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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

June 1, 2012

VIA ONLINE SUBMISSION (www.regulations.gov)

Mr. James H. Freis
Director
Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, VA 22183

RE: Docket No. FINCEN-2012-0001; (RIN) 1506-AB15:
Customer Due Diligence Requirements for Financial Institutions

Dear Director Freis:

This letter responds to the request for comment on an advance notice of proposed rulemaking to address customer due diligence requirements for financial institutions (Notice), which was recently issued by the Financial Crimes Enforcement Network (FinCEN) with the support of its parent agency, the Department of the Treasury. U.S. law already requires a long list of financial institutions operating in the United States to establish anti-money laundering (AML) programs to combat money laundering, terrorist financing, and foreign corruption.[1] U.S. financial regulators already require those financial institutions, as part of an effective AML program, to conduct customer due diligence and maintain risk-based, know-your-customer (KYC) policies, procedures, and documentation.[2] The proposed rule is, thus, unnecessary unless it clarifies or improves existing AML safeguards. The proposed rule should not be undertaken if it would weaken or confuse current due diligence and KYC efforts.

Summary of Comments. While the Notice discusses some customer due diligence provisions that would clarify or strengthen existing AML safeguards, it also contains troubling suggestions that would represent a step back from current practice and should not be included in a rulemaking. This letter offers comments on both the positive and negative aspects of the Notice, and makes the following recommendations if a customer due diligence rule is proposed:

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[1] See Section 352 of the Patriot Act, P.L. 107-56 (October 26, 2001), codified at 31 USC §5318(h). Covered financial institutions are listed in 31 USC §5312(a)(2). While the law requires all of the listed financial institutions to establish AML programs, in 2002, the Treasury Department issued "temporary" exemptions USC permitting several categories of financial institutions to disregard the statutory requirement. See 31 CFR §103.170, codified by interim final rule published at 67 FR 21110 (April 29, 2002), as amended at 67 FR 67547 (November 6, 2002) and corrected at 67 FR 68935 (November 14, 2002). Treasury also delegated its rulemaking authority in this area to FinCEN. See Treasury Order 180-01 (Sept. 26, 2002). Despite the passage of ten years, the "temporary" exemptions created by Treasury have yet to be lifted. The proposed customer due diligence rule would provide an opportunity to eliminate those exemptions and establish a timetable for all listed financial institutions to establish AML programs and conduct customer due diligence.

[2] See, e.g., Bank Secrecy Act/Anti-Money Laundering Examination Manual, Federal Financial Institutions Examination Council, (8/24/2007), at 56-59 (guidance for examining "Customer Due Diligence").

(1) require financial institutions to perform risk assessments of all accounts; (2) use the terms "nominal" and "beneficial" owner in the proposed rule to ensure its consistency with statutory due diligence requirements; (3) require financial institutions to ask new accountholders if they are acting on behalf of another person; (4) require financial institutions to identify the beneficial owners of an account in writing; (5) revise the deeply flawed, proposed definition of the beneficial owners of a legal entity, to rely on control rather than just ownership, and to exclude nominees and managers from the definition; (6) create beneficial ownership information exemptions for entities that pose low AML risk and already make ownership information available; (7) require attorneys to certify that they will not use an attorney-client or law office account to enable their clients to circumvent AML safeguards or conceal suspicious activity; (8) treat an intermediary account as requiring enhanced due diligence, if the intermediary is not legally obligated to maintain an AML program, and (9) establish minimum due diligence requirements for Politically Exposed Persons seeking to open an account.

Importance of Customer Due Diligence. Over the last decade, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has worked to strengthen U.S. AML efforts by conducting investigations exposing how money launderers, terrorists, organized crime, corrupt officials, tax evaders, and others have utilized U.S. financial institutions to conceal, transfer, and spend suspect funds.[3] The Subcommittee's investigations have provided detailed case histories and concrete evidence of the need for greater transparency and due diligence to stop abuses that are fueling crime and undermining tax fairness. Our investigations have shown not only how wrongdoers utilize shell corporations, trusts, attorneys, corporate service providers, and other means to conceal their identities and gain access to the U.S. financial system; but also how financial institutions can protect themselves and the U.S. financial system from misuse. The Subcommittee's work provides ample support for designing a strong customer due diligence rulemaking that clarifies or improves the status quo, and this letter hereby incorporates the Subcommittee's hearing records as part of the administrative rulemaking record.

