Securities Industry Association
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Via Electronic Mail

February 11, 2002

Office of the Assistant General Counsel (Enforcement)
Attention: Official Comment Record
Room 2000
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Counter Money Laundering Requirements – Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks, Notice of Proposed Rulemaking, 31 C.F.R. Part 104

Dear Sir or Madam:

The Securities Industry Association ("SIA")[1] appreciates this opportunity to comment on the proposed rule (the "Proposed Rule") that the Department of the Treasury ("Treasury") has issued with respect to sections 313 and 319(b) of the USA PATRIOT Act (the "PATRIOT Act" or the "Act"), adding new anti-money laundering sections to the Bank Secrecy Act ("BSA"). The

[1] The SIA brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, brokers-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 million investors directly and indirectly through corporate, thrift and pension plans. The industry generates $358 billion of revenue and employs approximately 760,000 individuals. (More information about the SIA is available on its home page: http://www.sia.com.)

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purpose of those amendments is to "make it easier to prevent, detect, and prosecute international money laundering and the financing of terrorism." In general, section 313 prohibits covered financial institutions from providing correspondent accounts to foreign shell banks and requires them to take reasonable steps to ensure that correspondent accounts are not used indirectly to provide banking services to foreign shell banks. Section 319(b) requires financial institutions that provide correspondent accounts to foreign banks to keep records of the owners of the foreign banks and the names and addresses of their agents for service of process in the United States.

As Treasury is aware, the SIA and the securities industry are strongly committed to the prevention of money laundering and terrorism, and have continually been working with Treasury to help develop sound and effective rules to protect U.S. securities firms from being used for those purposes. Indeed, the securities industry's commitment to preventing money laundering and terrorism is exemplified by the fact that many securities firms have voluntarily adopted practices and procedures to detect and prevent money laundering that go beyond existing regulations. The SIA and the securities industry have, in addition, worked with the Office of Foreign Assets Control ("OFAC") both to provide input to OFAC regarding industry practices and to educate firms about issues within OFAC's purview. Since the September 11 terrorist attacks, the SIA and the securities industry have been working closely with Treasury and the Securities and Exchange Commission ("SEC"), as well as other regulators and law enforcement, to identify terrorists and to cut off their access to financial markets. The SIA thus applauds the passage of the PATRIOT Act as a significant step towards further protecting the U.S. financial system. Moreover, the SIA believes that generally the approach Treasury has taken in the Proposed Rule of creating a certification process is a practical and effective means of implementing the Act's objectives.

Notwithstanding the SIA's support of the goals of the PATRIOT Act, it must be recognized that due to the Act's swift passage, necessitated by the need to take prompt action in response to the terrorist attacks on our nation, many of its key elements require further explication.[2] Thus, although the SIA generally supports the approach that Treasury has taken in the Proposed Rule, we believe that further limited refinements are necessary to provide clarification to financial

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2 See generally *Oxley Predicts Corrections Package Covering New Money Laundering Law*, 11 BNA A-35 (Jan. 16, 2002), in which House Financial Services Chairman Michael Oxley (R-Ohio) comments during a January 15, 2002 teleconference with members of the banking industry that because the Act was quickly drafted in the final weeks of 2001, "[i]t is almost mandatory to follow up with a technical corrections package . . . ."

institutions, including broker-dealers, and to further the Act’s objectives. Accordingly, the SIA raises below several recommendations, which we hope will contribute to the development of a final rule that will strike an appropriate balance between advancing the Act’s goals and avoiding unnecessary burdens on financial institutions or discouraging legitimate foreign investment in U.S. financial markets.

The SIA’s recommendations address two general areas for possible refinement and explication: definitions and compliance procedures. The definitional refinements the SIA suggests are (i) for purposes of section 319(b), which requires ownership information for foreign banks, the definition of “correspondent bank” should exclude accounts for which ownership has already been subject to close scrutiny by an authoritative source; (ii) the definition of "correspondent bank" should also exclude for purposes of section 319(b) certain transactions in which a foreign bank is a market participant; (iii) the term “foreign branches” should be excluded from the definition of covered financial institution consistent with the terms of the PATRIOT Act; and (iv) in order to assure parity between the banking and securities industries, the exception permitting correspondent accounts for shell banks that are regulated affiliates of depository institutions should be expanded to include those that are regulated affiliates of broker-dealers.

The recommendations the SIA makes with respect to the Act’s compliance procedures are (i) elimination of unnecessary duplication in recordkeeping in order to maximize resources available to detect and deter money laundering and terrorism; (ii) clarification of the safe harbor provisions to reflect that they apply to financial institutions relying on Forms FR Y-7; (iii) expansion of the provisions requiring termination of accounts to permit freezing accounts and other market action when termination is not feasible, and extension of the Act's limitation on liability provision to include such acts; (iv) creation of a certification enabling foreign banks to identify themselves, and allotment of additional time for financial institutions to review established accounts; (v) adoption of a negative recertification process to take place every three years; and (vi) clarification that the term "original" applies to electronic and facsimile documents and deletion of, or further explication on, the term "accepted" in the certification and recertification forms.

