Financial Institutions and Securities

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FinCEN Issues Anti-Money Laundering Rules on Foreign Correspondent and Private Banking Accounts: Substantial Due Diligence Mandated for Banks, Broker-Dealers, Mutual Funds, Others

Summary

On January 4, 2006, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) published in the Federal Register final and proposed rules to implement section 312 of the Patriot Act. [1] That provision, entitled "Special Due Diligence for Correspondent Accounts and Private Banking Accounts," is one of the significant amendments made to the Bank Secrecy Act—the statutory framework for federal anti-money laundering (AML) regulations—in the wake of the September 11 terrorist attacks. With the quickening pace of enforcement actions for AML violations, including criminal charges and penalties in some cases of $50 million or more,[2] the new section 312 rules loom large.

In general, the **final rule** mandates due diligence steps to be taken for US "covered financial institutions"—including banks, securities broker-dealers, mutual funds and others—that maintain: (i) correspondent accounts for foreign financial institutions; and/or (ii) private banking accounts for foreign individuals. For correspondent accounts maintained for foreign financial institutions, key requirements include:

- determining whether the foreign financial institution must be subjected to "enhanced" due diligence;
- assessing the money laundering risk presented by the foreign institution; and
- applying appropriate procedures to mitigate identified risk.

For private banking accounts, key requirements include:

- identifying the nominal and beneficial owners of the account;
- determining the source of the funds in the account;
- reviewing transactional activity to ensure that it is consistent with known information about the account; and
- determining whether any nominal or beneficial account owner is a senior foreign political figure, in which case additional safeguards must be applied to detect proceeds of foreign corruption.

While FinCEN has indicated that many of the requirements in the final rule may be implemented in a "risk-based" manner, thereby suggesting that not all requirements must be applied to all accounts, it is not always clear where such flexibility exists and to what extent due diligence procedures may be curtailed.

In any event, the requirements in the final rule apply beginning April 4, 2006, for any account established on or after April 4, 2006, and the requirements apply beginning on October 2, 2006, for any account established before April 4, 2006.

In general, the **proposed rule** prescribes "enhanced" due diligence requirements for covered financial institutions that maintain accounts for foreign banks deemed to be of particular AML concern—namely those operating under: (i) an offshore banking license, defined generally as a license that is conditioned on the prohibition of transactions with the people or currency of the licensing jurisdiction; or (ii) a license issued by a foreign country designated as "non-cooperative" in AML matters by an intergovernmental organization, if the United States concurs with that designation; or (iii) a license issued by a foreign country designated as warranting special AML measures by the US Treasury Department. Among the "enhanced" due diligence requirements that the proposed rule would impose are:

- reviewing documentation relating to the foreign bank's AML program;
- monitoring transactions involving the correspondent account;
- if the correspondent account is a "payable through account," obtaining identification information regarding persons with authority to direct transactions through the correspondent account;
- if the shares of the foreign bank are not publicly traded, ascertaining the owners of the foreign bank; and
- determining whether the foreign bank maintains accounts for other foreign banks ("nested banks"), and in some circumstances conducting due diligence on those nested banks.

Here again, FinCEN has suggested that enhanced due diligence should be "risk-based" but has not always clearly indicated where, and to what extent, financial institutions have the latitude to curtail their due diligence procedures.

Comments on the proposed rule are due on March 6, 2006.

Background

Section 312 of the Patriot Act imposes substantial due diligence requirements on US financial institutions that maintain correspondent accounts for foreign financial institutions and private banking accounts for foreign individuals.

Although section 312 became effective on July 23, 2002, many of its terms and obligations, as a practical matter, required implementing regulations for them to have effect. Attempting to issue such regulations in advance of the statutory effective date, FinCEN issued a proposed rule on May 30, 2002. Then, facing the statutory deadline and substantial industry concerns about the proposed rule, FinCEN issued an "interim final" rule (interim rule) on July 23, 2002, in which FinCEN relied on separate authority in the Bank Secrecy Act to temporarily exempt from the requirements of section 312 financial institutions other than banks and certain other institutions that were left subject to limited parts of the interim rule.[3]

The interim rule acknowledged that it would be difficult to implement comprehensive due diligence measures until the issuance of a final rule defining key terms and obligations. Nevertheless, FinCEN instructed the non-exempt institutions to focus AML compliance efforts on private banking accounts for foreign individuals. FinCEN further instructed banks (but not broker-dealers, futures commission merchants or introducing brokers) to focus compliance efforts on correspondent accounts that pose high money laundering risk, especially accounts maintained for high risk foreign banks—that is, accounts subject to "enhanced due diligence" under section 312 because they are operating under an offshore license or in high-risk jurisdictions.

