sifma

Invested in America

June 8, 2012

Via Federal E-rulemaking Portal: http://www.regulations.gov

Regulatory Policy and Programs Division
Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 39
Vienna, VA 22183
Attn: Mr. James H. Freis, Jr.

Re: Customer Due Diligence Requirements for Financial Institutions
Regulatory Identification Number 1506-AB15
Docket Number FinCEN-2012-0001

Dear Director Freis:

The Securities Industry and Financial Markets Association (SIFMA)[1] and its Anti-Money Laundering and Financial Crimes Committee appreciate the opportunity to comment on the Financial Crimes Enforcement Network's (FinCEN) Advance Notice of Proposed Rulemaking pertaining to Customer Due Diligence (CDD) Requirements for Financial Institutions (the "ANPRM" or the "Proposal").[2] We understand that the Proposal is intended to elicit input from various industries concerning the potential application of a proposed CDD rule, that would include an express requirement for obtaining beneficial ownership.

SIFMA strongly supports the efforts of FinCEN in working with financial institutions to implement robust, risk-based anti-money laundering (AML) compliance programs. We are especially appreciative of FinCEN's outreach to the securities industry and its willingness to engage in open and meaningful dialogue on this topic. We remain committed to continuing our dialogue with FinCEN and welcome this opportunity to provide input into the rulemaking process. We also strongly support FinCEN's goal of creating greater transparency and

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org. The Anti-Money Laundering and Financial Crimes Committee represents the collective views of approximately 40 securities firms, including institutional, retail, clearing and on-line firms.

[2] Advance Notice of Proposed Rulemaking, Customer Due Diligence Requirements for Financial Institutions, 77 Fed Reg. 13046 (Mar. 5, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-03-05/pdf/2012-5187.pdf. The comment period for responding to the ANPRM was extended until June 11, 2012. 77 Fed. Reg. 27381 (May 10, 2012).

harmonizing and clarifying expectations relating to CDD, particularly given the industry's historical understanding of the AML statutory requirements, which does not fully comport with recent guidance issued by FinCEN.[3]

We first provide an Executive Summary to highlight for you our key comments with respect to each element of the proposed CDD rule and other concerns, which we address in greater detail in the discussion that follows.

I. EXECUTIVE SUMMARY

In summary form, our comments are as follows:

- **Complexities of the Securities Industry**. FinCEN should take into account the complexities and unique nature of the securities industry when crafting any proposed CDD rule to ensure that a final rule effectively mitigates potential money laundering risks.

- **New AML Requirements**. With the exception of the Customer Identification Program ("CIP") requirement in the first CDD element (Element One), the remaining prongs of the proposed CDD rule are new requirements for the securities industry.

- **Risk-Based Requirements**. Any proposed CDD rule should be risk-based.

- **CDD Coverage**. Only a "Customer," as defined under the CIP Rule, should fall within the scope of any proposed CDD rule. Any proposed CDD rule should confirm that existing regulatory guidance with respect to the definition of Customer (*e.g.,* CIP guidance regarding omnibus and introducing/clearing relationships) continues to remain in effect.

- **CDD Element One**. Any proposed CDD rule should make explicitly clear that Element One of the proposed CDD rule is satisfied by compliance with the existing and independent CIP Rule.

- **CDD Element Two**. Obtaining the purpose and nature of account and expected activity does not advance the detection of suspicious activity.

- **CDD Element Three**. FinCEN's Proposed Definition of beneficial ownership ("Proposed Definition") should be modified for the following reasons:

    - The Proposed Definition of beneficial ownership is vague, difficult to implement from an operational perspective, may cause confusion because it

[3] As noted in the Letter from the Investment Company Institute, SIFMA, and the Futures Industry Association to FinCEN and the U.S. Securities and Exchange Commission (the "SEC") (June 9, 2010) (hereafter "June 9th Letter") (*see* Attachment A), CDD is not presently required by the AML program rules for the securities industry. As a result, the Joint Guidance on "Obtaining and Retaining Beneficial Ownership Information," FIN- 2010-G001, (Mar. 5, 2010) (hereafter "March 2010 Beneficial Ownership Guidance"), issued by FinCEN and other regulators, has created, and continues to cause, great confusion in the securities industry.

conflicts with other beneficial ownership definitions (*e.g.*, FATCA[4] and Section 312 of the PATRIOT Act[5]) and does not fit all types of customer relationships (*e.g.*, trusts, omnibus relationships and pooled investment vehicles).