Finally, we propose some long-term alternatives that we believe will make the Act more effective by helping financial institutions identify foreign shell banks and expediting the certification process.

I. TREASURY SHOULD REFINE CERTAIN DEFINITIONS APPLICABLE TO THE ACT

Treasury has asked for comment with respect to the breadth of the definition of correspondent account, including, among other things, the extent to which different types of accounts may be used, directly or indirectly, to provide financial services to foreign shell banks; the extent to which different types of accounts may be used to facilitate money laundering or other criminal transactions; and whether particular types of accounts pose so little vulnerability to criminal transactions as to merit exclusion from the broad definition of "correspondent account." It also requested comment on the "adverse business implications" of adopting the broad definition.

In response to those requests, we suggest that this legislation would best be served by a definition of “correspondent account” that varies in relation to the legislative intent behind the Act’s different sections. For instance, a very broad definition of “correspondent account” is appropriate for section 313, which is intended to create a blanket prohibition against dealings with unregulated foreign shell banks. The purpose of section 319(b), on the other hand, is to require recordkeeping as a means of identifying foreign banks whose owners may be money laundering or terrorism risks and ensuring that process can be served on such banks. Thus, the definition of “correspondent account” for section 319(b) should exclude accounts with foreign banks whose ownership already has been subject to close scrutiny by an authoritative source. Section 312, which appears to be concerned with identifying beneficial owners of accounts, might best be served by a definition of “correspondent account” that takes into consideration both the ownership of the foreign bank and the customers it serves. On the other hand, section 311 appears to operate as a catch-all provision.[3]

A. <u>For Purposes Of Sections 319(b), The Definition Of "Correspondent Account" Should Exclude Accounts For Which Ownership Has Already Been Subject To Close Scrutiny By An Authoritative Source</u>

While the statute defines “correspondent account” for banks, Congress specifically delegated to Treasury the responsibility to "define by

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[3] The SIA intends to provide detailed comment on sections 311 and 312 at such time that the implementing regulations are proposed but notes its concern that an extension of the broad definition of "correspondent account" might present significant problems in the application of the due diligence and enhanced due diligence requirements.

regulation the term 'account'" for broker-dealers and other non-bank financial institutions, and to include within the meaning of that term "arrangements similar to . . . correspondent accounts." PATRIOT Act § 311. Treasury now proposes for purposes of sections 313 and 319(b) to adopt for broker-dealers the definition of correspondent account that the Act applied to banking institutions: "an account established to receive deposits from, make payments on behalf of a foreign bank, or handle other financial transactions related to such bank." See Proposed 31 C.F.R. § 104.10(b); PATRIOT Act § 311(a).

The SIA supports Treasury's approach, advocated by the SIA, to broadly construe the term "correspondent account" with respect to the shell bank provisions of the Act found in section 313. However – as perhaps is contemplated by the nature of Treasury's requests for comments – that approach is overly broad with respect to section 319(b). In this regard, we note that recently, Senator Carl Levin, a chief architect of the PATRIOT Act, emphasized

> the need . . . to focus our anti-money laundering efforts on the highest risks. It is important to realize that this principle is embedded in the new law, which is designed to focus scarce resources on the worst problems – such as shell banks, offshore jurisdictions, and noncooperative countries.[4]

Accordingly, for purposes of section 319(b), Treasury should carve out from the definition of "correspondent account" accounts for which ownership has already been subject to close scrutiny by an authoritative source and that therefore pose minimal, if any, risk of being used to launder money or finance terrorism. Those accounts include:

1. **Correspondent Accounts Held by Certain Publicly Traded Foreign Banks**

Although the SIA recognizes that the collection of ownership information pursuant to section 319(b)'s recordkeeping provisions might serve to help financial institutions recognize privately held foreign banks that are controlled by suspicious entities or individuals, we believe that the recordkeeping provisions relating to ownership are unnecessary with respect to certain classes of publicly

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4 *Hearing on The Financial War on Terrorism and the Administration's Implementation of the Anti-Money Laundering Provisions of the USA Patriot Act, Prepared Statement of the Honorable Carl Levin (D-Mi) United States Senator* (Jan. 29, 2002), available at http://www.senate.gov/banking.

traded foreign banks – for example, banks whose shares are traded on an exchange that is a member of the International Federation of Stock Exchanges ("FIBV")[5] or are regulated by member of the International Organization of Securities Commissions ("IOSCO").[6] Such publicly-traded banks are already subject to myriad regulations which would make it extremely unlikely for them to be controlled by people or entities involved in money laundering or financing of terrorism. In addition, the identity of large shareholders would, in certain instances, be a matter of public record pursuant to securities reporting requirements. Thus, we believe that the Act's recordkeeping provisions should not apply to such financial institutions.[7]

Indeed, such an exemption would be consistent with the Act's "enhanced due diligence" requirements of section 312, which require covered financial institutions to ascertain ownership identity of foreign offshore banks and foreign banks in noncooperative jurisdictions, but only to the extent that their shares are "not publicly traded." Thus, by not requiring covered financial institutions to obtain their ownership information from publicly traded foreign banks under section 319(b)'s recordkeeping requirements, Treasury would bring the rules governing section 319(b) into harmony with the statutory language of section 312.