Impact on Financial Institutions. The Notice requests comment on the extent to which the proposed rule would affect covered financial institutions. The proposed rule is expected to apply first to banks, securities firms, mutual funds, and commodity firms and, at a later unspecified date, to other types of financial institutions covered by the Bank Secrecy Act.

If issued, a proposed customer due diligence rule would likely not require significant changes in the AML policies and procedures already in place at the financial institutions proposed for initial coverage. The Subcommittee routinely asks a variety of large and small U.S. financial institutions for account information as part of its investigations. Since enactment of the Patriot Act in 2001, the Subcommittee has witnessed a dramatic improvement in the AML programs at many U.S. financial institutions, including with respect to due diligence and KYC

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[3] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010); "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006); "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act," S.Hrg. 108-633 (July 15, 2004); "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (March 1, 2 and 6, 2001); and "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999). See also U.S. Senate Committee on Homeland Security and Governmental Affairs, "State Business Incorporation – 2009," S.Hrg. 111-953 (June 18 and Nov. 5, 2009).

policies and procedures. The past decade has also seen significant improvements in the capabilities and sophistication of AML technologies used to conduct customer due diligence. Our experience is that, today, virtually all U.S. financial institutions already have policies, procedures, and systems in place requiring their personnel to know their customers, conduct risk-based due diligence before opening an account, and perform ongoing account monitoring. While the precise customer due diligence policies, procedures, and infrastructure vary from institution to institution, they generally already exist at the places we've contacted.[4]

On the issue of beneficial ownership, the Subcommittee has often asked U.S. financial institutions to identify the beneficial owners of specific accounts, especially accounts opened in the name of offshore or domestic shell corporations. Our experience has been that virtually all large U.S. financial institutions already have policies and procedures in place requiring their personnel to know who the beneficial owners are of accounts opened by high risk entities, such as shell corporations. In addition, when the Subcommittee asks for the names of the beneficial owners, in the vast majority of cases, the financial institutions have the information. In addition, the Subcommittee has rarely encountered disagreement or confusion over who the beneficial owner is for a particular account; the persons behind an account – who control and benefit from the account – are typically well known by the financial institution. At the same time, the Subcommittee has experienced tremendous variance in how beneficial ownership information is collected, stored, and updated. It is not unusual for the information to be conveyed verbally by a financial institution to the Subcommittee; almost none uses a standardized method or form to track beneficial ownership information.

Because U.S. financial institutions as a whole already have customer due diligence policies, procedures, and systems in effect today, the industry generally would not have to implement major changes if the proposed rule, as discussed in the Notice, were to be issued.

That good news comes, however, with a major caveat. While many financial institutions have well developed customer due diligence policies, procedures, and systems in place, the Subcommittee has frequently encountered financial institutions that fail to effectively implement or comply with their own AML requirements. In other words, from our perspective, while customer due diligence policies, procedures, and infrastructure are generally already in place, effective implementation is often sorely lacking.

The following comments address the Notice's discussion of the possible elements of a proposed rule.

Elements of Customer Due Diligence

The Notice requests comment on a proposal to require customer due diligence efforts to include four elements, each of which is to be carried out using a risk-based approach: (1) conducting initial due diligence to verify a customer's identity before opening an account; (2) understanding the intended purpose and nature of the account and expected activity; (3) identifying the account's beneficial owners; and (4) conducting ongoing monitoring of the

[4] One reason is that federal AML examiners have already been conducting, for years, examinations of the customer due diligence efforts in place at U.S. financial institutions. See, e.g., Bank Secrecy Act/Anti-Money Laundering Examination Manual, Federal Financial Institutions Examination Council, (8/24/2007), at 56-59 (guidance for examining "Customer Due Diligence").

customer relationship and account activity. Each of these elements provides a commonsense approach to effectively assess risk, conforms with international and U.S. practice,[5] and would help prevent, detect, and investigate any suspicious activity.

