issued on March 5, 2010, the approach from the leadership of the prudential regulators was that it merely re-stated existing expectations. Despite a clear statement to that effect, many banks across the country reported being asked by examiners how they had changed their policies and procedures to reflect the new guidance. ABA strongly suspects that, contrary to FinCEN's assumptions, any new rule would be met with corresponding expectations from examiners and auditors for new and updated policies and procedures to reflect the new issuance from FinCEN. At a minimum, examiners and auditors would be likely to expect documentation that the bank had reviewed their policies and procedures to ensure consistency with the new mandate.

In the initial phase of CIP, a financial institution identifies a customer and then, based on a risk-assessment, makes a determination whether further analysis is needed. The ANPR, though, seems to prescribe that further analysis regardless of risk. In fact, referencing both foreign correspondent accounts and private banking accounts raises two account types where further analysis and investigation is conducted with no consideration of risk, as more fully explored below. When the Federal Financial Institutions Examination Council (FFIEC) issued the uniform examination manual for BSA/AML compliance in 2005, it firmly established the concept of risk-assessment for the nation's banks. Over the years since the successful roll-out of the manual, the concept of risk-assessment and risk profiles has been refined and expanded. ABA believes that the element of due diligence should follow – not precede – the risk assessment. When the customer profile and risk are such that a bank determines standard diligence is sufficient then no further investigation should be prompted. It cannot be stated strongly enough that it is important to keep the risk analysis in proper perspective if its' essential role in BSA compliance is to be preserved. ABA believes that the premise of the initial stages of the CDD rule elaborated in the ANPR almost turns this concept upside down by moving towards establishing levels of due diligence for a customer regardless of risk. A financial institution will generally know the expected level of activity in an account based on the type of account. The financial institution can then for departures from anticipated levels of activity based on these general parameters. The due diligence outlined by the proposal would be a check-the-box system that does not affect risk but would consumer precious resources for investigation that would be better used monitoring for anomalies.

Beneficial Ownership Information

Currently, there are two limited situations where a bank *must* collect beneficial ownership information. First, under Section 312 of the USA Patriot Act a bank that offers private banking accounts must take reasonable steps to identify the nominal and beneficial owners of the account. Second, Section 312 requires a bank that offers certain correspondent banking services for foreign financial institutions to take reasonable steps to obtain information about the identity of any person with authority to direct transitions through any correspondent account that

is a payable-through account, along with sources and beneficial owners of funds or other assets in the payable-through account.

FinCEN is considering expanding these requirements to all customers. In taking this step, FinCEN may also provide guidance on customers that may be considered low-risk and therefore exempt from the new requirements.

ABA Comments

At the outset, it is important that FinCEN acknowledge that the two limited instances where beneficial ownership information must be collected reflect a specific Congressional mandate in statute based on what are perceived and defined as inherently high-risk situations. The ANPR would depart from the statutory mandate and impose a high level of investigation regardless of risk or defined risk.

ABA believes that FinCEN must do more to justify this departure. There is nothing in the ANPR that demonstrates a problem with the current approach to risk-assessment and customer identification. If there is nothing to clearly demonstrate the need then a new rule should not be proposed, especially one which inherently identifies all non-individuals as high risk customers.

Possible Definition of Beneficial Owner

As previously stated, it is important to distinguish between a beneficiary and a beneficial owner. Review of the FATF standards indicates that the two are not clearly separated, and ABA believes that unless any suggested rule clearly eliminates beneficiaries from the definition, there will be much unnecessary and fruitless attempts to identify and verify the identity of individuals who have no authority over the funds in an account, may not know the funds even exist, and may themselves not exist.

When beneficial ownership information is required, FinCEN has defined a beneficial owner as "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." ABA agrees that the first part of the definition that focuses on control of the assets in an account is appropriate since that is where AML risk lies. If the risk-based approach is to be preserved, further identification of the individual who has the authority to control the funds in an account should be applied at the discretion of the financial institution, based on perceived risk.

The problem with the proposed approach is its reference to entitlement to the funds. That alone is a vague concept that needs further elaboration and specificity. However, even then, entitlement may be irrelevant to an AML analysis since entitlement to the funds may be qualified or may be a right that is not vested. For many trust relationships, the person who may be entitled to the funds may not yet exist or may not be aware that the possibility of future ownership is there. ABA recommends that the approach should not be based on "entitlement" to funds but rather existing and current ownership that is already vested *and* that allows that individual to exert influence or control. By the same token, to help clarify regulatory expectations and dampen confusion that already exists around beneficial ownership, any rule should clearly explain that if an official or individual associated with a legal entity has no authority or control over the funds in an account at the bank, that individual should be deemed irrelevant to the account and irrelevant to CDD.