2. **Correspondent Accounts Held by Qualified Intermediaries**

In select instances, the U.S. Internal Revenue Service (the "IRS") permits U.S. financial institutions to rely on foreign financial institutions that are

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5 FIBV is the global trade association for the exchange industry. Its membership is comprised of 55 regulated exchanges and accounts for 97% of the world stock market capitalization. To become a FIBV member, an exchange must pass an application and due diligence review process, and must adhere to specific market principles, including honesty and fairness, diligence, capabilities, maintenance of customer information, disclosure of information to customers, avoidance of conflicts of interest and compliance with all regulatory requirements. More information about the FIBV is available at http://www.fibv.com.

6 IOSCO is an international organization of securities regulators established to promote high standards of regulation, to establish effective surveillance of international securities transactions and to promote the integrity of the markets by a rigorous application of its standards and by effective enforcement against offenses. More information about the IOSCO is available at http://www.iosco.org.

7 We suggest that in order to facilitate the administration of this and the other exemptions we propose to the definition of "correspondent account", Treasury should amend the model certification form by adding a "check off" box in which a foreign bank can indicate whether it falls within an exemption and thus need not report its ownership information.

"Qualified Intermediaries" ("QIs") to administer the withholding of taxes on behalf of its customers, without having to provide the IRS with documentation as to the identity or tax status of those customers. In order to become a QI, a foreign financial institution must enter into a 60-page agreement with the IRS, in which the QI agrees to abide by numerous IRS procedures, including the maintenance of know-your-customer documentation on its account holders, and consents to being audited by the IRS or an auditor approved by the IRS. In determining whether to approve a foreign financial institution as a QI, the IRS considers, among other things, (i) the type of know-your-customer laws and practices to which the foreign financial institution is subject; (ii) the extent and nature of supervisory and regulatory control exercised under the laws of the foreign country over the foreign customers; and (iii) the financial condition of the foreign person. See generally Treas. Reg. §1.1441-1.

Because QIs are subject to such intense scrutiny prior to their status being approved by the IRS, they are highly unlikely to be controlled by individuals involved in money laundering and/or terrorism activities. Accordingly, an exemption from ownership reporting requirements for foreign banks that have been approved as QIs would be appropriate and consistent with the position of trust granted to them by the IRS.

3. Correspondent Accounts Held by Banks In FATF Member Countries

We also propose exempting from the requirements of section 319(b) correspondent accounts held by foreign banks that are subject to the laws of members of the Financial Action Task Force on Money Laundering ("FATF"). As Treasury is aware, FATF is an intergovernmental body established to develop and promote policies to combat money laundering. Its members[8] are strongly committed to the implementation of the FATF-developed "Forty Recommendations" for setting forth a framework for anti-money laundering efforts. Among those recommendations are (i) the criminalization of the laundering of proceeds of serious crimes and the enactment of laws to seize and confiscate the crime proceeds; (ii) the requirement that financial institutions identify all clients, including any beneficial owners of property, and to keep appropriate records; and (iii) the obligation of financial institutions to report suspicious transactions to competent national authorities. Because FATF members

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[8] FATF's 29 member countries are Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Kingdom of the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

are leaders in the international efforts against money laundering and because they represent the locales with the most stringent anti-money laundering legislation, accounts held by foreign banks subject to regulation by FATF members are very unlikely to be owned by entities or individuals that pose money laundering or terrorism risks.

Like our suggestion to exempt accounts held by publicly-traded banks, this approach would also serve to harmonize the recordkeeping requirements of section 319(b) with the due diligence provisions of section 312. In particular, section 312 requires information on the owners of foreign banks to be obtained for purposes of "enhanced due diligence" – that is, due diligence performed with respect to offshore banks and banks licensed in "noncooperative" countries. Under the Proposed Rule, however, financial institutions would be required to obtain that information for all accounts, even those of banks regulated by FATF member countries. This would eviscerate the distinction drawn by Congress between the level of scrutiny appropriate for banks from those countries that are committed to preventing money laundering and those that are not.[9]

4. <u>**Accounts For Holding Pension Plan Assets**</u>

Accounts for investment of pension funds also pose a minimal risk of being used to launder money or fund terrorism. For example, under certain circumstances, foreign banks are permitted to hold assets of a qualified plan under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). These accounts should not be considered "correspondent accounts" for purposes of section 319(b).

Section 2550.404b-1 of the Department of Labor Regulations sets forth the very restrictive scheme under which the Department of Labor will deem a foreign bank eligible to hold qualified plan assets. Among other conditions, the foreign bank must (i) be "supervised or regulated by a government agency or regulatory authority in the foreign jurisdiction having authority" over such bank; (ii) be "liable to the plan"; and (iii) identify, upon request, the "name, address and principal place of business of the foreign entity which acts as custodian for the plan and the name and address of the governmental agency or other regulatory authority that supervises or regulates that foreign entity." These regulations make clear that

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9 This carve-out would also be consistent with the United Kingdom's Financial Services and Markets Act 2000, a comprehensive anti-money laundering law that exempts customers from a list of well-regulated countries from certain customer identification and recordkeeping requirements.

foreign banks eligible to hold ERISA plan assets are not likely to pose an appreciable money laundering risk.