The interim rule remains operative for banks during the period before the effective dates of the final rule. Specifically, the interim rule requires banks to continue to comply with the due diligence requirements mandated by section 312 until it is supplanted by the final rule.[4] However, the new final rule provides that other covered financial institutions are exempt from the section 312 due diligence requirements until those requirements become effective in accordance with the final rule.[5]

Final Rule—Due Diligence on Foreign Financial Institution Correspondent Accounts and Private Banking Accounts

Published on January 4, 2006, the final rule is comprised of two main parts: (i) requirements applicable to correspondent accounts for foreign financial institutions (sometimes referenced below as the "correspondent account rule") and (ii) requirements applicable to private banking accounts for foreign individuals (sometimes referenced below as the "private banking rule").

Due Diligence On Foreign Financial Institution Correspondent Accounts

Scope—Key Terms. The final rule on correspondent accounts maintained for foreign financial institutions applies to any "**covered financial institution.**" The final rule defines this key term to mean: (i) an insured bank, (ii) a commercial bank, (iii) an agency or branch of a foreign bank in the United States, (iv) a federally insured credit union, (v) a savings association, (vi) an Edge Act corporation, (vii) a federally regulated trust bank or trust company subject to a separate requirement to implement an AML program, (viii) an SEC-regulated broker-dealer, (ix) a CFTC-regulated futures commission merchant or introducing broker, or (x) a mutual fund.[6]

FinCEN explained that it reached its conclusion regarding the meaning of "covered financial institution" because these are the types of entities that maintain "**correspondent accounts,**" as that term is defined in separate Patriot Act provision.[7] Although not defined in section 312, FinCEN

decided—against the wishes of many commenters seeking a narrower "correspondent account" definition—to import the broad definition used elsewhere in FinCEN's regulations and to define the term as an account established for a foreign financial institution to handle any financial transactions related to that foreign financial institution.[8] Non-bank financial institutions are subject to the final rule because FinCEN determined that they offer accounts enabling foreign financial institutions to engage in ongoing transactions in the US financial system either on their own behalf or for their customers. FinCEN negated the claim that proprietary correspondent accounts, in which the foreign bank or institution is acting as principal, should be excluded as presenting a low risk for money laundering, stating that such accounts can and have been used to facilitate money laundering through the commingling of bank funds and individual customer funds in order to hide an individual's funds and account activity.[9]

While the definition of "correspondent account" does not narrow the scope of the rule, the definition of "**account**" does. In particular, the "account" definition excludes isolated or infrequent transactions, such as a one-time wire transfer or securities transaction. An "account" is thus a formal relationship to provide regular, ongoing services. This definition is similar to the definition used in the AML customer identification program (CIP) rules, except that the CIP rules have several exemptions from the definition of account, most notably for accounts obtained via an acquisition, merger or assumption of liabilities. These have not been carved out of the "account" definition in the final due diligence rule. In an effort to tailor the definition of correspondent account, FinCEN added to the final rule specific definitions for the term "account" as it applies to the various covered financial institutions.

