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January 27, 2003

Department of the Treasury,
1500 Pennsylvania Avenue, N.W.,
Washington, D.C. 20220.

Attention: Section 311 – Designation of Jurisdictions
regcomments@do.treas.gov

Re: Notice of Designation of Nauru and Ukraine as
Primary Money Laundering Concerns

Ladies and Gentlemen:

The New York Clearing House Association L.L.C. (the “Clearing House”),¹
joined by the Bankers’ Association for Finance and Trade² and the Securities Industry
Association (collectively, the “Associations”),³ appreciate the opportunity to comment on the

¹ The member banks of the Clearing House are: Bank of America, National Association; The Bank of New York; Bank One, National Association; Citibank, N.A.; Deutsche Bank Trust Company Americas; Fleet National Bank; HSBC Bank USA; JPMorgan Chase Bank; LaSalle Bank National Association; Wachovia Bank, National Association and Wells Fargo Bank, National Association. Members of the Clearing House’s affiliate, The Clearing House Interbank Payments Company L.L.C., that have participated in the preparation of this letter and endorse its views are American Express Bank Ltd. and the U.S. offices of UBS AG.

² The Bankers’ Association for Finance and Trade has, since 1921, been the spokesperson for the international interests of the U.S. commercial banking industry.

³ The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-

Notice of Designation (the “Notice”) issued by the Department of the Treasury (“Treasury”) designating Nauru and Ukraine as jurisdictions of primary money laundering concern and providing notice of proposed special measures to be imposed on those jurisdictions pursuant to Section 311(a) of Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (Pub. L. No. 107-56) (the “Act”). 67 Fed. Reg. 78,859 (Dec. 26, 2002).

The Notice designates Nauru and Ukraine as jurisdictions of primary money laundering concern pursuant to 31 U.S.C. § 5318A(a) (as added by Section 311(a) of the Act) and indicates Treasury’s intent to impose (i) one or more information-gathering and recordkeeping requirements of the special measures described in 31 U.S.C. § 5318A(b)(1) through (4) on Ukraine (the “Ukraine Special Measures”), and (ii) the special measure described in 31 U.S.C. § 5318A(b)(5) on Nauru (the “Nauru Special Measure,” and collectively with the Ukraine Special Measures, the “Special Measures”). Specifically, the Notice states that Treasury is considering the following two measures with respect to Ukraine:

1. Requiring U.S. financial institutions to identify and record the nominal or beneficial owners of accounts with any one of the following characteristics: (a) the accountholder has an address in Ukraine; (b) \$50,000 or more is transferred from a U.S. account into an account in the Ukraine; or (c) \$50,000 or more is transferred from an account in the Ukraine into a U.S. account; and
2. Requiring U.S. financial institutions to identify and record the beneficial owners involved in financial transactions that are captured electronically and that are over \$50,000.

67 Fed. Reg. at 78,862. With respect to Nauru, the Notice indicates that Treasury intends to propose regulations prohibiting U.S. financial institutions from “opening or maintaining in the United States any correspondent account or a payable-through account for a foreign financial institution if the account involves Nauru or any institution licensed by Nauru.” Id.

dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80

The Associations are committed to assisting the Government's efforts to detect and prevent money laundering and the financing of terrorism. We appreciate Treasury's concerns regarding Nauru, and have no disagreement with the proposed resolution (although, as discussed below, some clarification would be helpful). We believe, however, that the Ukraine Special Measures either should not be adopted or should be replaced with appropriate sanctions against Ukraine, as discussed below. U.S. financial institutions should not be confronted with the choice between (i) greatly increased risk of liability and highly burdensome monitoring and recordkeeping requirements, and (ii) closing all Ukrainian accounts and thereby sanctioning Ukraine on a de facto basis. Stated differently, if the Government wishes to sanction Ukraine, it should do so directly.

The Associations are also concerned with the lack of specificity in the Notice regarding the parameters of the Special Measures. Although we understand that the Notice was not intended to address all of the specifics that would be included in the final Special Measures, we believe that without adequate specificity, institutions could be at substantial risk in their attempts to implement the final Special Measures. In addition, we believe that the final Special Measures should have a delayed effective date so that institutions have sufficient time for implementation.