Elements of the Proposed Definition
For this possible rule, FinCEN is considering a definition that would include each individual who directly or indirectly owns more than 25% (similar to requirements under the Bank Holding Company Act) OR, if no individual meets that threshold, any individual who has at least as great an equity interest as any other individual, AND the individual with greater responsibility than any other individual for managing or directing the regular affairs of the entity.

ABA believes that this standard unnecessarily complicates and confuses the approach. Unless regulatory expectations are clear and well-articulated, the likelihood of successful compliance and supervision declines. The second part of the definition is confusing and will not be easily calculated or applied and does not appear to be even relevant for AML purposes. Moreover, the ability of any financial institution to determine owners who hold the same equity interest as any other owner requires a level of investigation and monitoring that is both extremely invasive and unduly costly, and ABA strongly urges that part of the definition be eliminated from consideration.

The real focus should be on the ability to control the funds or other assets in an account. In fact, the only reason that levels of ownership should come into play is that an individual with a large enough interest in a legal entity can influence control due to his or her ownership interests. The first line should focus on those with authority over the funds in an account. Then, since an individual with significant interests can exert influence over those with signing authority, if an individual owns more than 25% of the entity, that person should be considered if deemed appropriate under a risk-based evaluation, but it should be limited to those with a significant ownership interest.

Potential Exemptions

According to FinCEN, there may be instances when collecting CDD information is not needed. For example, certain individuals are exempt from CIP requirements like accounts opened under certain employee benefits plans. FinCEN is considering whether those exempt from CIP also could be exempted from a CDD rule.

ABA agrees that certain entities may be so low-risk that it is unnecessary to expose those customers to additional requirements. At the outset, it would be appropriate to start by exempting any entity not already subject to CIP requirements. Second, FinCEN should certainly incorporate the exemptions that are outlined in legislation pending in Congress, such as those with registered securities subject to oversight by the Securities and Exchange Commission, any financial institution subject to oversight and examination by federal or state authorities, including any exchange or clearing agency, any investment company, any insurance company or public utility.

FinCEN has already set a very clear precedent for other low-risk exemptions in the final rule on prepaid access for money services businesses published, July 29, 2011. Identifying certain customers and products as inherently low-risk or lower risk is also consistent with recommendations that FATF has raised in connection with financial inclusion. For example, there are times when prepaid programs are administered by holding the funds in omnibus accounts. It would be entirely appropriate to exempt these accounts from the extensive analysis otherwise contemplated by the rule, because (1) prepaid cardholders do not beneficially own the omnibus account depositor, and (2) although prepaid cardholders beneficially own the funds in

the omnibus account, they are either subject to CIP (e.g., for general-purpose reloadable cards) or present a low AML risk (e.g., non-reloadable, low-value cards).

Another potential exemption is long-term commercial equipment leases. The finance company performs extensive due diligence on the customer at the outset and the nature of the transaction makes it very low risk for abuse by money launderers or terrorists. Subjecting these transactions to additional requirements would substantially add to the costs with little commensurate benefits.

The possibility that some entities are, by their nature, lower risk emphasizes again the need for FinCEN to identify the varying legal entities, consider the structure of a particular entity and the statutory underpinnings that create it, the information publicly available to verify the structure of the entity and those individuals involved in its creation, and the existence of other controls like fiduciary duty or securities registration that sufficiently address the risks to minimize the threat of the entity being abused for money laundering, terrorist financing and other financial crimes. Therefore, ABA strongly urges FinCEN to consider the many controls already in place which affect different legal entities and which make them less susceptible to money laundering or terrorist financing. For example, as noted above, corporations that are registered and have securities traded on one of the national exchanges are subject to extensive oversight and supervision and far less likely to be susceptible to money laundering. By the same token, individual state laws impose extensive fiduciary responsibilities on trusts that must be taken into account, while for pensions, trust and other retirement funds, the Employee Retirement Income Security Act of 1974 (ERISA) imposes obligations and restrictions to be considered when assessing the risks presented by those entities for possible abuse by money launderers and terrorists. In other words, FinCEN must acknowledge that state and federal laws already impose certain obligations, expectations or restrictions that affect the ability of an individual to subvert a charter to nefarious purposes.