Moreover, because pension plans qualified under ERISA are subject to complex U.S. regulatory schemes, which include, among other things, high penalties for early withdrawal, they would not be attractive as money laundering or terrorism finance vehicles. For these reasons, accounts held by foreign banks that hold assets of regulated foreign pension or retirement plans should similarly be exempted.

B. The Definition Of "Correspondent Account" Should Exclude For Purposes Of Section 319(b) Certain Transactions In Which A Foreign Bank Is A Market Participant

It should be noted that foreign banks play an integral role as market participants in the capital markets area, including in investment banking transactions as members of syndicates or as counterparties in securities trades. This fact should not be overlooked as Treasury implements this legislation.

Thus, transactions on which foreign banks are counterparties subject to extensive due diligence, such as foreign exchange ("forex"), derivatives and other capital markets transactions, also should be excluded from the definition of "correspondent account" for purposes of section 319(b). Due to the level of due diligence that already is performed, these transactions present very little risk of being used for money laundering or financing terrorism.[10]

In particular, because forex and derivatives transactions require an extension of credit, foreign banks and other counterparties to those transactions are subject to a thorough due diligence review. Foreign banks that are counterparties to capital markets transactions, which ordinarily require broker-dealers to assume transaction-related and credit risks, are subject to a similarly high level of due diligence. Indeed, the report by the Minority Staff of the U.S. Senate Permanent Subcommittee On Investigations entitled "Report On Correspondent Banking: A Gateway to Money Laundering" (the "Levin Report") recognized that where there

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[10] Because these transactions often do not occur through "accounts", they occasionally may, as a threshold matter, technically fall outside the definition of "correspondent account." For instance, forex trading typically is conducted on a transaction-by-transaction basis without the use of an account. While some derivative products, like listed options, trade through accounts, certain derivatives trades like swaps are done on a transaction-by-transaction basis. Capital market transactions, such as underwritings, securities offerings and other investment banking activities, also are not typically conducted through traditional client accounts.

is an extension of credit to a foreign bank, due diligence is conducted to evaluate "the foreign bank's management, finances, business activities, reputation, regulatory environment and operating procedures." Levin Report at 4.

As the Levin Report found, transactions involving a thorough due diligence review tend not to pose significant money laundering risks: "Money launderers are primarily interested in services that facilitate the swift and anonymous movement of funds across international lines. These services do not require credit relationships." Levin Report at 35. See also Id. at 4. Thus, the Levin Report concluded that "[f]oreign banks intending to launder funds may choose to limit their correspondent relationships to non-credit services to avoid scrutiny and move money quickly, with few questions asked." Id. at 35. Because existing procedures for due diligence on counterparties to forex, derivatives and other capital markets transactions serve the dual purpose of identifying and, consequently, deterring money launderers and terrorists, they warrant exclusion from the definition of "correspondent account" for purposes of section 319(b).

However, in the event that Treasury nonetheless deems these transactions "correspondent accounts", it should recognize that since they frequently have been conducted on a transaction-by-transaction basis, gathering the required information for "established accounts" will be very difficult and, in many cases, impossible. Thus, for these transactions, the information required by the Act can only reasonably be obtained prospectively.[11]

C. "Foreign Branches" Should Be Excluded From The Definition of Covered Financial Institution

The Proposed Rule covers not only U.S. financial institutions, but also any "correspondent accounts provided by a foreign branch of a covered financial institution to a foreign bank." See Proposed 31 C.F.R. §§ 104.10(c), 104.40(a). Treasury has requested comment on the extent to which correspondent accounts provided by foreign branches of covered financial institutions to foreign banks are actually established, maintained, administered or managed in the United States and whether imposing the shell bank prohibition on foreign branches of covered

[11] As an additional minor technical matter, Treasury states that "futures accounts to purchase futures" would be correspondent accounts. Futures accounts are held for trading, or for buying and selling futures and options on futures, never simply for purchasing. We suggest this language be amended to describe accounts for trading of futures or options on futures, or for the purchase and sale of futures or options on futures.

financial institutions is commensurate with the size, location, and activities of such institutions.

We do not believe that the inclusion of foreign branches is consistent with the intent of the Act, which repeatedly states that its concern is with accounts maintained "in the United States." For instance, section 313 states that a covered financial institution shall not "establish, maintain, administer, or manage a correspondent account *in the United States*" for a foreign shell bank. Section 319(b) likewise specifies that it is applicable to any "covered financial institution which maintains a correspondent account *in the United States* for a foreign bank." Moreover, the application of section 319(b) to foreign branches not only would create tension between this unambiguous statutory language and its implementing regulations, but it also would place foreign branches in the untenable position of potentially having to violate the laws of their jurisdictions and breach their own record keeping obligations in order to comply with U.S. laws. Given these concerns, the term "foreign branch" should be excluded from the Proposed Rule.