Risk-Based Approach and Risk Assessments

The Notice repeatedly discusses or refers to risk-based measures. Any proposed rule may also want to expressly instruct financial institutions to take a risk-based approach to all customer due diligence efforts. This approach would not only conform with past U.S. practice, but also align the proposed rule with international AML standards issued by the Financial Action Task Force (FATF) on Money Laundering.[6] A risk-based approach enables financial institutions to develop effective risk profiles for clients, products, businesses, and affiliates, and to efficiently allocate AML resources to target the most serious money laundering and terrorist financing risks. Since AML risks vary with each customer, a "one-size-fits-all" approach is not necessary or appropriate.

The proposed rule should also expressly require financial institutions to subject each customer to a risk assessment, record that assessment in the account KYC materials, and engage in appropriate, risk-based due diligence efforts to verify the client's identity and monitor the account.[7] To be effective, no class of customers should be exempt from either a risk assessment or some level of account monitoring in case the initial assessment proves inaccurate. For global banks with affiliates around the world, a risk assessment should be performed for each affiliate seeking to open a U.S. account, since some may pose a high risk of having clients engaged in money laundering, terrorist financing, or corruption.

The proposed rule may also want to provide guidance on appropriate risk factors for classifying accounts. Those factors could include whether a prospective customer is a natural person or legal entity, including the type of entity; whether the customer is based in the United States or another country and that country's risk status; and whether the customer itself poses risks or is engaged in high risk activities. This type of guidance could draw on risk factors already identified in FATF materials or other federal AML materials.

Beneficial Ownership

Effective risk assessments require accurate and meaningful KYC information about persons seeking to open accounts. Useful information must look beyond the nominal owner of a financial account to ascertain the true beneficial owners. Without a list of the beneficial as well as the nominal owners of an account, an institution's assessment of its customers' risk profiles will be incomplete and inadequate, in particular because the highest risk customers are likely to be concealed behind nominees.

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[5] See, e.g., "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations," (Feb. 2012), FATF Recommendation 10; Bank Secrecy Act/Anti-Money Laundering Examination Manual, Federal Financial Institutions Examination Council (8/24/2007), at 56-59 (guidance for examining "Customer Due Diligence").

[6] See id., FATF Recommendation 1.

[7] This approach would be consistent with the existing rule implementing the Customer Identification Program required under Section 326 of the Patriot Act, codified at 31 USC §5318(l) ("CIP must contain risk-based procedures for verifying the identity of the customer within a reasonable period of time after the account is opened.").

Applying Requirement to All Accounts. The Notice proposes requiring U.S. financial institutions to obtain beneficial ownership information for all accounts, a requirement that would resolve an ongoing FATF criticism of an existing gap in U.S. AML laws and bring U.S. law into alignment with international standards.[8] In most cases, the beneficial owner of an account is the same as the accountholder of record and should pose virtually no added burden on financial institutions to identify and document. In other cases, ascertaining the beneficial owner is more difficult, such as for accounts opened by offshore shell entities, but those accounts are likely already subject to enhanced due diligence due to their higher risk. In still other cases, it may not be obvious that an accountholder is acting on behalf of another person; financial institutions need to become aware of such situations and identify the beneficial owners of such accounts in order to understand the true customer and perform an accurate risk assessment.[9]

Given the range of accountholders and the importance of accurate risk assessments to an effective AML program, requiring financial institutions to obtain beneficial ownership information for all accounts makes sense, provided that reasonable exemptions are established and financial institutions are allowed to use a risk-based approach that includes conducting minimal beneficial ownership due diligence for low risk accounts.

Using Nominal and Beneficial Owner Terms. The Notice indicates that a proposed due diligence rule would address a variety of beneficial ownership issues, including accounts opened in the name of legal entities, intermediaries, and agents. To address those issues, the proposed rule should make it clear that financial institutions are obligated, for every account, to identify both the nominal and beneficial owners. The nominal owners are the owners of record; the beneficial owners are those standing behind the nominees. To accomplish that task, the proposed rule should consistently use those two terms. Including the terms "nominal" and "beneficial" owner in the proposed rule would provide, not only concepts that are easy to grasp, but also a construct that makes the meaning of each term clearer by way of contrast. Using those two terms would also help ensure the proposed rule is consistent with the existing due diligence requirements of Section 312 of the Patriot Act, which already incorporates both terms.[10]

Requiring Written Beneficial Owner List. One issue about which the Notice is notably silent involves how beneficial ownership information should be maintained. Currently, beneficial ownership information is not recorded in any standardized way, and may not be written down at all. The lack of any documentation requirement encourages inattention to and confusion over accurate and complete beneficial ownership information.