- For covered *banking institutions*, account means "any formal banking or business relationship established by a bank to provide regular services, dealings, and other financial transactions and includes a demand deposit, savings deposit, or other transaction or asset account and a credit account or other extension of credit." The issuance by a bank of a funds transfer to, or a receipt by a bank of a funds transfer from, a foreign bank does not, by itself, create an account relationship on behalf of the foreign bank.
  - FinCEN noted that the relevant definition of account is the same as in the section 313/319 rule.[10]
- For covered *securities broker-dealers*, account means "any formal relationship established with a broker or dealer in securities to provide regular services to effect transactions in securities, including, but not limited to, the purchase or sale of securities and securities loaned and borrowed activity, and to hold securities or other assets for safe keeping or as collateral."
  - FinCEN described correspondent accounts for broker-dealers as including accounts for foreign financial institutions to purchase, sell, lend or otherwise hold securities, prime brokerage accounts, foreign currency trading accounts, transaction-related custody accounts and over-the-counter derivatives contracts, whether for the financial institution as principal or for its customers.[11]
  - Again, FinCEN noted that the relevant definition of account is the same as in the section 313/319 rule.[12]
- For covered *mutual funds*, a correspondent account includes "accounts for foreign financial institutions (including foreign banks and foreign securities firms) in which these foreign financial institutions may hold investments in such mutual funds as principals or for their customers, and which the foreign financial institution may use to make payments or to handle other financial transactions on the foreign institution's behalf."[13]
  - The preamble points out that these mutual fund accounts have sufficient similarities to correspondent accounts of banks to be subject to the rule.[14]
- For covered *futures commission merchants* and *introducing brokers*, account means "any formal relationship established by a futures commission merchant to provide regular services, including, but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on any contract of a sale of a commodity for future delivery, or options on a commodity."
  - FinCEN described correspondent accounts for futures commodities merchants and introducing brokers as including accounts for foreign financial institutions for trading foreign currency and over-the-counter derivatives transactions, whether for the financial institution as principal or for its customers.[15]
  - As part of its rationale, the preamble states that "introducing brokers can play an important role in

preventing money laundering in the futures industry because they are in a position to know the identity of customers they introduce to futures commission merchants and to perform due diligence on such customers, including monitoring trading activity (and are subject to suspicious activity reporting requirements)."[16]

- In both the securities and commodities context, FinCEN noted that to the extent that introducing and clearing brokers share accounts, these firms may consult and share information with each other to fulfill their due diligence obligations.

The rule further defines a "**foreign financial institution**" in a manner similar, but not identical, to the definition of a US "covered financial institution" so as to include those institutions that may pose a more significant risk for money laundering. In particular, a foreign financial institution includes: (i) a foreign bank (which includes foreign branches of US banks); (ii) a foreign branch or office of a US broker-dealer, futures commission merchant, introducing broker or mutual fund; (iii) any person organized under foreign law that, if it were in the United States, would be a broker-dealer, futures commission merchant, introducing broker or mutual fund; and (iv) any person organized under foreign law that is a currency dealer or money transmitter (except an entity that engages in such activities as an incidental part of its business, such as a hotel that engages in currency exchange transactions for its guests). Significantly, a foreign central bank or equivalent monetary authority is **not** a foreign bank within the meaning of the rule.

Due Diligence Requirements. In general, a covered financial institution must incorporate into its AML program—and have approved by its board of directors, board committee or senior management—due diligence procedures that are focused on correspondent accounts maintained for foreign financial institutions. Those due diligence procedures must include, at a minimum, procedures for: (1) determining whether the foreign financial institution must be subjected to "enhanced" due diligence as set forth in the proposed rule; (2) assessing the money laundering risk presented by the foreign institution; (3) applying appropriate procedures to mitigate that risk; and (4) determining what steps to take in circumstances in which satisfactory due diligence cannot be performed.

Enhanced Due Diligence Determination. As to the first requirement, while the content of the required enhanced due diligence measures may change pending finalization of the proposed enhanced due diligence rule, the triggers for application of enhanced due diligence likely will not. That is because section 312 itself provides very specific criteria for assessing when a foreign correspondent account must be subjected to enhanced due diligence. In particular, as discussed in the section below on the proposed enhanced due diligence rule, section 312 mandates enhanced due diligence for any correspondent account maintained for a foreign bank that is operating under an offshore banking license or a license issued by certain high-risk countries.

Risk Assessment. Assuming that the correspondent account is not subject to the enhanced due diligence that is the province of the proposed rule, the final rule and preamble provide a list of relevant factors for assessing the AML risk presented by any other foreign financial institution correspondent account. As the preamble explains, "[t]he starting point for [covered] financial institutions . . . should be a stratification of their money laundering risk based on a review of the relevant risk factors."[17]

Although the rule does not strictly mandate examination of any specific risk factor, it provides that, "as appropriate," a covered financial institution should examine the following risk factors: (i) the nature of the foreign institution's business and the markets it serves; (ii) the nature of the account, i.e., type of services to be provided, purpose, and anticipated activities; (iii) the nature and duration of the account relationship, including, if relevant, any relationship with an affiliate of the foreign financial institution; (iv) the AML and general supervisory regime of the jurisdiction that issued the charter or license to the foreign financial institution and, to the extent reasonably available, information regarding the AML and supervisory regime of the country in which a parent of the accountholder is incorporated or chartered;[18] and (v) information known or reasonably available regarding the foreign financial institution's AML record.

