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Ladies and Gentlemen:

The Investment Company Institute, the Securities Industry and Financial Markets Association, and the Futures Industry Association (the "Associations")[1] have been carefully evaluating the March 5, 2010 *Guidance on Obtaining and Retaining Beneficial Ownership Information* (the "*Guidance*").[2] The Associations and their members strongly support the efforts of the Financial Crimes Enforcement Network ("FinCEN") and the Securities and Exchange Commission ("SEC") to encourage financial institutions to implement robust, risk-based anti-money laundering ("AML") compliance programs. As discussed below, however, we have three fundamental concerns with the *Guidance*.

- First, we are concerned about the statement in the *Guidance* that "customer due diligence" ("CDD"), as described in the *Guidance*, represents an "existing regulatory expectation[]" previously communicated by the regulators to securities and futures firms. In fact, until earlier this year, only the federal banking regulators had published their CDD expectations, as set forth in the Federal Financial Institutions Examination

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1 The Investment Company Institute (ICI) is the national association of U.S. investment companies. The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of more than 600 securities firms, banks and asset managers. The Futures Industry Association (FIA) is a principal spokesperson of the commodity futures and options industry.

2 *Guidance on Obtaining and Retaining Beneficial Ownership Information*, FinCEN Guidance, FIN-2010-G001 (Mar. 5, 2010).

Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual (the "Bank Manual").[3] We do not believe that the Bank Manual is an appropriate vehicle to provide guidance about Bank Secrecy Act ("BSA") expectations to securities and futures firms not subject to examinations under the Bank Manual.

- Second, the expectations in the *Guidance* relating to the collection and verification of beneficial ownership information as part of CDD conflict with the approach to beneficial ownership set forth in the BSA, and are impracticable. Among other things, we believe it is practically impossible for financial institutions to "verify beneficial owners," as the *Guidance* suggests, given that most entities organized under U.S. law are not required to disclose information about their beneficial owners.

- Finally, we observe that the *Guidance* – and particularly the description of "enhanced due diligence" ("EDD") in the *Guidance* – includes many of the same concepts that appear in rules that require certain financial institutions to conduct due diligence on certain private banking accounts and correspondent accounts maintained for non-U.S. persons.[4] To the extent the *Guidance* was designed to apply elements of these rules to *all accounts* maintained by financial institutions, we strongly believe that such action may be done only through formal rulemaking, with the opportunity for public comment and after a thorough cost/benefit analysis.[5]

Representatives of our Associations and their member firms have raised these concerns with representatives from FinCEN, the SEC and the Commodity Futures Trading Commission ("CFTC"), and were encouraged to put these concerns in writing in order to begin a dialogue about how best to move forward. As discussed below, we request a meeting with representatives from FinCEN, the SEC and the CFTC to address the need for separate, revised guidance that is appropriately tailored to the specific and varied operations of securities and futures firms.[6] Until such further guidance is provided, we request that you advise relevant inspections and examinations staff that our member firms are not required to follow the specific CDD and beneficial ownership requirements set forth in the *Guidance*.

I. Customer Due Diligence

The term "Customer Due Diligence" does not appear in the BSA or the regulations thereunder.[7] It is not used in the preambles to the proposed or final rules requiring financial institutions to implement AML programs, file suspicious activity reports ("SARs"), or verify the identity of

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[3] Federal Financial Institutions Examination Council, *Bank Secrecy Act / Anti-Money Laundering Examination Manual* (Apr. 29, 2010).

[4] *See* 31 C.F.R. §§ 103.178(b)(1) ("Private Banking Account Rule"), 103.176 ("Correspondent Account Rule").

[5] Administrative Procedure Act, 5 U.S.C. §§ 500 *et seq.*

[6] The Associations also consulted with the American Council of Life Insurers, which concurred with our request for additional, industry-specific guidance to the extent that the *Guidance* was intended to apply to the activities of life insurers.