To strengthen existing AML safeguards, the proposed rule should require all financial institutions to include a list of the beneficial owners of an account in writing in the account documentation, preferably in a standardized format that clearly identifies the information for

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[8] In 2006, FATF criticized U.S. Customer Identification Program rules, because they "do not require a financial institution to look through a customer that is an entity to its beneficial owners." "Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America," (June 23, 2006) at ¶445.

[9] Another part of the Notice requests comment on whether financial institutions should be required to ask all customers whether they are acting on behalf of another. This letter supports that approach as explained below.

[10] See, e.g., 31 USC §5318(i)(3)(A)(requiring financial institutions to "ascertain the identity of the nominal and beneficial owners" of certain private bank accounts).

what it is. Forms with beneficial ownership information have long been required in Switzerland,[11] and have been recommended by the World Bank.[12] In the United States, Bank of America announced its intention in 2010, to begin using such a form for non-publicly traded corporations.[13] The information could be provided on a form signed by the accountholder, as required by Switzerland and recommended by the World Bank, or a written list could be compiled by the financial institution itself and included in existing KYC materials. The proposed rule could mandate the type or content of the form or list, or leave the details up to financial institutions; it could require written information only for new accounts or create a transition period to obtain written information for existing accounts as well. The bottom line is that the proposed rule should require account KYC materials to include a written and periodically updated list of an account's nominal and beneficial owners in a standardized format that regulators and others can easily identify and review.

Revising A Flawed Definition. As part of its discussion of beneficial ownership issues, the Notice acknowledges that the Treasury Department has a longstanding definition to identify the beneficial owner of an account:

> "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."[14]

The Notice does not propose changing that definition, nor does it criticize the definition, but it also proposes adding a new regulatory definition to identify the beneficial owners of a legal entity. The Notice does not explain how the two definitions would work together, or why both types of beneficial ownership definitions are needed.

In addition, the proposed new definition is deeply flawed and should be revised. Its first and most important flaw is that, to identify an entity's beneficial owner, the proposed definition would rely solely on the concept of ownership of an "equity interest." "Equity interest" is not defined, nor is it an accepted term of art in either U.S. or international law. It is not clear how the concept would apply to entities other than corporations, such as trusts and foundations. More importantly, for decades, criminals and other wrongdoers have established corporations, trusts and foundations that they control, but in which they do not have an identifiable ownership interest, either direct or indirect, thereby limiting the usefulness of the proposed definition.

Multiple Subcommittee hearings have exposed these arrangements. In a 1999 hearing, for example, the Subcommittee highlighted a Cayman Island shell corporation, Trocca Ltd., that had been established by Citibank Private Bank through its Cayman affiliate, Cititrust, for a client, Raul Salinas, then brother of the President of Mexico.[15] Cititrust formed the corporation

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[11] The required Swiss form is known as "Form A." For examples, see "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999), at 445; "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008), at 554.

[12] See "Politically Exposed Persons: A policy paper on strengthening preventative measures," Stolen Asset Recovery Initiative, World Bank, Theodore Greenberg at al. (2009), at Recommendation 2, Box 2.2.

[13] See "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010), at 24-25.

[14] 31 CFR §1010.605(a).

[15] See "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999), at 890 et seq.

in such a way that its shareholders, directors, and officers were all offshore shell corporations owned by Cititrust. A year later, Cititrust established a numbered trust and transferred the corporate shares to that trust, so that it held 100% of Trocca's shares. From the corporation's inception, Mr. Salinas had no direct or indirect ownership of Trocca Ltd. – only an understanding that Cititrust would follow his wishes in managing the accounts opened in the name of that shell corporation. The proposed definition attempts to address this situation by defining beneficial owners as "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." But Mr. Salinas never "owned" any shares in Trocca; he simply gave Citibank Private Bank a "letter of wishes" about how he'd like the funds in the Trocca accounts to be handled. That letter of wishes made him a beneficial owner of the Trocca accounts, but it did not make him a shareholder of the corporation or give him an "equity interest" in the company.