The Bank Secrecy Act Advisory Group (BSAAG) would prove an excellent resource to help with this task. And, given the breadth and variety of legal entities affected, as it did with new classes of financial institutions under the Patriot Act, ABA suggests that FinCEN build on different legal entities step-by-step and not all at once.

Similarly, since the rule would impact all levels of account relationship, including extensions of credits, it would be appropriate to identify those *products* that are, by their nature, sufficiently limited in risk for money laundering or abuse by criminals that these products should be exempt.

Existing Customers

Another critical question that must be addressed is how to address existing customers. CIP generally applies to new accounts only. To that extent, FinCEN is looking to a risk-based approach as a way to tackle the many legal entities that already have account relationships.

ABA suggests that the best approach to existing customers is to have a progressive system. Generally, financial institutions use a triggering event, such as a change in management or authorized signers or change in profile to re-examine a customer and re-assess the risk. Similarly, an existing customer should only be subject to expanded CDD following a triggering event and any rule should outline changes that would trigger a review.

Agents

Finally, there is the question of how to implement the requirements when an account is opened by one individual acting as a representative for another. One solution being considered would

require a bank to obtain a statement from all customers to the effect that the account is not being opened on behalf of anyone else. If the account is being opened for another individual, then CDD would apply to the person for whom the account is being opened.

ABA believes that requiring such a statement for all accounts is an unnecessary burden that cannot be justified by the costs to collect and maintain that information. ABA believes that the most effective rules and the ones that yield the most consistent enforcement are the ones that are simple and straightforward. Generally, it should be safe to presume that an individual is opening an account for himself or herself unless the facts-and-circumstances strongly indicate something to the contrary.

Ongoing Account Monitoring

According to FinCEN, CDD is an ongoing obligation, and financial institutions should update their CDD information on a customer as needed based on the risk profile of the customer. This step is considered important for compliance with suspicious activity reporting obligations under the BSA. FinCEN is considering adding this element as a formal part of any CDD rule.

At the outset, this single expectation completely undermines FinCEN's premise that a new CDD rule would be minimally invasive. To collect and track the data will be both costly and invasive, but to then impose a new monitoring expectation over-and-above the collection of the information will be extremely burdensome and complex and will decidedly increase the costs associated with any rule.

The problem with collecting new data is that it automatically imposes expanded expectations for using the data. Once the information has been collected, what additional monitoring will be expected? Since existing systems do not track the data, will banks be expected to revise software systems and programs to track beneficial owners and other relevant information? Since there are no existing mechanisms to verify the information, what expectations will be imposed to ensure the information is current and regularly updated? If additional information is collected on a beneficial owner, does the beneficial owner become a "customer" for other purposes such that the person would be entitled to disclosures like privacy notices? And what must a bank do when it cannot collect or verify the information? Will banks be expected to close accounts and/or file suspicious activity reports (SARs) on those entities?

ABA certainly agrees that it is appropriate to adjust risk profiles on customers *when some trigger causes the re-evaluation.* However, ABA is concerned that the way FinCEN is approaching this could be interpreted by examiners and auditors in such a way that it becomes an expectation for review and updating even when there is nothing material that has changed in the customer profile that justifies a revision to the existing risk profile. ABA also suspects that there is confusion between this type of monitoring and monitoring for suspicious activity.

Banks use a variety of parameters to detect instances of transactions or series of transactions that are out of the ordinary. For smaller institutions, it may be as simple as familiarity with an individual customer's habits. For larger institutions, sophisticated software may be used. This is clearly expected by regulators as part of the process used to identify suspicious transactions. Monitoring for a suspicious transaction, though, is different from monitoring the status of an account. Adding an expectation for monitoring customer status on a routine basis is the kind of regulatory creep that bankers often associate with BSA compliance, where bankers are

expected to act based on rules that have nothing to do with detecting and deterring criminal enterprises.

Additional Comments

In addition to the preceding discussion, FinCEN raised the following ten specific questions. While most have been addressed above, ABA believes it would be productive to address FinCEN's questions here as well.

1. ***What changes would be required if a specific CDD rule is adopted? FinCEN believes that any changes would be minimal given current CIP requirements.***

While ABA questions whether a rule is necessary, whatever step is taken must be coordinated with existing CIP and SAR requirements. The real danger is that examiners and auditors will expect banks to change policies and procedures to reflect new regulatory expectations, as has been demonstrated in the past.