D. Section 313's "Regulated Affiliate" Exception Should Be Expanded To Include Regulated Affiliates of Broker-Dealers

Section 313(a) provides an exception to the general prohibition against providing correspondent accounts to shell banks for those shell banks that are (i) "affiliates" of depository institutions, credit unions, or foreign banks that maintain a physical presence in the United States or a foreign country; and (ii) subject to supervision by the banking authority in that country. See PATRIOT Act § 313(a).

This portion of the Act overlooks the fact that some reputable broker-dealers may have foreign affiliates that are organized as banks and, notwithstanding their lack of a physical presence in that jurisdiction, are subject to supervision by virtue of their affiliation with those broker-dealers. Because the Act applies to a broader range of financial institutions than the banking industry, to which the Act's language is sometimes more directly focused, Congress granted Treasury "broad discretion" to develop "compliance obligations of securities brokers and dealers." Given Treasury's commitment "to maintain parity in treatment" between the banking and securities industries, Treasury should construe the "regulated affiliate" exception to include regulated affiliates of broker-dealers.[12]

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[12] We believe this situation arises because of the last-minute inclusion of broker-dealers in the definition of "covered financial institution" without amending corresponding provisions of the Act. The SIA suggests that Treasury can alleviate this inconsistency by defining "correspondent account" for broker-dealers as excluding accounts for regulated affiliates of

Indeed, because these affiliates are regulated, they are distinguishable from entities of concern to Congress, with "weak financial supervisory and enforcement regimes" and would therefore pose no greater money laundering risk than would similarly situated affiliates of regulated banks. PATRIOT Act § 302(a)(4). In contrast, denial of the exception to shell bank affiliates of regulated broker-dealers would effectively preclude any financial institution from dealing with those institutions, even though they are affiliated with regulated entities.

The SIA therefore urges Treasury to broaden the regulated affiliate exception so that it applies to foreign banks that are regulated affiliates of broker-dealers that maintain a physical presence in the United States or a foreign country and that are subject to supervision by the securities authority in that country.

II. CERTAIN PROCEDURES FOR COMPLIANCE WITH THE ACT SHOULD BE REFINED AND CLARIFIED

A. Treasury Should Not Require Unnecessary Duplication In the Collection Of Certification and Recertification Forms

The Proposed Rule is unclear as to whether responses to model certification and recertification forms must be obtained for each account, or whether it is sufficient to obtain a completed form for each foreign bank, regardless of whether that foreign bank has more than one account with the covered financial institution. Because mandating covered financial institutions to obtain completed forms for each account would be unnecessarily duplicative and would not seem to serve any anti-money laundering or anti-terrorism purpose, we propose that the regulation make clear that completed forms need only be obtained for each foreign bank, not for each account of each foreign bank. We note that the model forms, which seek information on foreign banks with "one *or more*" correspondent accounts, appear to contemplate this approach. (emphasis added).

Another efficiency that would advance the Act's objectives would be to permit financial institutions to rely on forms obtained by their parent companies, subsidiaries or affiliates. In this way, financial institutions within, for instance, the same bank holding company would be able to pool their information on foreign banks and coordinate efforts to identify shell banks or other suspicious entities or accounts, thus enabling them efficiently to meet their obligations under the Act.

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broker-dealers. However, to the extent that such a construction may require Treasury to seek Congressional approval, such a modification would be appropriate given Congress' acknowledgement that "technical corrections" may be necessary. See n.1, supra.

On a related point, we suggest that it is unnecessary to obtain duplicate forms for foreign bank parent companies and their subsidiaries. Because the ownership information supplied by a parent bank ordinarily will reflect the ownership information for each of its wholly-owned subsidiary banks, it seems unnecessarily redundant to require covered financial institutions separately to collect forms from the parent bank and its wholly-owned subsidiaries. A more streamlined but equally effective alternative would be to allow a parent bank's model certification or recertification form to fulfill section 319(b)'s requirements for itself and each of its wholly-owned subsidiary banks.

Similarly duplicative is the fact that the Proposed Rule may result in multiple model forms being obtained for the same account from two different brokerage firms. For example, both an introducing broker and a clearing broker might be required under the Proposed Rule to obtain identical forms for the same account. A prime broker might also be viewed as being required to obtain the same documentation as an executing broker for the same account. The Proposed Rule should recognize that the present regulatory scheme allows such firms contractually to allocate account responsibilities between themselves. See NYSE Rule 382(b). Thus, if one firm agrees either in such a contract or pursuant to other regulations permitting the division of account responsibilities to take responsibility for obtaining the model certification or recertification form for the account and to make a copy of it available to the other firm, that should suffice to bring both firms within the safe harbor.[13]

B. The Act's Safe Harbor Provisions Should Be Clarified To Reflect That They Apply To Financial Institutions Relying On Forms FR Y-7

Under the Proposed Rule, financial institutions are not required to use the model forms provided by Treasury. However, financial institutions that opt to do so may avail themselves of a "safe harbor" for purposes of compliance with sections 313 and 319(b). In the preamble to the Proposed Rule, Treasury states that covered financial institutions can alternatively "meet [their] recordkeeping obligations" under section 319(b) by using the current Forms FR Y-7[14] filed by the

[13] For example, with respect to futures accounts, the model certification and recertification forms would be obtained (i) either by the clearing broker or the executing broker in the case of give-up transactions; and (ii) either by a broker that introduces an account or the broker that carries the account.