A 2006 Subcommittee hearing provides a second example. That hearing examined a situation in which a Cayman Island bank formed a Cayman charitable trust, called Security Capital Trust. The trust's grantor and trustee were the bank, and its sole beneficiary was "any qualified charity designated by the trustee at the time the trust terminates."[16] In effect, Security Capital Trust was constructed so that no one had an equitable interest in the trust's assets until the trust terminated. The bank, as trustee, then caused the trust to form a Cayman shell corporation called Security Capital Ltd. The trust owned 100% of the corporation's shares. The corporation's directors and officers were split between the Cayman bank's employees and the employees of a corporate service provider in the Isle of Man. The Subcommittee investigation disclosed that the persons behind both the trust and the corporation were U.S. citizens, Sam and Charles Wyly. After the Cayman trust and corporation were formed, the Wylys caused other offshore corporations and trusts they controlled to send, over time, a total of $140 million to Security Capital Ltd. which then "loaned" the incoming funds to Wyly family members and businesses in the United States. The Wylys controlled and benefited from both the entities, but at no time did either own, directly or indirectly, any "equity interest" in Security Capital Ltd. or Security Capital Trust.

A third example involves two California shell corporations discussed at a Subcommittee hearing in 2010.[17] Both corporations, Beautiful Vision Inc. and Unlimited Horizon Inc., were formed by an attorney at the request of a client, Teodoro Nguema Obiang Mangue, eldest son of the President of Equatorial Guinea. Their incorporation papers did not list their nominal or beneficial owners, and Mr. Obiang's name never appeared in either set of papers. Beautiful Vision listed the attorney as its president; Unlimited Horizon did not identify any director or officer, but listed the attorney as authorized to accept service of process for the company. The documentation obtained by the Subcommittee never specified who technically "owned" the shares in either company; they may have been held by the attorney, Mr. Obiang, or someone else. The attorney opened several U.S. bank accounts in the name of one or the other corporation. Some of the accounts listed the attorney as the account signatory, company president, and on one occasion as the company owner; others listed Mr. Obiang as the account signatory without specifying his relationship to the corporation that opened the account. In addition, at one bank, the attorney opened an account in the name of his law firm and used it

[16] "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006), at 440 et seq.
[17] "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010), at 155 et seq.

solely to accept wire transfers from Mr. Obiang and then transfer the funds to the accounts held in the names of the shell corporations. It is unclear whether, under the proposed definition, Mr. Obiang would qualify as a beneficial owner of either corporation or of any of the corporate and law firm accounts; it appears it would depend upon who held the corporate shares.

Using Control as a Beneficial Ownership Test. The three examples just provided indicate that, in many cases, equity ownership is not a good test to identify the beneficial owners of a legal entity, since ownership interests can be easily manipulated or hidden behind nominees or legal counsel – practices with a long history in offshore jurisdictions. These problems are explicitly acknowledged and discussed in the federal BSA/AML Examination Manual.[18]

The longstanding Treasury definition of beneficial ownership does not rely on the concept of ownership at all, instead using control and entitlement to funds as the key factors to identify the beneficial owners of an account:

> "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."[19]

This definition gets to the heart of beneficial ownership – identifying the natural persons who exert actual control over an account or benefit from it – rather than focusing on technical questions of legal ownership of the entity in whose name the account was opened. Those technical questions may involve nominees, convoluted legal structures, and misleading arrangements that have little or nothing to do with who controls an account's assets.[20] In addition, as used in the existing Treasury regulation, control is a straightforward concept that regulators, financial institutions, and clients can easily understand. In contrast, establishing "equity ownership" of a legal entity involves complex legal concepts that invite confusion, disputes, and litigation.