While FinCEN suggests any changes would be minimal, nearly every banker who has commented has indicated that a rule in this area will cause significant changes and be extremely disruptive. For example, every banker has stated that to track this information will require significant overhaul to existing software systems. The impact on small businesses due to increased costs will be particularly noticeable and may possibly make it difficult for small businesses to maintain banking relationships.

2. ***Is the proposed definition of "beneficial owner" clearly understood and easily applied? What exemptions would be appropriate?***

ABA believes that the proposed definition is neither clear nor easily understood. For example, there is still a great tendency to confuse beneficial owner and beneficiary. Another question that arises involves the possible ownership threshold, and even putting aside the vagueness of determining an ownership level when no one individual holds a 25% stake, there is the question of how and what factors will be used to determine whether an individual has crossed the threshold.

There is also the unanswered question about what beneficial ownership means for different legal entities. For example, consider partnerships where a firm could easily have 50 partners but only two general partners with authority to exercise control. There is clearly no need to expend time and energy and scarce resources investigating each and every partner, especially since partnerships are essentially private associations of individuals organized for a particular purpose set forth in the chartering documents. Moreover, partnerships are not always registered with legal authorities and so there is no simple means to verify the information.

And, as noted above, the possible variations on control and ownership over the funds or the entity mandate a clear focus on risk and flexibility.

3. ***When does a financial institution currently collect beneficial ownership information? How is the information obtained?***

Generally, information on customers is collected at account opening. For most banks, the information is part of the "on-boarding" process. Banks use this to establish a preliminary risk profile and then, after the account has been open for a period, may verify the initial assessment.

Banks use a variety of mechanisms to make the initial assessment. Currently, banks often use a risk-based approach which considers the product or service, the channel that introduced the customer to the bank, other account relationships with the bank, the type of business and so forth. Internet searches are sometimes performed to identify publicly available information about a potential customer, although this is sometimes only applied on a risk-basis. Most bankers believe that any new CDD rule would mean that the analysis would become prescribed and required regardless of risk, since the focus of the ANPR is not on risk but on collection of data.

4. ***Does the current risk-based approach produce differences across industries in the kind of ownership information collected? Does this present challenges for relying on information collected by another financial institution?***

Because the types of relationships vary with the types of products and services offered, the types of information also will vary across industries. To a certain extent, there are similarities in what is collected, but different industries operate in the context of different regulatory environments, under different legal constraints, and with different business models.

Just as there are different types of legal entities, the differences in industries will make it challenging to create a rule that attempts a consistent model. These differences have been reflected in the ongoing discussions since the interagency guidance was issued over two years ago.

5. ***Are there other elements of CDD that would be more effective and efficient to achieve the goals set forth by the proposal?***

ABA believes that the logical starting point for any expectation is with the risk profile and risk assessment that should be the foundation of AML compliance. The first step after CIP is conducted is to identify the inherent risk which is identified as the result of the information collected through CIP. ABA believes that the logical process would be to use CIP, assess the initial risk, and then judge from that whether more information is needed.

One of the problems with the current discussion of beneficial ownership is the failure to articulate terms clearly. For example, risk, customer identification, verification, the level of diligence and expectations are all merged and cross-cut into mush. The first step should be to explain clearly what is meant by beneficial ownership to reach a commonly understood concept. The fact that beneficial ownership and beneficiary continue to be confused underscores that this has not yet been achieved. Once that is done, and once there is clear recognition that there are many different entities subject to different controls, the next step in the process can be taken. However, without an easy way to verify information, the exercise will not be effective.

What appears to be important is to identify the element of control and determine if there is risk there. That is what should trigger enhanced analysis. ABA would submit that is what is already being done. It seems, then, that this exercise is really trying to impose an obligation on the financial industry to collect and maintain updated information about entities authorized by governmental authorities when it is the governmental authorities that are better positioned to carry out this obligation.

6. *Should any proposed CDD step be consistent with existing CIP rules, including exemptions?*

Since a successful CDD program has to build on the foundation of CIP, failure to integrate the two carefully will yield confusing and unworkable results. Therefore it is critical that the two coordinate and be consistent. As noted elsewhere, the existing exemptions for CIP purposes should be integrated into any possible CDD rule. If any change is necessary to those exemptions, a careful explanation of why more is necessary – one that weighs the costs against potential benefits – is important to present.