I. Ukraine Special Measures Do not Serve their Stated Purpose

The Notice indicates that the basis for the designation of Ukraine as a jurisdiction of primary money laundering concern and the imposition of the Ukraine Special Measures is the determination by the Financial Action Task Force ("FATF") in December 2002 that Ukraine should be subject to countermeasures. FATF designated Ukraine as non-cooperative in the fight against money laundering and placed it on the FATF Non-Cooperative Countries and Territories list in September 2001 because, according to FATF, it lacked an effective anti-money laundering regime. 67 Fed. Reg. at 78,862. In its December 2002 release, FATF identified certain

million investors directly and indirectly through corporate, thrift and pension plans. The industry generates \$358 billion of revenue and employs approximately 760,000 individuals.

countermeasures which could be imposed against Ukraine, some of which are broadly consistent with the Ukraine Special Measures.⁴

In our view, however, special measures one through four, as described in 31 U.S.C. § 5318A(b)(1) through (4), were not intended to be used as sanctions against foreign jurisdictions, rather they were designed as recordkeeping and information-gathering mechanisms. We believe these special measures were intended to provide U.S. law enforcement with additional tools to address perceived threats to the U.S. financial system, as identified by the U.S. Government. Their function is to aid law enforcement in the collection of information related to, and provide transparency for, financial activity conducted either in geographic areas or by entities designated as of primary money laundering concern. This view is reflected in comments by Senator Sarbanes in floor debate concerning predecessor legislation, where he explained that the “special record-keeping” measures serve to “eliminate the curtains behind which launderers hide.” Cong. Rec. S10562 (Oct. 11, 2001).

This view is further confirmed by the statements of former Deputy Secretary Stuart Eizenstat in hearings before the Senate Banking, Housing and Urban Affairs Committee. In describing the need for the special measures set forth in Section 311, Mr. Eizenstat noted that the few anti-money laundering tools available to law enforcement at that time fell on either end of a broad spectrum.⁵ At one end, the Secretary could issue Treasury Advisories advising financial institutions of problem areas or institutions. On the other end of the spectrum was the International Emergency Economic Powers Act (“IEEPA”), which gives the President the authority to issue full economic sanctions and blocking orders suspending activity with offending targets. Mr. Eizenstat explained that the special measures in Section 311 were conceived in an

⁴ Based on press accounts, each of Canada, Germany, the United Kingdom and Finland has imposed sanctions against Ukraine requiring increased scrutiny of transactions and accounts involving Ukraine. In our view, a risk-based approach that requires enhanced scrutiny and enhanced due diligence of Ukraine accounts and transactions is preferable to the approach taken in the Ukraine Special Measures and is consistent with the risk-based approach Treasury has adopted in other contexts.

⁵ See Hearing on the Administration’s “National Money Laundering Strategy for 2001” before the Comm. On Banking, Housing, and Urban Affairs, 107th Cong. (Sept. 26, 2001) (statement of Former Deputy Secretary Stuart Eizenstat, U.S. Department of the Treasury).

effort to provide additional, more flexible methods of dealing with money laundering problems that fell somewhere in the spectrum between Treasury Advisories and IEEPA sanctions. Mr. Eizenstat also noted that “[r]equiring . . . record retention could prove invaluable to law enforcement and help the government better to understand the specific money laundering mechanisms at work.” Id.

Accordingly, if Treasury’s objective is to impose sanctions on Ukraine as punishment for its failure to adopt international standards against money laundering, it should look to authorities designed to impose sanctions, such as IEEPA or special measure five, rather than using the recordkeeping and information-gathering mechanisms in 31 U.S.C. § 5318A(b)(1) through (4) for this purpose. If instead Treasury is interested in information-gathering, it should provide U.S. financial institutions with more specific direction and appropriate protection.

II. Specific Issues to be Addressed in the Final Special Measures

As stated above, the Associations believe that the parameters of the final Special Measures should be well-defined to reduce the risk of non-compliance by U.S. financial institutions and to avoid undue costs and burdens. We also believe, however, that the final Special Measures must allow for flexibility in determining what steps would be "reasonable and practicable" for an institution to take in complying with the final Special Measures. We recognize that the Notice was not intended to provide all of the details that a final order or regulation would provide, and, therefore, the following suggestions are intended to assist Treasury in drafting the final Special Measures.

A. The Scope of the Final Special Measures Should be More Specific

At the outset, we believe that the Special Measures should provide clear direction to U.S. financial institutions as to Treasury's intentions regarding termination of accounts and blocking of transactions. This is the case not only with imposition of the Ukraine Special Measures, but also with the Nauru Special Measure. Also, we respectfully submit that U.S. financial institutions must receive adequate protection for any action taken with regard to an account or transaction as a result of a Special Measure.