The overarching requirement is that covered financial institutions analyze the risks presented by each correspondent account maintained for a foreign financial institution, weighing some or all of the factors listed above.

Risk Mitigation. FinCEN has endeavored to give flexibility to covered financial institutions by making the correspondent account rule "risk-based." Accordingly, the final rule does not specify any specific due diligence measures that a covered financial institution must apply. Rather, the appropriate due diligence procedures depend on the level of risk assessed by

the financial insitution. The rule states that the due diligence measures should be designed to detect and report suspected money laundering activity and should include a "periodic review" of correspondent account activity sufficient to determine that the activity is consistent with information known about the account.[19] The preamble adds that in some cases involving correspondent accounts for foreign banks, the risk may be sufficiently high that the covered financial institution may want to impose "enhanced" due diligence procedures, such as transaction testing, even if the foreign correspondent account does not formally trigger the enhanced due diligence procedures under section 312.[20]

When Satisfactory Due Diligence Cannot Be Performed. The correspondent account rule does not specify what actions a covered financial institution should take when satisfactory due diligence cannot be performed but instead simply indicates that the institution must have procedures to address such situations and that these procedures may include refusing to open an account, suspending account activity, filing a suspicious activity report (SAR), and/or closing an account.

Due Diligence on Private Banking Accounts

Scope—Key Terms. The final rule on private banking accounts applies to the same set of "covered financial institutions" as those subject to the correspondent account rule. With respect to these covered financial institutions, the final rule generally adopts the statutory definition of the key term "**private banking account**": that term covers an account or combination of accounts that: (1) requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000; (2) is established on behalf of or for the benefit of one or more non-US persons who are nominal or beneficial owners of the account; and (3) is assigned to a liaison between the covered financial institution and the direct or beneficial owner(s) of the account.

With respect to each of these three definitional points, the rule and preamble provide additional color. First, and perhaps most significantly, the rule and preamble make clear that unless the covered financial institution strictly requires a **minimum of $1,000,000** in the account or combination of accounts, the private banking rule does not apply. The preamble acknowledges that this is a potential loophole in the rule but concludes that it is a loophole mandated by the text of section 312.[21] Second, a "**non-US person**" is a natural person who is neither a US citizen nor permanent resident alien. In order to qualify as a private banking account within the meaning of the rule, one or more such foreign individuals must be a nominal or "**beneficial owner**" of the account, where beneficial ownership means control over the account or entitlement to the account funds or assets that is sufficient to give that individual practical control. Thus, some significant measure of control is a touchstone of beneficial ownership under the private banking rule.[22] Third, a "**liaison**" is the covered financial institution's employee who develops or continues a long term relationship with the client; the level of service that a liaison provides is highly personalized and includes tailoring services to individual client requirements, anticipating client needs, and personal contact. A person who is a customer service representative or an account manager assigned to a large group of customers ordinarily does not provide the level of service to qualify as a liaison.

Finally, the private banking rule broadly defines the key term "**senior foreign political figure**" (SFPF). The term covers: (i) a current or former senior official in the executive, legislative, administrative, military, or judicial branches of government, or in a major foreign political party, or in a foreign government-owned enterprise; (ii) a corporation, business or other entity formed by or for the benefit of a SFPF; (iii) an immediate family member of an SFPF;[23] and (iv) a person widely and publicly known (or actually known by the covered financial institution) to be a close associate of a SFPF. This last component—widely and publicly known as a close associate of a SFPF—is of potentially broad sweep. Particularly in light of the fact that high profile enforcement actions have focused on failures to monitor SFPF accounts,[24] the breadth of this term in the final rule looms large.