Corrupting the Concept by Referencing Management. Another problem with the proposed definition is that it confuses the concepts of beneficial ownership and management. It proposes that, if no shareholder can be identified holding at least a 25% "equity interest" in a legal entity, then financial institutions can treat as a "beneficial owner" the shareholder who has "greater responsibility than any other individual for managing or directing the regular affairs of the entity." First, it is not clear how a financial institution would determine which shareholder has the greatest management "responsibility" for a legal entity as opposed to determining who exerts the most "control" over the entity's account. Second, it suggests that an employee of a shell corporation that holds shares in the accountholder (which could be another shell corporation) could, if serving as the account signatory, be deemed to be a "beneficial owner" of the accountholder. But nominal shareholders who manage a legal entity are not the beneficial

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[18] See Bank Secrecy Act/Anti-Money Laundering Examination Manual, Federal Financial Institutions Examination Council (8/24/2007), at 290-297 (guidance for examining "Business Entities (Domestic and Foreign"), including section on "Nominee Incorporation Services").

[19] 31 CFR §1010.605(a).

[20] See also Anderson v. Commissioner, 164 F.2d 870 (7th Cir. 1947), affg. 5 T.C. 443 (1945) ("A taxpayer is the beneficial owner of property if the taxpayer controls the property or has the economic benefit of ownership of the property.").

owners of that entity, and to pretend otherwise confuses and corrupts the very meaning of beneficial ownership.

The point of this part of the proposed definition seems to be to set up a fallback position in the event that NO beneficial owner holding a 25% equity interest in the legal entity that opened the account can be identified, but that is a dangerous course of action at odds with longstanding U.S. and international practice. If a beneficial owner cannot be identified for an account, the solution should be, not to name a manager or nominee, but to refuse to open the account.[21]

Excluding Nominee Accountholders. A related problem is that the proposed definition does not clearly exclude the possibility of a nominee being treated as the beneficial owner of a legal entity. Suppose a corporate service provider forms a new corporation, opens an account in the name of the corporation, and then uses one of its employees as the account signatory. The proposed definition should be revised to state explicitly that a nominee cannot qualify as a beneficial owner of a legal entity or of an account opened by that entity.

Lowering 25% Threshhold to 10%. Still another problem is that the proposed definition proffers a specific ownership threshold of 25% to identify beneficial owners. Because control, rather than ownership, is the preferable test for beneficial ownership of a legal entity, this threshold should be stricken. It should also be stricken, because specifying a disclosure threshold simply invites wrongdoers to arrange their affairs to come in below the threshold. Wrongdoers can simply issue more shares of stock or identify more trust beneficiaries, using nominees, to avoid triggering the criteria. If this threshold is nevertheless retained, using a 25% threshold instead of the 10% threshold in the Foreign Account Tax Compliance Act (FATCA) also raises concerns, because it applies a lower disclosure standard to persons opening accounts in the United States versus abroad. At a minimum, the proposed rule should use the same 10% trigger that FATCA uses for all non-U.S. accounts held by U.S. persons.

Substituting Levin-Grassley Definition. It is far from clear that a customer due diligence rule needs to define the beneficial owner of a legal entity, in addition to defining the beneficial owner of a financial account. Moreover, the proposed definition of the beneficial owner of a legal entity uses a concept, "equity ownership," that has no precedent in U.S. law, creates novel legal issues, engenders FATCA concerns, and diverges from the longstanding approach taken in the existing Treasury definition. The proposed definition also fails to incorporate the concept of control to identify beneficial owners, and fails to exclude management employees and nominees from being deemed beneficial owners. Those flaws should be corrected.

In place of the proposed definition, this letter suggests that, if the proposed rule addresses the issue of beneficial ownership of legal entities, Treasury and FinCEN consider using the beneficial owner definition contained in bipartisan legislation introduced by myself and Senator Grassley, S. 1483, the State Incorporation Transparency and Law Enforcement Assistance Act. The Levin-Grassley bill is already supported by the U.S. Treasury, Justice, and Homeland

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[21] See FATF Recommendation 10 (where a financial institution is unable to identify the customer and beneficial owner, "it should be required not to open the account, commence business relations or perform the transaction").

Security Departments, and has been endorsed by numerous law enforcement groups. Its definition does not contain any of the flaws just identified. It provides as follows:

"(1) **BENEFICIAL OWNER**

(A) **In General.** Except as provided in subparagraph (B), the term 'beneficial owner' means a natural person who, directly or indirectly –

(i) exercises substantial control over a corporation or limited liability company; or

(ii) has a substantial interest in or receives substantial economic benefits from the assets of the corporation or limited liability company.