[14] Foreign banks that maintain U.S. branches or agencies are required annually to file with the Federal Reserve a Form FR Y-7. The Federal Reserve describes the form as "an annual

foreign bank. The SIA's concern is that the Proposed Rule does not provide a safe harbor for financial institutions that choose the FR Y-7 alternative. We believe that this omission is simply an oversight. The SIA is similarly concerned that the FR Y-7 should enable a financial institution to meet the obligations imposed by the Act pursuant to the requirements of section 313.

Forms FR Y-7 provide information that is substantially similar to the information that is to be obtained by way of the model certification forms. In addition, because they are reviewed by the Board of Governors of the Federal Reserve System "to determine compliance with U.S. laws and regulations", they are presumptively reliable. See Instructions to the FR Y-7 at www.federalreserve.gov. As Treasury has identified the FR Y-7 as a means of meeting the Act's recordkeeping obligations, it has apparently determined that the form is a satisfactory means of obtaining the requisite information. Thus, there does not appear to be any basis for denying safe harbor protection for U.S. branches or agencies of foreign banks that opt to rely on the Forms FR Y-7. Indeed, because the ability to rely on Forms FR Y-7 will ease the administration of the Act's recordkeeping provisions without compromising the effectiveness of the Act, this option should be encouraged by way of an extension of the safe harbor protections.

In addition, it is unclear whether reliance on a FR Y-7 to "meet . . . recordkeeping obligations" could fulfill a covered financial institution's obligations under section 313. The model certification and recertification forms provided by Treasury fulfill a financial institution's obligations for both sections 313 and 319(b). If obtaining a FR Y-7 only fulfills an institution's obligations under 319(b), then it will still be required to obtain a certification form from the foreign bank. Under this scenario, a covered financial institution opting for the FR Y-7 approach would realize little benefit. We do not believe that Treasury intended such a result when it provided for use of the FR Y-7 to fulfill recordkeeping obligations.

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report of FBOs [foreign banking organizations] that have a U.S. banking presence." The report collects financial statements, nonbank subsidiary financial statements, shares and shareholder information, and data on the eligibility to be a qualified FBO as defined in Regulation K (of the Board of Governors of the Federal Reserve System,12 CFR § 211.23)." http://www.federalreserve.gov. It requires a foreign bank to supply, among other things, the name and address of its agent for service of process in the United States and information on the foreign bank's ownership.

In our view, banks that are required to file Forms FR Y-7 are not shell banks. This conclusion is based on the facts that (i) Forms FR Y-7 are required of foreign banks that have a "banking presence" in the United States; (ii) the form itself requires the foreign bank to list the street address of its principal office, the "physical location" of its principal office, and its mailing address; and (ii) foreign banks required to file Forms FR Y-7 include all foreign banking organizations "that are organized under the laws of a foreign country and that are engaged in the business of banking in the United States through subsidiary banks, Edge or agreement corporations, subsidiary commercial lending companies, or their own branches or agencies."

Assuming that a bank filing an FR Y-7 is by definition not a shell bank, it seems only reasonable that by obtaining a copy of a current FR Y-7, a financial institution should satisfy its obligations under both sections 313 and 319(b) and obtain a safe harbor for the institution under both sections.

Alternatively, the SIA proposes that, to the extent that Treasury believes that an FR Y-7 will not provide certain information required by the Act, the Proposed Rule be amended to require foreign banks providing Forms FR Y-7 to answer only Question 2 of the model certification form, calling for information relating to shell banks.

C. The Account Termination Provisions Should Be Amended To Protect Broker-Dealers From Liability For Necessary Acts Such As Liquidation, And To Permit Freezing Illiquid Positions When Termination is Not Feasible

The PATRIOT Act requires "termination" of correspondent accounts under section 319(b) in instances where the foreign bank customer fails to provide account records in response to a lawful request by Treasury or the Attorney General of the United States. See USA PATRIOT Act § 319(b), 31 U.S.C. § 5318(k)(3)(C). The Proposed Rule adds a provision requiring termination where the foreign bank customer fails to provide to the covered financial institution the information necessary for the recordkeeping requirements of section 319(b). See Proposed 31 C.F.R. § 104.40(d).

The SIA has serious concerns regarding the mechanics of terminating accounts at broker-dealers. The Proposed Rule states that covered financial institutions that terminate accounts "shall not be liable" for such termination. It also recognizes that with respect to accounts that have "open securities or futures positions" at the time of termination, covered financial institutions may exercise "commercially reasonable discretion in liquidating such open positions." While we appreciate Treasury's inclusion of this language to assist broker-dealers, we are concerned that those provisions may not go far enough to protect broker-dealers.