[7] 31 U.S.C. §§ 5311 *et seq.*; 31 C.F.R. §§ 103.11 *et seq.*

their customers.[8] FinCEN has adopted specific rules requiring financial institutions to conduct due diligence on accounts established or maintained for certain foreign persons, but these rules apply only to "correspondent accounts" maintained for foreign financial institutions, and to "private banking accounts" maintained for certain foreign persons.[9] While the CDD concept is embodied in Recommendation 5 of the FATF's Forty Recommendations, FATF recommendations are not enforceable on U.S. financial institutions unless and until they are implemented by the United States. The FATF itself has observed that Recommendation 5 has never been implemented fully by the United States.[10]

Prior to the publication of the *Guidance*, the primary official pronouncement of the regulators' CDD expectations appeared in the Bank Manual, first published in June 2005. The *Guidance* acknowledges that the Bank Manual "is issued by the federal banking regulators regarding AML requirements applicable to banks," but states that "it contains guidance that may be of interest to securities and futures firms."

We do not believe that the Bank Manual is an appropriate vehicle to provide guidance to securities and futures firms not subject to examinations under the Bank Manual. The Bank Manual describes how the federal banking regulators will inspect banks not only for compliance with their obligations under the BSA, but also to ensure that banks are not engaging in unsafe or unsound practices in violation of specific banking regulations not applicable to securities and futures firms.[11] It is prepared by the federal banking regulators, and is tailored to the specific operations of the banking industry. For example, it addresses how banks should incorporate various BSA obligations in traditional banking functions such as lending activities, bulk shipments of currency, pouch activities, ATM transactions, and other functions not germane to securities and futures firms.

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8 *See generally* 31 U.S.C. §§ 5318(g), (h), and (l) and the regulations thereunder.

9 *See generally id.* §§ 5318(i), (j), and (k) and the regulations thereunder.

10 *Financial Action Task Force*, *Summary of the Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism* (June 23, 2006), at 299 ("FATF Report"). The CDD section of the FATF Report states that there is "[n]o explicit obligation to conduct ongoing due diligence" under United States law except in certain defined circumstances (*e.g.*, foreign correspondent and private banking accounts). While the FATF report notes that "[t]he U.S. authorities interpret the suspicious activity reporting obligations as necessarily requiring institutions to have policies and procedures in place to undertake ongoing due diligence generally," as noted above, the term "customer due diligence" is not mentioned in the SAR rules or the preambles to the SAR rules. The FATF Report concluded the United States had not fully incorporated CDD into its AML/CFT regime, and recommended that the United States "[i]ntroduce an explicit obligation that financial institutions should conduct ongoing due diligence." To date, however, the United States has not adopted a law or regulation requiring financial institutions to implement CDD processes.

11 The Bank Manual notes, for example, that CDD processes can aid in allowing a bank to "adhere to safe and sound banking practices." *See* Bank Manual, *supra* note 3, at 63. For an overview of the federal banking regulators' expectations relating to unsafe and unsound practices, *see* Section 15.1 of the FDIC's Risk Management Manual of Examination Policies, *available at* http://www.fdic.gov/regulations/safety/manual/index.html.

Because the Bank Manual does not provide specific guidance relevant to the unique and varied customer types, products and services of securities and futures firms, we do not believe it is appropriate to expect these financial institutions to look to the Bank Manual for guidance about their obligations under the BSA, including with respect to CDD.[12] Rather, as discussed below, we would welcome the opportunity to work with you to develop CDD guidance that is appropriately tailored to the customer types, products and services of securities and futures firms.

II. Beneficial Ownership

We also are concerned that the expectations in the *Guidance* relating to the collection and verification of beneficial ownership information as part of CDD are impracticable, and conflict with the approach to beneficial ownership taken by the BSA and the regulations thereunder.