Due Diligence Requirements. In general, a covered financial institution must incorporate into its AML program due diligence procedures designed to detect and report known or suspected money laundering or suspicious activity through any private banking account administered by a covered financial institution. Even if the account is established outside the United States, it is subject to the private banking rule if it is administered by a covered financial institution in the United States.[25]

At a minimum, the due diligence on private banking accounts must include reasonable steps to: (a) ascertain the identity of all nominal and beneficial owners of a private banking account; (b) ascertain whether any nominal or beneficial owner is a SFPF; (c) ascertain the source of funds

deposited into, and the purpose and expected use of, the private banking account; (d) review account activity to (i) ensure that it is consistent with other information known about the account, and (ii) detect and report suspicious activity. In addition, (e) in the case of an account for which an SFPF is a direct or beneficial owner, the due diligence must include scrutiny of the account to detect and report transactions that may involve the proceeds of foreign corruption. Further, (f) the procedures must indicate what a covered financial institution should do if it cannot perform satisfactory due diligence.

Ownership. With respect to the identification of nominal and beneficial owners, the preamble explains that a financial institution should determine whether the client is acting as an agent for another individual and should perform additional due diligence if there is doubt regarding beneficial ownership.[26] For an accountholder that is a legal entity that is not publicly traded, such as a private investment company or trust, a covered financial institution should obtain information regarding the structure and control of the entity so as to determine who constitutes a beneficial owner. Raising the bar further, the preamble states that covered financial institutions may not rely on foreign intermediaries to satisfy these due diligence obligations.[27]

Senior Foreign Political Figure Status. The preamble also states that determining whether an individual is an SFPF "will require robust due diligence procedures that need to go beyond reliance on a certification."[28] The preamble acknowledges that it may be particularly difficult to determine whether a client qualifies as an SFPF by virtue of that client's close association with an SFPF.[29]

The preamble advises that an institution should begin the SFPF due diligence process by obtaining employment history directly from the relevant individual. A covered financial institution then may need to check references, and "in virtually all cases, covered financial institutions will have an obligation to check the name of the prospective private banking client against databases of public information that are reasonably accessible and available."[30]

If there is some piece of information indicating that a client may be an SFPF, the preamble advises covered financial institutions to seek confirmation from the individual and, if the individual denies SFPF status, consider taking further confirming steps, such as checking additional references or databases.[31] If those further steps do not indicate SFPF status, a covered financial institution may conclude that the initial indicator of SFPF status was incorrect and that the client is not, in fact, an SFPF.

The preamble also acknowledges that reasonable due diligence policies may not always successfully identify SFPFs.[32]

Source of Funds and Purpose and Expected Use of Account. While the private banking rule does not require covered financial institutions to verify the source of every deposit placed into a private banking account, institutions are required generally to understand the origins of a client's funds. Unusually large transactions or funds originating from unusual sources, such as a government agency, may warrant particular scrutiny.[33]

SFPF Due Diligence for Proceeds of Foreign Corruption. When a nominal or beneficial owner is a SFPF, a covered financial institution must undertake enhanced scrutiny of the relevant account to detect and report transactions that may involve foreign corruption. The rule does not mandate any particular procedures, but the preamble suggests that the procedures may include consulting publicly available information from the client's home jurisdiction, contacting foreign branches of the covered financial institution, if applicable, and conducting greater scrutiny of the client's employment history and income sources. The preamble further states that the procedures should be risk-based—weighing the length of time the client has been out of office, the size of the account, and information obtained from public sources and other due diligence—and more or less scrutiny should be applied depending on the level of risk.[34]

When Satisfactory Due Diligence Cannot Be Performed. Like the correspondent account rule, the private banking rule does not specify what actions a covered financial institution should take when satisfactory due diligence cannot be performed but instead simply indicates that the institution must have procedures to address such situations and that these procedures may include refusing to open an account, suspending account activity, filing a SAR, and/or closing an account.

Proposed Rule—Enhanced Due Diligence on Correspondent Accounts for Certain High-Risk Foreign Banks

The proposed rule would implement the section 312 mandate that financial institutions perform "enhanced" due diligence on accounts maintained for certain high-risk foreign banks.