Indeed, account termination can pose unique and complex problems for broker-dealers and their customers. For instance, while funds (as opposed to securities) in a securities account can be transferred to any bank, including a foreign bank, an account containing U.S. securities must be transferred to a U.S. registered broker-dealer. Presumably, however, Treasury would not approve of securities from an account closed pursuant to the Proposed Rule being delivered to an account at another U.S. broker-dealer. Some securities could of course be delivered to clients, but in many situations, the requirement to terminate the account places the securities firm in the position of taking market action and liquidating the position without the customer's consent, possibly in conflict with the customer's investment strategy.

This general situation is further complicated by the fact that many products sold by broker-dealers may not be transferable or may impose penalties for early liquidation. For instance, broker-dealers often sell proprietary products, such as mutual funds that can only be held by that broker-dealer. Transfer in those cases, even to another U.S. broker-dealer, would be impossible. Some funds impose penalties for early withdrawal. Moreover, an account may well have illiquid positions, such as partnership interests. Still other transactions may involve futures and derivatives positions, the unwinding of which could have a significant negative economic impact on the customer.

An alternative that would largely avoid these problems would be for Treasury to permit broker-dealers to freeze, rather than terminate, securities accounts. In such a situation, the broker-dealer would not be permitted to accept any orders except to liquidate the account. Placing a freeze on an account is a much more workable solution.[15] It would address any money laundering concerns with the account while providing fewer opportunities for broker-dealers to breach their obligations to their customers, and protecting the investments of customers that may innocently have missed a deadline or otherwise inadvertently run afoul of this complex new law. However, to the extent that Treasury believes that freezing will not always be a suitable option, it should, at a minimum, permit broker-dealers

15 Compare the procedure under the OFAC sanctions program in which freezing is required when a financial institution determines that a customer's name is on the OFAC list.

to freeze proprietary products, non-liquid securities, and any other products that cannot be liquidated.[16]

Most importantly, because the limitation on liability provision of the Proposed Rule protects financial institutions that "terminate" accounts, but does not specifically provide protection for account liquidation or other actions broker-dealers may need to take in order to comply with the Act, broker-dealers may be exposed to liability for such necessary acts. Thus, the limitation on liability provision must explicitly be extended to include account liquidation, freezing of accounts or other actions that broker-dealers may be required or permitted to take in order to comply with the Act and Treasury's regulations.

Moreover, our apprehension about potential liability for covered financial institutions is exacerbated by the fact it is not clear that the Act even permits the creation of a requirement that compels termination in any instances other than the considerably more narrow termination requirement established by Congress. Although Congress specifically provided for termination upon notice from the Secretary of the Treasury or the Attorney General that a foreign bank failed to comply with a lawful request for records, Treasury's proposal requiring a financial institution to terminate accounts solely upon the financial institution's own determination that a deadline has passed for failure to provide information required under section 319(b), is not referenced in the Act. The SIA urges Treasury carefully to scrutinize this new termination requirement prior to the enactment of its final rule. To the extent that Treasury may have gone beyond the statute in creating this new termination requirement, we are concerned that the limitation on liability provision of the Proposed Rule may not ultimately protect covered financial institutions.

D. Treasury Should Amend The Model Certification Form To Enable Foreign Banks To Identify Themselves And Should Provide Additional Time For Financial Institutions To Review Established Accounts

As noted, section 313 of the PATRIOT Act prohibits financial institutions from providing correspondent accounts to foreign shell banks, and section 319(b) requires financial institutions to maintain records of the owners and U.S. agents for service of process of their foreign bank customers. See PATRIOT Act §§ 313(a), 319(b); 31 U.S.C. §§ 5318(j) and (k).

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[16] The rule should recognize that when terminating, liquidating or freezing a margin account, broker-dealers are permitted to satisfy the margin debt.

Treasury has requested comment on whether the term "foreign bank" should be defined more specifically.[17] Although the SIA believes that the current definition of "foreign bank" generally makes clear that it is intended to encompass foreign banking institutions, we are concerned about the difficulties financial institutions may encounter in implementing certain requirements of sections 313 and 319(b) that relate to foreign banks. For instance, as this definition did not previously exist, records of established accounts may be unclear as to whether the holder of the account is a foreign bank as defined by the proposed rule. In such instances, financial institutions should be permitted reasonably to rely on representations by those account holders as to whether they fall within the definition. We suggest, therefore, that Treasury include a section in the model certification form in which an account holder can indicate whether or not it is a foreign bank under the Act. The SIA proposes the following language for such a certification:

The undersigned: ___ (i) is organized under the laws of a foreign country; (ii) engages in the business of banking; (iii) is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations; and (iv) receives deposits in its regular course of business (hereinafter referred to as a "foreign bank").

___ is not a foreign bank.

In addition, the SIA believes that Treasury has underestimated the amount of time needed for financial institutions to fulfill the Act's requirement that they review and obtain information on all established accounts. Given the Proposed Rule's broad interpretation of the term "correspondent account", this may not be achievable in the time allotted.[18] In light of the breadth of such a review and the importance of its accuracy, the SIA requests an additional 90 days for broker-dealers to obtain the required information for established accounts.

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[17] The Proposed Rule defines "foreign bank" as any organization that (i) is organized under the laws of any foreign country; (ii) engages in the business of banking; (iii) is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal banking operations; and (iv) receives deposits in its regular course of business. See Proposed 31 C.F.R. § 104.10(f).