A. The *Guidance* Conflicts with the Treatment of Beneficial Ownership Under the BSA Regulations

1. The BSA Regulations Do Not Require Financial Institutions to Verify the Identity of Beneficial Owners

The *Guidance* states that a financial institution's CDD procedures should be "reasonably designed to identify and verify the identity of beneficial owners of an account, as appropriate, based on the institution's evaluation of risk pertaining to an account." This approach is inconsistent with existing law. While the BSA regulations require financial institutions to identify and verify the identity of their customers, they generally do not require financial institutions to identify and verify the identity of beneficial owners. The 2003 rules that require financial institutions to verify the identity of their customers generally allow financial institutions to treat the named accountholder as their "customer."[13] FinCEN and the federal financial regulators initially had proposed to require financial institutions to both "identify" and "verify the identity" of "any person authorized to effect transactions in a customer's account," but that proposal was not adopted. Instead, the final rules only require financial institutions to "obtain information" about persons with authority or control over accounts for customers that are not individuals, and only in those cases where a financial institution is not able to verify the "true identity" of the customer.[14] Moreover, the final rules dropped the proposal for financial

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[12] Although the Financial Industry Regulatory Authority ("FINRA") published a "Small Firm Template" in January 2010 that suggests CDD policies and procedures for small broker-dealers, the Small Firm Template itself notes that CDD "is not specifically required by the AML rules," and that "nothing in [the Small Firm Template] creates any new requirements for AML programs." FINRA, AML Small Firm Template, *available at* http://www.finra.org/Industry/Issues/AML/p006340. The Small Firm Template is not designed to extend regulatory requirements to broker-dealers – particularly to large broker-dealers for which the Small Firm Template is not designed. Moreover, the CDD section was added to the Small Firm Template and was published without any notice to, or input from, the broker-dealer community. The description of CDD in the Small Firm Template also appears to be lifted largely from the Bank Manual, and is not appropriately tailored to the securities industry. For these reasons, we strongly believe it needs to be reconsidered.

[13] *See* 31 C.F.R. §§ 103.121, 103.122, 103.123, and 103.131.

[14] *See, e.g., id.* § 103.131(b)(2)(ii)(C).

institutions to "verify the identity" of such persons. Accordingly, while a financial institution may request additional information about persons with authority or control over certain high risk accounts opened by persons other than individuals, the BSA regulations do not require financial institutions to "verify the identity" of beneficial owners of an account, as the *Guidance* suggests.

2. The BSA Regulations Require Financial Institutions to Obtain Beneficial Ownership Information Only for Certain High Risk Foreign Accounts

The BSA regulations do require certain financial institutions to obtain information about beneficial ownership, but only with respect to certain high risk accounts maintained for foreign persons.[15]

- Under the Private Banking Account Rule, certain financial institutions are required to obtain beneficial ownership information, but only with respect to an account that: (i) requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000; (ii) is established to benefit one or more non-U.S. persons who are direct or beneficial owners of the account; and (iii) is assigned to, or is administered or managed by, an individual acting as a liaison between the financial institution and the direct or beneficial owner of the account.[16] The Private Banking Account Rule does not require financial institutions to verify beneficial ownership.

- Under the Correspondent Account Rule, certain U.S. financial institutions are required to conduct due diligence on correspondent accounts maintained in the United States for foreign financial institutions. However, these U.S. financial institutions are only required to obtain beneficial ownership information about certain high risk foreign banks subject to EDD.[17] These high risk foreign banks are: (i) banks that operate under an offshore banking license; (ii) banks that operate under a banking license issued by a country designated as a "non-cooperative country or territory" by the FATF; and (iii) banks that operate under a license issued by a jurisdiction designated as warranting "special measures" pursuant to Section 311 of the USA PATRIOT Act. The Correspondent Account Rule does not otherwise require financial institutions to obtain information about beneficial ownership or verify beneficial ownership.