Statutory Triggers for Enhanced Due Diligence

The high risk banks for which section 312 mandates enhanced due diligence are those operating under any one of three types of licenses. First, enhanced due diligence is required when a correspondent account is maintained for a foreign bank operating under an offshore banking license. Section 312 defines an offshore banking license as a license that prohibits the bank from conducting banking activities with the citizens of, or with the local currency of, the licensing country.[35]

Second, enhanced due diligence is required when a correspondent account is maintained for a foreign bank operating under a banking license issued by a foreign country that has been designated as non-cooperative in AML matters by an intergovernmental group of which the United States is a member and with which designation the United States concurs. As the preamble to the proposed rule notes, the only currently relevant intergovernmental group is the Financial Action Task Force (FATF), with whose "non-cooperative" designations the United States has always concurred.[36]

Third, enhanced due diligence is required when a correspondent account is maintained for a foreign bank operating under a banking license issued by a foreign country that the Treasury Department has designated as warranting special measures because of AML concerns.[37]

The proposed rule adopts all of these statutory triggers for enhanced due diligence. Accordingly, a primary step in establishing a correspondent account for any bank is to ascertain whether the bank operates under any of these three types of licenses.

Proposed Enhanced Due Diligence Requirements

Under the proposed rule, covered financial institutions—the same set of institutions subject to the final correspondent account/private banking rule summarized above—generally must conduct enhanced due diligence on accounts for any foreign bank that is operating under an offshore license or a license issued by a high-risk jurisdiction.

The proposed rule would require the following enhanced due diligence measures:

First, conducting risk-based scrutiny of the account to guard against money laundering and detect and report suspicious activities. This scrutiny should include, depending on the assessment of the risk presented by the correspondent account: (i) reviewing documentation relating to the foreign bank's AML program; (ii) considering whether that AML program is reasonably designed to detect and prevent money laundering; (iii) monitoring transactions involving the correspondent account so as to detect and prevent money laundering; and (iv) if the account is a "payable through account," obtaining information regarding any person with authority to direct transactions through that account, and the sources and beneficial owner of funds in the account;

Second, determining whether the foreign bank maintains accounts for other foreign banks (to which the preamble refers as "nested banks") and in some circumstances conducting due diligence on those nested banks;

Third, if the foreign bank's shares are not publicly traded, ascertaining the identity and ownership interests of each of the foreign bank's owners; and

Fourth, determining steps to take in circumstances in which satisfactory due diligence cannot be performed.

<u>*Risk-Based Scrutiny of Account.*</u> The preamble to the proposed rule explains that covered financial institutions need not conduct an audit of a foreign bank's AML program but instead should review, "as appropriate," the foreign bank's written AML program or description thereof to determine whether it is reasonably designed to prevent and detect money laundering. The preamble also states, however, that this step may not be necessary in every case, especially when the covered financial institution has been dealing with a foreign bank for a long time, knows the bank well, and knows that it is well-regulated.[38] The general emphasis on taking "risk-based" measures suggests that if a covered financial institution has a reasonable basis for assigning a low risk to a correspondent account, less scrutiny is required.

In any case, however, a covered financial institution should review the correspondent account for suspicious activity and must be particularly alert for activity that is not in accord with the type, purpose and anticipated activity of the correspondent account. Again, however, the proposed rule and preamble make clear that the level of scrutiny should depend on the risk assessment of the correspondent account.

Additional measures generally are necessary if the account is a "payable through account." The proposed rule defines a payable through account as an account through which the foreign bank permits its customers to engage in banking activities with the covered financial institution, either directly

or through a subaccount. In the case of a payable through account, the covered financial institution should obtain information about the identity of the persons with authority to direct transactions through the correspondent account and the sources and beneficial ownership of funds or other assets in the account. Neither the proposed rule nor the preamble, however, specifies the extent of information that must be obtained.

Review Nested Banks. A covered financial institution must determine whether a foreign correspondent bank maintains accounts for other foreign banks, so-called "nested banks." The preamble explains that the covered institution generally may accomplish this by requesting from the foreign correspondent bank a description of its foreign bank customer base and consulting "readily available banking reference guides," although the preamble does not specify those guides.[39] In addition, wire transfer activity may indicate the existence of nested banks.