[18] Under the Proposed Rule, information on established accounts must be obtained not later than 90 days after publication of the final rule.

E. **The Recertification Process Should Be Modified To Require A Negative Certification Process That Takes Place Every 3 Years**

The Proposed Rule states that information provided by a foreign bank pursuant to sections 313 and 319(b) must be verified every two years or at any time a covered financial institution has reason to believe that the previously provided information is no longer accurate. See Proposed 31 C.F.R. § 104.40(c). A model recertification form, which would provide a safe harbor, is provided for this purpose.

The SIA concurs that it is necessary for covered financial institutions to keep current the information required by those sections, but notes that there is a serious administrative burden in requiring financial institutions to recertify or verify information kept on file for foreign banks. The SIA suggests that an effective alternative approach would be a "negative affirmation" procedure and that this process take place every three years instead of every two years. Under this approach, covered financial institutions would send their correspondent account customers model recertification forms as required at the required time period (*e.g.*, every three years), but would require those customers to complete and return the form only if their information has changed, or if the information is no longer accurate. Covered financial institutions would thus be permitted to assume that their records are current if they do not receive updated forms.

The proposed three-year period derives from the fact that foreign banks must update the information contained in their Forms W-8 every three years for purposes of the United States withholding tax rules. Because many such banks will also be affected by the Proposed Rule, we believe that the recertification procedure under section 319(b) should be made consistent with the time period for updating Form W-8 filings by foreign banks, that is, every three years. Thus, a three year recertification would alleviate to some extent the administrative requirement on both foreign banks and U.S. institutions, while not compromising any of the goals of the Act. This is particularly the case given that required information must, in any event, be verified "at any time a covered financial institution has reason to believe that the previously provided information is no longer accurate."

F. **The Proposed Rule Should Make Clear That The Term "Original" Applies To Electronic And Facsimile Documents**

We also note that the Proposed Rule's requirement that covered financial institutions retain the "original" of any document provided by a foreign bank requires clarification in light of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 (2000) (the "E-Sign Act"), which gives legal effect to electronic records and signatures. Although we assume that E-Sign applies to the Act, that should be made clear in the Proposed Rule. [19] Similarly, documents obtained via facsimile are also considered to be equivalent to original documents. See, e.g., Fed. R. Evid. 1003 (unless a genuine question is raised as to authenticity or it would be unfair to admit a duplicate in lieu of the original, "a duplicate is admissible to the same extent as an original").[20] Accordingly, the Proposed Rule should also permit covered financial institutions to treat documents received via facsimile as originals.

G. The Term "Accepted" As Used In The Model Forms Should Be Deleted Or Clarified

Financial institutions that use the model forms are required to sign that the form has been "[r]eceived, reviewed and accepted." We suggest that the term "accepted" be eliminated, as it is synonymous with "received" and "reviewed." To the extent "accepted" has a meaning beyond "received" and "reviewed", further explication is necessary.

III. LONG-TERM ALTERNATIVES

The SIA understands that over time, Treasury is seeking to identify ways to optimize the PATRIOT Act for both effectiveness and administrative efficiency. Along those lines, the SIA proposes for discussion the following long-term possibilities: the creation of an Internet site containing a listing of foreign banks, known shell banks, countries that permit shell banks and foreign banks that indirectly provide banking services to shell banks; and the creation of an Internet site where foreign banks can post and update their model certification forms, which could be relied upon by covered financial institutions.

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[19] The purpose of the E-Sign Act is to encourage the use of electronic records and signatures. It provides: "Notwithstanding any statute, regulation, or other rule of law, with respect to any transactions in or affecting interstate or foreign commerce (1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity or enforceability solely because it is in electronic form; and (2) a contract relating to such transaction may not be denied legal effect, validity or enforceability solely because an electronic signature or electronic record was used in its formation." 15 U.S.C. § 7001(a).

[20] See also Tiberi v. CIGNA Ins. Co., 40 F.3d 110, 111 (5th Cir. 1994) (facsimiles are duplicates admissible as originals); Bazak Int'l Corp. v. Mast Indus., 535 N.E.2d 633 (N.Y. Ct. App. 1989) (facsimiles satisfy the statute of frauds).

The first suggestion would assist in the issue of broker-dealers and other financial institutions identifying foreign banks on their books; the second would expedite the certification process for both the financial institutions and the foreign banks.

IV. BURDEN OF COMPLIANCE

SIA believes that the estimates presented in the proposal vastly understate the burdens imposed by the rule. The proposal estimates that the average annual recordkeeping burden on each covered financial institution will be 9 hours. While it is clear that financial institutions will spend far more than 9 hours in complying with the terms of the rule, projecting the total costs of complying is somewhat difficult at this point because the magnitude of the costs will depend somewhat on the final rule that is adopted.

V. CONCLUSION

The securities industry remains committed to working toward eliminating money laundering and the financing of terrorism. We look forward to a continuing dialogue with Treasury on those matters. The SIA would be happy to provide any additional information or explanations that Treasury would find helpful as it finalizes the Rule for implementing this very important legislation.

Sincerely,

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