(B) **Exceptions.** The term 'beneficial owner' does not include –

(i) a minor child;

(ii) a person acting as a nominee, intermediary, custodian, or agent on behalf of another person;

(iii) a person acting solely as an employee of a corporation or limited liability company and whose control over or economic benefits from the corporation or limited liability company derive solely from the employment status of the individual;

(iv) a person whose only interest in the corporation or limited liability company is through a right of inheritance, unless the individual also meets the requirements of subparagraph (A); or

(v) a creditor of a corporation or limited liability company, unless the individual also meets the requirements of subparagraph (A)."

This definition was developed during the course of the legislative process in response to concerns expressed by Senators and other parties. The definition's strengths are that it provides a general legal standard flexible enough to apply to a number of situations, as well as a checklist of limited exceptions to help laypersons understand who qualifies as a beneficial owner. The definition incorporates the concepts of ownership, control, and fund entitlement to identify beneficial owners. It does not contain a disclosure threshold, and makes it clear that nominees and employees do not qualify as beneficial owners.

Exempting Some Legal Entities. In addition to proposing a definition to identify the beneficial owners of a legal entity, the Notice proposes exempting certain legal entities that present a low AML risk and whose ownership information is already readily available to law enforcement and regulators. The Notice indicates that this exemption could apply to accounts opened by financial institutions regulated by U.S. agencies and publicly traded corporations. The proposed exemption is both practical and sensible, and should be included in a proposed customer due diligence rule. The twin criteria of low risk and available ownership data would

help ensure that financial institutions do not spend resources gathering due diligence information for low risk accountholders and instead concentrate their AML efforts in areas where the need is greatest. The exemption would also streamline the due diligence rule and reduce its cost, without reducing its effectiveness.

In developing the exemption in a proposed rule, Treasury and FinCEN may want to consider the Levin-Grassley bill, S. 1483, which already contains a list of legal entities that may be appropriate to qualify under the proposed exemption. The Levin-Grassley list includes not only regulated financial institutions and publicly traded corporations, but also state-regulated insurance companies, registered accounting firms, registered hedge funds, state regulated utilities, and charitable organizations whose ownership information is already filed with the IRS. At the same time, the proposed rule should be careful not to extend the exemption to legal entities that pose more than minimal AML risks, such as foreign financial institutions, shell corporations, or trusts or foundations, whose ownership is unknown to law enforcement or regulators. The exemption should be limited, as proposed, to entities that are both low risk and whose ownership information is already readily obtainable by U.S. regulators and law enforcement.

Beneficial Ownership Declarations. The proposed rule may also want to include a provision explicitly allowing financial institutions to accept and reasonably rely on any declaration of beneficial ownership submitted by a legal entity to a governmental body under penalty for providing false information. The U.S. Congress is currently considering legislation to require persons seeking to form a U.S. corporation to identify, as part of a state incorporation process, the corporation's beneficial owners and update that information over time. If such legislation were enacted into law, financial institutions would be able to ask their corporate customers to provide a copy of the beneficial ownership information submitted to their state of incorporation and rely on that information unless the financial institution had reason to know the information was incorrect. Being able to obtain and reasonably rely on an already prepared and regularly updated list of beneficial owners would support, simplify, and reduce the costs associated with financial institutions' due diligence efforts relating to corporations. By explicitly addressing this issue, the proposed rule would not only put a process in place to take advantage of any beneficial ownership declarations that are eventually generated here or in other countries, but also provide an additional benefit from the establishment of such systems.

Agent Accounts

The Notice requests comment on how to treat accounts opened by customers, such as law firms or accounting firms, who may be acting on behalf of other parties without disclosing that fact to the financial institutions opening the accounts. The Notice indicates that the proposed rule is considering requiring financial institutions, as part of their due diligence process, to ask clients to affirm that they are not acting on behalf of another. If a client were to disclose instead that it was acting on behalf of another, the proposed rule would need to explicitly require the client to identify that other party and disclose the beneficial owners of the account. This type of inquiry would help ensure financial institutions know who they are dealing with and conduct accurate risk assessments. If this type of inquiry were made part of the account opening process, it would provide a cost effective KYC measure.