In addition, the BSA authorizes the Secretary of the Treasury to require domestic financial institutions to take certain specified "special measures," including requiring financial institutions "to obtain and retain information concerning the beneficial ownership of any account opened or maintained in the United States by a foreign person," if the Secretary determines that a foreign

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15 *Id.* §§ 103.178(b)(1), 103.176. In addition, if a U.S. bank or broker-dealer maintains a correspondent account in the United States for a foreign bank, the U.S. bank or broker-dealer is required to obtain information about the owners of the foreign bank. *Id.* § 103.177(a)(2).

16 *Id.* § 103.175(o).

17 As part of the EDD process, financial institutions must identify each owner of the foreign bank (if the bank is not publicly traded), as well as each owner's ownership interest. Financial institutions also must identify "any person with authority to direct transactions through any correspondent account that is a payable-through account, and the sources and beneficial owner of funds or other assets in the payable-through account."

financial institution or foreign financial account poses a "primary money laundering concern."[18] For this purpose, the Secretary of the Treasury is required to issue regulations defining "beneficial ownership," which such regulations "shall address issues related to an individual's authority to fund, direct, or manage the account … and an individual's material interest in the income or corpus of the account, and shall ensure that the identification of individuals … does not extend to any individual whose beneficial interest in the income or corpus of the account is immaterial."[19] While the Secretary of the Treasury has invoked this statute to determine that certain foreign financial institutions pose a "primary money laundering concern," the Secretary has not required domestic financial institutions to obtain additional information about beneficial ownership as a "special measure" under this authority, nor has the Treasury defined "beneficial ownership" for this purpose.

Accordingly, the BSA and the regulations thereunder require financial institutions to obtain beneficial ownership information only with respect to certain high risk foreign accounts. In contrast, the *Guidance* envisages that financial institutions should obtain, and verify, beneficial ownership information across a significantly broader range of accounts – domestic and foreign – in order to determine *whether* a customer relationship poses greater risks.[20] We do not see any basis in the BSA for such a requirement. Indeed, in a 2002 report to Congress, the Treasury Department and the federal financial regulators specifically declined to recommend that certain trusts and corporations organized as "personal holding companies" be required to "disclose their beneficial owners when opening accounts or initiating funds transfers at any domestic financial institution."[21] The regulators recommended no further beneficial ownership reporting requirements for such trusts and corporations, citing the need to ensure "that a balance is struck between the potential for abuse of asset management vehicles, such as trusts, personal holding companies, and other vehicles, and the limitation and costs resulting from regulatory requirements."[22]

B. Financial Institutions Do Not Have the Ability to Verify Beneficial Owners of Entities Organized Under U.S. Law

We also are concerned that financial institutions do not have the ability to reliably "verify" beneficial ownership, as described in the *Guidance*. The United States generally does not require

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18 31 U.S.C. §§ 5318A.

19 *Id.* § 5318(e)(3).

20 For example, the *Guidance* states that "[w]here the customer is a legal entity that is not publicly traded in the United States, such as an unincorporated association, a private investment company (PIC), trust or foundation," a financial institution should obtain "information about the structure or ownership of the entity *so as to allow* the institution to determine whether the account poses heightened risk" (emphasis added).

21 A personal holding company, for this purpose, is a "corporation or business or other grantor trust whose assets are predominantly securities, bank certificates of deposit, or other securities or investment instruments (other than those relating to operating subsidiaries of the corporation or trust) and that has 5 or fewer common shareholders or holders of beneficial or other equity interest." USA PATRIOT Act § 356(c)(4).

22 Report to Congress in Accordance with Section 356(c) of the USA PATRIOT Act (Dec. 31, 2002).

entities to disclose the identity of their beneficial owners at the time they are incorporated or organized. Without access to this information, it is impossible for financial institutions to reliably obtain and verify information about the beneficial owners of most entities organized under U.S. law.