The covered financial institution must include procedures for determining when, given the apparent existence of nested banks, the covered institution will identify, conduct due diligence on, and assess the AML risks posed by such banks. The preamble explains that factors that may be considered in that determination include the type of nested bank, the AML and general supervisory regime of the nested bank's jurisdiction, the activity taking place through the US correspondent account, and the foreign bank's AML program as it applies to the nested banks.[40] In particular, if the foreign bank's AML program does not appear adequate, the preamble suggests that this should weigh in favor of conducting due diligence on nested banks. To the extent a foreign correspondent bank refuses to provide information on nested banks, the preamble suggests that the covered financial institution should consider "whether . . . it is prudent to establish or maintain the correspondent account."[41]

Identification of Foreign Correspondent Bank's Owners. For any foreign correspondent bank whose shares are not publicly traded, i.e., traded on a market that is regulated by a foreign securities authority, a covered financial institution must obtain the identity of the owners of the foreign bank and the extent of each owner's interest. For this purpose, under the proposed rule, an owner is a person who directly or indirectly owns, controls, or has the power to vote 10 percent or more of any class of securities of a foreign bank. Further, members of the same family—spouse, parent, sibling, child, or spouse's parent or sibling—are considered to be one person, e.g., brothers who each own 5% of a foreign bank's shares must be identified by the covered financial institution.

When Satisfactory Due Diligence Cannot Be Performed. Like the final rule for correspondent and private banking accounts, the proposed enhanced due diligence rule does not specify what actions a covered financial institution should take when satisfactory due diligence cannot be performed. Instead, it simply indicates that the institution must have procedures to address such situations, and that these procedures may include refusing to open an account, suspending account activity, filing a SAR, and/or closing an account.

NOTES

1. 71 Fed. Reg. 496 (Jan. 4, 2006) (final rule); 71 Fed. Reg 516 (Jan. 4, 2006) (proposed rule).

2. *See, e.g., United States v. AmSouth Bancorporation* (S.D. Miss., Oct. 12, 2004) (Deferred prosecution agreement); for a recent record penalty of $80 million, *see In the Matter of the New York Branch ABN AMRO Bank N.V., New York, New York,* FinCEN Assessment of Civil Money Penalty No. 2005-5 (Dec. 19, 2005); *In the Matter of ABN AMRO Bank N.V., Amsterdam, The Netherlands, et al.,* Order of Assessment of Civil Money Penalty, Monetary Payment and Order to File Reports Issued Upon Consent, FRB Dkt. No. 05-035-CMP-FB (Dec. 19, 2005).

3. 67 Fed. Reg. 48,347 (July 23, 2002). Under the interim rule, securities broker-dealers, futures commission merchants and introducing brokers regulated by the CFTC were subject only to the private banking requirements of section 312, while banks were subject to both the private banking and correspondent account requirements. Uninsured national trust banks, non-federally regulated, state-chartered uninsured trust companies and trust banks, and non-federally insured credit unions were exempt from the interim rule.

4. Admittedly, the interim rule provides relatively vague guidance, although banks will likely look to the final due diligence rule and proposed enhanced due diligence rule for guidance, because they will soon have to comply with the due diligence rule and some version of the proposed enhanced due diligence rule.

5. Banks for whom the interim rule remains relevant include insured banks, commercial banks, US agencies and branches of foreign banks, federally insured credit unions, savings associations and Edge Act corporations. Entities exempted from this requirement include securities broker-dealers, futures commission merchants, introducing brokers, mutual funds, and trust banks or trust companies that have a federal regulator.

6. 71 Fed. Reg. 500. Entities not covered by the final rule include closed-end investment companies, state chartered uninsured trust companies and trust banks, and non-federally insured credit unions. FinCEN stated that it was not appropriate to subject them to the provisions of section 312 until they are required to have anti-money laundering programs. Notably, this definition does not include money services businesses such as currency dealers and money transmitters. FinCEN explained that money services businesses do not maintain correspondent accounts. Foreign currency dealers and money transmitters are, however, within the scope of "foreign financial institution" that may trigger due diligence requirements for US covered financial institutions. The preamble notes that other types of institutions, such as operators of credit card systems, are not covered by the final rule but are still subject to requirements to implement AML programs. 71 Fed. Reg. 498.

7. *See* 31 U.S.C. § 5318A(e)(1)(B) (as amended by Patriot Act § 311); 31 C.F.R. § 103.175.

8. *See* Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks; 67 Fed. Reg. 60,562, 60,563-60,564 (Sept. 26, 2002) (The "313/319 Rule").

9. 71 Fed. Reg. 497-498.

10. 71 Fed. Reg. 501.

11. 71 Fed. Reg. 499.