More may be needed, however, for attorney-related accounts. In 2010, the Subcommittee held a hearing and released a report describing a number of incidents in which an attorney opened a bank account in the name of his law office or designated it as an attorney-client account, used the account to carry out financial transactions on behalf of a specific foreign political figure, and did so without alerting the bank to the foreign official's involvement. As a result of that investigation, Senator Coburn, the Subcommittee's Ranking Minority Member, and I issued the following bipartisan recommendation:

> "Treasury should issue an AML rule requiring U.S. financial institutions to obtain a certification for each attorney-client and law office account that it will not be used to circumvent AML or PEP controls, accept suspect funds involving PEPs, conceal PEP activity, or provide banking services for PEPs previously excluded from the bank; and requiring enhanced monitoring of such accounts to detect and report suspicious transactions."[22]

This type of certification process could be included in the proposed rule and used to obtain commitments from attorneys – as well as other intermediaries acting on behalf of others – that they will not use an account to circumvent a financial institution's AML or PEP safeguards or conceal suspicious activity.

Intermediary Accounts

The Notice also requests comment on how to handle due diligence for accounts opened by intermediaries whose accounts are routinely used to carry out transactions on behalf of their own clients. While these accounts pose many due diligence issues, one principle that should be captured in a proposed rule is that such accounts pose higher risks when the accountholder itself is not required by law to maintain an AML program. Many types of intermediaries, such as banks, securities firms, insurance companies, commodity firms, and money service businesses, are already required by law to establish AML programs and use due diligence when opening accounts for clients. Other intermediaries, such as real estate agents, escrow agents, hedge funds, and corporate service providers, are generally exempt from federal AML requirements and generally do not undertake due diligence reviews of their clients.[23] The proposed rule should, at a minimum, require intermediary accounts opened by entities that are not required by law to maintain AML programs to be designated as higher risk accounts necessitating enhanced due diligence.

Politically Exposed Persons

Finally, one customer due diligence issue that is not addressed in the Notice involves Politically Exposed Persons (PEPs). In 2006, FATF urged the United States to broaden and strengthen the due diligence requirements for PEP accounts.[24] In 2009, a report issued under the

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[22] "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010), at 131.

[23] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010) at 129, 212-240 (discussing real estate and escrow agents); and "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006) at 177, 185-198, 455-466 (discussing corporate service providers and hedge funds).

[24] See "Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America," (June 23, 2006) at ¶¶ 514, 516.

aegis of the World Bank presented evidence that financial institutions were doing a poor job of handling PEP accounts to prevent money laundering and the acceptance of the proceeds of corruption.[25] The report recommended, among other measures, that PEP accounts be treated as high risk accounts requiring enhanced due diligence. It also recommended that financial institutions be required as part of their due diligence process to ask if the nominal or beneficial holder of an account is a PEP; crosscheck accountholder names against a high quality PEP database; obtain any PEP asset declarations from their home jurisdictions; maintain a list of PEP accounts; and review all PEP accounts on an annual basis. FATF also recommends that PEP accounts be opened only with senior management approval; that financial institutions analyze the source of wealth and incoming funds; and that financial institutions conduct ongoing account monitoring.[26]

The proposed due diligence rule provides a valuable opportunity to establish minimum due diligence requirements for PEP accounts to bring U.S. practice in line with international standards, and strengthen U.S. anti-corruption efforts. Currently, U.S. financial institutions are required to apply enhanced due diligence only to a "senior foreign political figure, or any immediate family member or close associate" who opens a private banking account with at least $1 million.[27] The proposed rule should broaden the PEP due diligence requirement to apply to all types of accounts and all types of PEPs, and propose minimum standards in line with the best practices identified in the World Bank report.

Thank you for this opportunity to comment on the proposed rule.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations

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[25] See "Politically Exposed Persons: A policy paper on strengthening preventative measures," Stolen Asset Recovery Initiative, World Bank, Theodore Greenberg at al. (2009).
[26] FATF Recommendation 12.
[27] See Section 312 of the Patriot Act, codified at 31 USC §5318(i)(3)(B).