The U.S. Congress is considering S. 569, the *Incorporation Transparency and Law Enforcement Assistance Act* (the "Incorporation Bill"), which is supported by President Obama's administration.[23] The Incorporation Bill would require states to obtain a list of beneficial owners of most corporations and limited liability companies formed under their laws, and would direct the Government Accountability Office to study beneficial ownership requirements for partnerships and trusts. Until there is a mechanism for financial institutions to reliably obtain and verify information about the beneficial ownership of entities formed under U.S. law, it is impossible for U.S. financial institutions to "verify" beneficial ownership information for most domestic entities.[24]

C. The Regulators Recently Criticized the "Ambiguity and Breadth" of the "Beneficial Owner" Concept Used in the *Guidance*

We also have concerns about the lack of a reasonable definition of "beneficial owner" in the *Guidance*. The *Guidance* does not define "beneficial owner," but rather states that the definition in the Private Banking Account Rule "may be useful for purposes of this [*Guidance*]."[25] Yet only six months ago, the Treasury Department criticized the "ambiguity and breadth" of what is, in essence, the same definition of "beneficial owner" in the Incorporation Bill, stating that the definition "will make compliance uncertain, time-consuming, and costly."[26] The expectation in the *Guidance* that financial institutions will identify and verify "beneficial owners," by reference to the definition of that term in the Private Banking Account Rule, cannot be reconciled with the Treasury Department's criticism of the definition of "beneficial owner" in the Incorporation Bill.

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23 S. 569, 111th Cong., 1st Sess.

24 The *Guidance* also suggests that a financial institution may share "beneficial ownership information across business lines, separate legal entities within an enterprise, and affiliated support units." We note that certain U.S. federal and state laws, as well as a financial institution's own internal policies, may restrict the financial institution's ability to share beneficial ownership information with affiliated companies. We believe it is appropriate for a financial institution to share beneficial ownership information on an enterprise-wide basis only if such action is consistent with applicable law and the financial institution's privacy policies.

25 *See* 31 C.F.R. § 103.175(b).

26 At hearings on the Incorporation Bill on November 5, 2009, David Cohen, Assistant Secretary of the Treasury for Terrorist Financing, stated that:

> Under S. 569 as currently drafted, the ambiguity and breadth of the definition of beneficial ownership, coupled with burdensome disclosure requirements, makes compliance uncertain, time consuming and costly. The definition and application of beneficial ownership information requirements should be sufficiently straightforward and simple in application to work for the full range of covered legal entities – from small, start-up businesses to large, complex legal entities – and regardless of whether the applicant is a foreign or U.S. person.

III. "Enhanced Due Diligence" and Related Concepts in the Private Banking and Correspondent Account Rules

Finally, we observe that the *Guidance* – and particularly the description of EDD in the *Guidance* – includes many of the same concepts that appear in the Private Banking Account Rule and Correspondent Account Rule. For example, the *Guidance* states that information obtained as part of CDD and EDD should be used to identify any discrepancies between an account's intended purpose and activity and the actual sources of funds and account use – a directive that also appears in the Private Banking Account Rule and Correspondent Account Rule.[27] If the intent of the *Guidance* was to apply elements of the Private Banking Account Rule or Correspondent Account Rule to all accounts maintained by a financial institution, then we strongly believe that such action may be done only through formal rulemaking, with the opportunity for public comment and after a thorough cost/benefit analysis.

IV. Request for Additional Guidance Tailored to Securities and Futures Firms

The Associations strongly support the efforts of FinCEN and the SEC to provide meaningful BSA guidance to financial institutions. However, for the reasons discussed above, we have significant concerns that the *Guidance* does not reflect the current BSA requirements of securities and futures firms, and is not appropriately tailored to the specific customer types, products and services of such financial institutions. We therefore request a meeting with representatives from FinCEN, the SEC and the CFTC to begin a dialogue about providing separate, revised guidance to securities and futures firms. Until such further guidance is provided, we request that you advise your relevant inspections and examinations staff that our member firms are not required to follow the specific CDD and beneficial ownership requirements set forth in the *Guidance*.