In addition, as stated above, we believe that the final Special Measures should be clear as to their scope, by defining the financial institutions, transactions and accounts that are

intended to be subject to the Special Measures. The Notice does not define these terms. We are very concerned that if the final Special Measures are unclear as to the scope of these terms, it could lead to confusion, inconsistent implementation, increased risk of non-compliance and, ultimately, wasted resources.

For example, the meaning of “accounts,” for purposes of the Special Measures, and the meaning of “financial transactions,” for purposes of the Ukraine Special Measures, is unclear. See 67 Fed. Reg. at 78,862. With respect to accounts, the language of the Notice seems to focus on deposit accounts. The Notice offers no indication as to what other types of accounts, if any, are intended to be covered by the Ukraine Special Measures. The Notice also requires U.S. financial institutions to collect and record ownership data for “financial transaction[s] . . . captured electronically and that [are] over \$50,000,” without defining the term. Id. The types of accounts and transactions that are covered by the Special Measures should be explicitly described.

The meaning of “beneficial ownership” is also unclear. Treasury has proposed a definition of “beneficial ownership” for purposes of Section 312 of the Act (see 67 Fed. Reg. at 37,742), but does not indicate in the Notice as to whether it intends that definition to apply in this context. In our view, the proposed definition for Section 312 would not be appropriate for the Ukraine Special Measures because it is overly broad.

The Notice contains conflicting descriptions of the Nauru Special Measure. Section II of the Notice states that the Nauru Special Measure “will prohibit *financial dealings* by U.S. financial institutions with any Nauru licensed institution” (emphasis added). 67 Fed. Reg. at 78,860. However, Section IV(A) of the Notice describes the Nauru Special Measure as prohibiting financial institutions from “*opening or maintaining* in the United States any correspondent account or payable-through account for a foreign financial institution if the account *involves* Nauru or any institution licensed by Nauru” (emphasis added). 67 Fed. Reg. at 78,862. If the description in Section II of the Notice is the correct one, U.S. financial institutions would need to know precisely what kinds of “financial dealings” are prohibited by the Nauru Special Measure. See id. On the other hand, if the description in Section IV(A) of the Notice is more correct, more ambiguity arises. The scope of this prohibition is potentially extremely broad and could be read to require U.S. financial institutions to close accounts of foreign financial

institutions through which any transaction that “involves” Nauru is accomplished or even attempted.

Without further guidance, the application of the prohibition to accounts that “involve” Nauru could have anomalous and presumably unintended results. For example, an intermediary financial institution could receive a payment order from its foreign respondent financial institution containing a reference in a message field to an invoice of a Nauru trading company. Given the language in the Notice, the intermediary could be required to close the account of the respondent institution from which it received the payment order. We do not believe that Treasury intended for the Nauru Special Measure to produce this outcome, yet it is possible given the ambiguity of the language in the Notice. Further direction is needed in the final Nauru Special Measure as to the scope and meaning of the prohibition.

B. Suspicious Activity Reporting

The Associations respectfully request that Treasury consider providing guidance in the final Special Measures regarding the extent to which transactions and accounts covered by the Special Measures should be reported to the Financial Crimes Enforcement Network pursuant to applicable suspicious activity reporting (“SAR”) rules. In addition, Treasury should clarify in the final Special Measures whether the filing of a SAR (without further action) would be a sufficient response if an institution is unable to obtain the required information under the Ukraine Special Measures after taking reasonable steps, or if the account must be closed.

III. Difficulty and Cost of Compliance

In selecting special measures, the Act requires the Secretary of the Treasury to consider, inter alia, “whether the imposition of any particular special measure would create a significant competitive disadvantage, *including any undue cost or burden associated with compliance*, for financial institutions organized or licensed in the United States.” 31 U.S.C. § 5318A(a)(4)(B) (emphasis added). Moreover, Section 311 contemplates that the Secretary will set out steps that it determines are “reasonable and practicable” to obtain and retain beneficial ownership information. 31 U.S.C. §§ 5318A(b)(1)(B)(iii) and (b)(2). We suggest that Treasury define, via a formal rulemaking or through informal guidance, “reasonable and practicable

steps”⁶ in such a way as to afford institutions flexibility in complying with the final Special Measures. Without that flexibility, we believe that the Ukraine Special Measures will impose considerable costs and burdens on U.S. financial institutions in a number of respects.