7. *Which of the two approaches to verification is the more meaningful?*

Basically, when an account is established, the account belongs to the legal entity. Under general CIP process, a financial institution will verify whether the entity has legal status, to the extent that is possible through existing registries.[4] For safety-and-soundness or anti-fraud reasons, the financial institutions is also likely to verify that the person who will act on behalf of the entity is, in fact, authorized to do so.

Here, the question itself reflects the problem inherent in a one-size-fits-all approach. For some entities, like certain trusts where there may be no legal documentation, it would be appropriate to identify the individual opening the account. Another example would be a sole proprietorship where the individual owning the business is the person who should be identified and, from a risk perspective, most financial institutions would want to verify that person's identity. In other instances, the primary focus might be confirming that the individual acting for the entity has that authority.

Fundamentally, the type of verification a financial institution conducts will depend on three critical factors: (1) the type of entity involved; (2) the risk that entity presents; and (3) and most important, the ability to access reliable government data to verify the information.

It is also important to draw a clear distinction between collecting information and verifying information. It is one thing to collect information about the entity when an account is opened, but if the risk-based approach is to be preserved, any further investigation should depend on risk and a trigger that mandates further analysis. Similarly, where the product involved is low-risk, such as a standard retail checking or savings account, there is no benefit to requiring that financial institutions investigate and establish anticipated activity when the account is opened; the activity and use of the account can be anticipated by the nature of the account in question.

[4] For example, if the customer is a corporation, the financial institution may confirm that corporate charter with state authorities. For other entities, the financial institution may review documentation. However, much of the information collected will be limited to whatever is presented by the customer since there is nothing to independently verify the information presented by the customer.

8. Are there particular products or services that should be exempt because they are, by their nature, low risk?

ABA believes that there are products and accounts or services that can and should be exempted. Where some products or services by their nature require enhanced due diligence, there are others that require lesser diligence. For example, a payable-on-death account that is only reflected in the title on the account is low-risk. Similarly, ABA believes that the risk should also reflect instances where other factors or supervisory requirements offer other controls that minimize or control for risks, like certain prepaid products.

9. Should any financial institutions be exempt from CDD because they are low risk?

ABA suspects that there are financial institutions that limit their offerings to the types of products and services that do not lend themselves to money laundering or terrorist financing that might be exempt. Most depository institutions will and do conduct some level of diligence when opening accounts, both to protect themselves, their customers and their shareholders. What is important and what is reflected in the question is that the level of diligence which is due should depend on other factors: the type of customer, the risk profile presented by the customer, the products and services used by the customer, and other factors unique to the particular legal entity that is the customer. If a financial institution is exempted, it should be based on the oversight and supervision. It might be more appropriate to exempt a depository institution that is subject to regular exams by federal supervisors than it would be to exempt a financial institution that is not regularly examined or only lightly supervised. The more important focus, though, should be on the product, since that is where the inherent risk lies.

10. What is the possible impact of a new CDD mandate on customers?

ABA believes that there is a clear danger from unintended consequences. The costs and burdens associated with an expanded evaluation of customers will inevitably increase costs. The commensurate expectations for expanded monitoring of customers also will add to costs. And, there are some customers who will perceive the expanded request for information as intrusive and an invasion of privacy. All these factors can drive customers to seek alternatives and, as they do, they can and do turn to underground providers or black markets for their financial needs. The more innocent customers that do this, the more fertile the environment there is for these underground markets, which in turn helps facilitate transactions by financial criminals and terrorists. ABA firmly encourages FinCEN to be sensitive to these risks in moving forward.

Conclusion

ABA appreciates the opportunity to comment on the ANPR. We urge FinCEN to use this as a first step for an ongoing dialogue with the industry, prudential regulators, law enforcement and the public about the scope of government mandated financial activity surveillance. The BSAAG is only one forum to carry out these discussions but we strongly urge FinCEN to take advantage of that vehicle, possibly by calling a special meeting of the Plenary for that purpose, especially since this is such a critical issue.

ABA also strongly urges FinCEN to recognize that it is not acting in a vacuum. This possible proposal would be introduced into an AML regime that many regard as highly successful and exemplary for other jurisdictions around the world. Therefore, any step should be carefully calibrated to fit within and build on existing mandates and expectations and not created as an overlay without consideration on how it fits or affects what currently exists.

ABA looks forward to continuing to work with FinCEN as it conducts further evaluation of the need and foundation for expanding such surveillance and the reporting of sensitive private financial information that it would compel.

Sincerely,

Robert G. Rowe, III
Vice President & Senior Counsel