We look forward to discussing with you the following concepts, which we believe should be addressed in the revised guidance.

- **Tailored to Securities and Futures Firms.** The revised guidance should be appropriately tailored to the customer types, products and operations of securities and futures firms. For example, it should clearly define what is meant by CDD, and set forth how it should be implemented by securities and futures firms. These firms collectively service tens of millions of accounts, largely on an intermediated basis, where many firms either have no direct contact or very limited direct contact with their customers. The revised guidance should acknowledge the different CDD risks associated with servicing different types of customer bases (*e.g.*, institutional vs. retail accounts), and different types of accounts within those customer bases. It also should acknowledge the necessity for these firms to rely on CDD performed by intermediaries or others with direct contact with the customer,[28] and be consistent with guidance previously provided by the regulators under other BSA regulations.[29]

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27 31 C.F.R. § 103.178(b).

28 *See, e.g.*, FATF Recommendation 9, which states that "[c]ountries may permit financial institutions to rely on intermediaries or other third parties to perform elements … of the CDD process." In accordance with this recommendation, it is common throughout the European Union, and most other FATF member jurisdictions, for financial institutions to rely on CDD performed by "eligible introducers" – which are typically regulated intermediaries that have a direct relationship with the customer. We believe it is vitally important for any future CDD guidance to

- **Use of Beneficial Ownership Information.** The revised guidance should acknowledge that financial institutions currently are not *required* to obtain beneficial ownership information as part of their due diligence or EDD processes, except insofar as required by the Private Banking Account Rule or the Correspondent Account Rule. It should make clear that financial institutions that nonetheless determine to obtain beneficial ownership information about higher risk customer relationships may do so using a risk-based approach. Financial institutions also should not be expected to "verify" such information given that U.S. entities generally are not required to disclose their beneficial owners.

- **Time to Implement CDD Processes.** Because the regulators have not previously communicated their CDD expectations to securities and futures firms, they should be afforded sufficient time to develop CDD processes they have deemed necessary and appropriate for their businesses, to upgrade and enhance systems as necessary to implement these processes, and train appropriate employees on the specific elements of their CDD processes.

- **Application to Certain Financial Institutions.** Finally, financial institutions that are not currently required to verify the identity of their customers under Section 326 of the USA PATRIOT Act, or to conduct due diligence on foreign accounts under Section 312 of the USA PATRIOT Act – such as life insurance companies – also should not be subject to CDD requirements. The Bank Manual notes that CDD "*begins with verifying the customer's identity* and assessing the risks associated with that customer." Financial institutions that are not required to verify the identity of their customers lack an essential element necessary for the development of an effective CDD program, and may not have the infrastructure necessary to integrate CDD into their AML programs.

We fully support the efforts of FinCEN and the federal financial regulators to assist financial institutions in developing and implementing appropriate AML compliance programs. We appreciate your consideration of our requests, and look forward to working with you on appropriate, risk-based CDD and beneficial ownership guidance tailored to the specific customer types, products and services of our member firms.

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acknowledge the need for financial institutions to rely on CDD performed by other regulated third parties.

[29] For example, pursuant to guidance issued under the customer identification program rule for broker-dealers and rules implementing Section 312 of the USA PATRIOT Act, a clearing firm generally is not required to verify the identity of customers introduced by introducing broker-dealers, and generally is not required to apply correspondent account or private banking account due diligence on introduced accounts. *See* Customer Identification Program Rule No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Arrangements According to Certain Functional Allocations, FinCEN Guidance, FIN-2008-G002 (Mar. 4, 2008); Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries, FinCEN Guidance, FIN-2006-G009 (May 10, 2006). Similarly, a clearing firm should not be expected to conduct CDD on customers introduced by introducing broker-dealers.

Sincerely,

/s/ Karrie McMillan

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