The Ukraine Special Measures require U.S. financial institutions to identify and record beneficial ownership information for accounts or transfers with certain characteristics. With respect to the first Ukraine Special Measure, it will be extremely burdensome, and perhaps impossible in some cases, to identify all accountholders with Ukrainian addresses. Our member institutions’ electronic databases may or may not include information that would identify Ukrainian addresses and, therefore, they may be required to place filters or screens in their databases (similar to filters or screens for transactions subject to Office of Foreign Assets Control prohibitions) for every city and town in Ukraine, or do a manual check, to be sure of capturing all accounts. Identification of all transfers of more than \$50,000 where the originating or receiving account is in Ukraine will be particularly difficult. Filters or screens will have to include the names of all Ukrainian banks or other financial institutions to be sure to capture transfers into or out of Ukraine accounts. Further, the potential for false hits is very high. For example, setting up filters or screens to search for “Ukraine” in a structured address field will yield hits for account owners residing in Ukraine, as well as owners residing on Ukraine Street. Institutions would have to manually sift through the relevant accounts and transactions to determine what hits are “legitimate.”

In addition, many non-U.S. financial institutions do not identify by name or address beneficiary or originator information on payment orders, so it will not be possible in many cases to determine the originator or ultimate beneficiary of funds transfers. Treasury should clarify the extent to which U.S. financial institutions will be responsible for obtaining this information.

We are particularly concerned by the beneficial ownership issue. A U.S. financial institution will rarely, if ever, have information on the beneficial ownership of accounts of other

⁶ Indeed, this approach was expressly contemplated by the House Committee on Banking and Financial Services when reporting a predecessor bill out of committee. *See* H.R. Rep. No. 106-728, at 23 (2001) (“The Secretary is encouraged to exercise [its authority to define terms] to define the meaning of the phrase [. . .] “reasonable and practicable steps” for purposes of Sections 5318A(b)(1)(B)(iii) and (b)(2) . . .”).

than its own customers. Moreover, such beneficial ownership information may not be capable of being captured in electronic form, thus increasing exponentially the burden and costs of compliance. For these reasons, we suggest that the requirement to identify and record beneficial ownership information not be absolute, and include a safe harbor for institutions that take “reasonable and practicable” steps to comply with the requirements, yet are unable to do so for reasons outside of their control.

Importantly, the Notice does not set out the steps that a U.S. financial institution should take if it cannot obtain the relevant nominal or beneficial ownership information. For example, the message field in a payment order could include a reference to a Ukrainian import-export company, but the financial institution would have no ability to obtain the required beneficial ownership information. The Notice does not indicate what steps the receiving financial institution should take to ensure compliance with the Special Measures. Potential actions could include rejecting the payment request, blocking it, or closing the account, each of which raises a host of burdens, complications and potential liabilities. Treasury should provide explicit direction for financial institutions in these cases, as well as protection from liability for any actions taken.

In addition, the Notice does not describe *when* a U.S. financial institution must obtain the required information. If the financial institution must obtain the information before executing a payment order or crediting an account of a beneficiary, it may be subject to liability. For example, Uniform Commercial Code Article 4A imposes liability on banks for delay or failure timely to execute payment orders or for failure timely to credit a beneficiary’s account. See U.C.C. §§ 4A-305, 404. If a bank violates Article 4A, it may be liable to pay interest compensation and damages. Id. As a result, the order or regulation imposing the Ukraine Special Measures must be very precise concerning the timing of the collection of this information, and must provide a safe harbor from liability for any actions taken.

As discussed above, the Associations believe that implementation of the Special Measures will require a substantial commitment of resources and, particularly in light of the significant initiatives underway in our member institutions to implement other requirements of the Act, should be given a sufficient implementation period. We respectfully request, therefore,

that the final Special Measures include a delayed effective date in order allow institutions time to comply.

In addition, we are concerned that compliance with these identification and recordkeeping requirements may be highly difficult, or even impossible, in certain circumstances, leaving U.S. financial institutions at substantial risk of violating the Special Measures. This particularly will be the case if the Ukraine Special Measures are imposed by order. For example, it is likely impossible to implement the types of filters or screens necessary to capture transactions and accounts involving Ukraine, as described above, within the 120-day period of an order issued pursuant to Section 311. To the extent that Treasury decides to impose the Ukraine Special Measures by order, we respectfully request that Treasury give institutions more flexibility in complying with the Special Measures during the initial period, e.g., by defining what “reasonable and practicable” steps are required during this period.

* * *

The Associations appreciate the opportunity to comment on the Notice, and would be pleased to discuss any of the points made in this letter in more detail. Should you have any questions, please contact Norman R. Nelson, General Counsel of the Clearing House, at (212) 612-9205, Thomas L. Farmer, General Counsel of the Bankers’ Association for Finance and Trade, at (202) 663-5537 or Alan Sorcher, Associate General Counsel of the Securities Industry Association, at (202) 296-9410.

Very truly yours,