12. 71 Fed. Reg. 501.

13. A recent comment letter dated February 3, 2006, to FinCEN from the Investment Company Institute requested confirmation that the final rule does not apply to accounts opened by US financial institutions with mutual funds for the purpose of effecting transactions of fund shares that are cleared and settled through the National Securities Clearing Corporation's Fund/SERV system. The letter stated, "We believe that the Correspondent Account Rule does not apply to a Fund/SERV account established, maintained, administered or managed for an NSCC member firm that is a US financial institution, even if the firm's customer is a foreign financial institution. In that case, the Correspondent Account Rule would apply to the account held by the NSCC member firm for the foreign financial institution." Letter found at http://www.ici.org/statements/cmltr/06_treas_aml_interpret_com.html.

14. 71 Fed. Reg. 499.

15. 71 Fed. Reg. 499.

16. 71 Fed. Reg. 499.

17. 71 Fed. Reg. 503.

18. The preamble suggests that in some cases, examination of the AML regime in the parent company's country may indicate less AML risk than would be apparent from an examination solely of the accountholder's country's AML regime. For example, one might reasonably view the AML risk as lessened if the parent of the foreign financial institution is incorporated in the United States or another country with a similarly robust AML regime. 71 Fed. Reg. 503.

19. FinCEN noted that it did not intend for the due diligence review, in the ordinary situation, to result in a scrutiny of every transaction occurring within the account. Rather, as described in the preamble, a covered financial institution might consider maintaining account profiles for their correspondents to anticipate how the accounts might be used and expected volumes of activity so that unusual activities might be more readily apparent. 71 Fed. Reg. 503.

20. 71 Fed. Reg. 503.

21. 71 Fed. Reg. 505.

22. The preamble notes that a minor child beneficiary would not be a beneficial owner, absent corresponding authority to control, manage or direct the account. FinCEN expects the covered financial institution to look through the nominal owner of the account to determine who has effective control of the account. 71 Fed. Reg. 504.

23. For purposes of the SFPF definition, a senior official or executive is a person with substantial government authority, and an immediate family member is a spouse, parent, sibling, child, or spouse's parent or sibling. The preamble states that the definition of a senior official or executive remains flexible to capture the range of individuals who pose a risk that their funds may be the proceeds of foreign corruption, but recognizes that this flexibility results in a lack of specificity. 71 Fed. Reg. 507.

24. *See, e.g., Matter of Riggs Bank, N.A.,* No. 2004-01 (May 13, 2004).

25. For instance, according to the preamble, the records of a private banking client may be physically located at a foreign branch of the covered financial institution, but an employee of the institution in the United States exercises control over and manages the day-to-day activities of the account or investment management decisions are made in the United States.

26. 71 Fed. Reg. 508. The preamble states that covered financial institutions will need to make a specific factual determination as to the beneficial ownership of an account on a case-by-case basis. 71 Fed. Reg. 508.

27. 71 Fed. Reg. 509.

28. 71 Fed. Reg. 509. In fact, the preamble states, "a covered financial institution should ordinarily perform sufficient due diligence to ensure that it is comfortable with the prospective customer and his or her source of funds. This type of due diligence should enable it to determine who the customer is, what his or her background is, and, specifically, if he or she is a [SFPF]." 71 Fed. Reg. 507.

29. 71 Fed. Reg. 510.

30. 71 Fed. Reg. 510.

31. 71 Fed. Reg. 510.

32. 71 Fed. Reg. 510.

33. The preamble states, "we do not expect covered financial institutions, in the ordinary course, to verify the source of every deposit placed into every private banking account. However, they should monitor deposits and transactions as necessary to ensure that the activity is consistent with information the institution has received about the client's source of funds and with the stated purpose and expected use of the account." 71 Fed. Reg. 509.

34. 71 Fed. Reg. 510.

35. 71 Fed. Reg. 513.

36. 71 Fed. Reg. 519. The FATF list of non-cooperative countries, called the "NCCT List," is available at www.fatf-gafi.org.

37. The Treasury list of countries and entities warranting special measures because of AML concerns is available at www.fincen.gov/reg_section311.html.

38. 71 Fed. Reg. 518.

39. 71 Fed. Reg. 518.

40. 71 Fed. Reg. 518-519.

41. 71 Fed. Reg. 519.

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