- The identification of beneficial ownership should be risk-based. Where appropriate, verification of beneficial ownership should be limited to verifying the identity of the beneficial owner, and not verifying beneficial ownership status.

- **CDD Element Four**. The term "ongoing due diligence" needs to be clarified to explain 1) whether it is addressing monitoring for suspicious activity pursuant to the existing and independent suspicious activity reporting requirement of Section 356 of the PATRIOT Act (the "SAR Rule"), 2) whether it pertains to an expectation that broker-dealers will periodically update CDD, or 3) whether FinCEN expects that CDD information should be tied to suspicious activity monitoring. If the first interpretation is correct, any proposed CDD Rule should be explicitly clear that Element Four is satisfied by compliance with the SAR Rule. If the second interpretation is correct, the requirement should be limited to event-driven situations. If the third interpretation is the right one, the present technology used by securities firms does not permit them to implement this approach to suspicious activity monitoring; FinCEN should therefore re-evaluate whether this approach is feasible.

- **Existing Customers**. All four elements of any proposed CDD rule (unless Element Four pertains to compliance with the SAR Rule) should not apply to existing Customers, unless they are limited to event-driven situations.

- **Exemptions.** Existing exceptions from the CIP Rule should be applied to the proposed CDD rule and any beneficial ownership requirement, and expanded to include certain lower risk entities.

- **Proposed CDD Rule Timing**. Any proposed CDD rule should include 1) a sufficient time period to implement the rule, 2) provide for a reasonable time period to perform CDD consistent with the CIP Rule, and 3) provide for an effective implementation date going forward, as material aspects of any proposed CDD rule will be new requirements.

- **Cost Considerations**. Costs will be substantial. FinCEN should therefore conduct a cost-benefit analysis as the ANPRM does not clearly articulate the benefits to law enforcement from the proposed CDD rule that would outweigh the costs to the industry, and should evaluate whether the proposed CDD rule will mitigate the risks that FinCEN is attempting to address. Significant costs would include, among others, any necessary technology enhancements, additions to staff to handle increased

[4] HIRE Act, 26 U.S.C. §§ 1471-1474 (2010) (a/k/a Foreign Act Tax Compliance Act and commonly referred to as "FATCA").

[5] USA PATRIOT Act of 2001, Pub. L. No. 107-56, § 312, 115 Stat. 272, 304 and its implementing regulations, 31 C.F.R. §§ 1010.605, 1010.610, 1010.620 (2011).

workload and updates to relevant documentation (*e.g.*, applications, policies, procedures and training).

II. RESPONSES TO FinCEN's QUESTIONS/ISSUES FOR COMMENT

Set forth below are our more detailed responses to the various questions/issues raised by FinCEN in the ANPRM.

A. The Proposed CDD Rule Should Take Into Account the Complexities of the Securities Industry.

As a preliminary matter, we urge that, in crafting any proposed CDD rule, FinCEN take into account the complexities and unique nature of the securities industry. As FinCEN is aware, the industry is comprised of many types of firms (*e.g.*, retail, institutional, clearing, and online) and offers various and numerous products (*e.g.*, equity, fixed income, options and derivatives). For example, broker-dealers establish omnibus relationships/accounts with financial intermediaries that, in turn, establish sub-accounts for the intermediary's clients to engage in Delivery Versus Payment ("DVP") transactions in which the assets and securities are not maintained with the broker-dealer. In the clearing context, AML responsibilities have historically been allocated between introducing brokers and clearing firms pursuant to a written clearing arrangement in a manner that is unique to the clearing firm regulatory context. Moreover, any CDD requirements should recognize the limitations of the information presently obtained by online firms, which, because they do not make securities transaction recommendations, are not presently required to obtain suitability information with respect to their Customers. Thus, any proposed CDD rule should make clear that it does not create new suitability obligations under the securities laws as interpreted by the Financial Industry Regulatory Authority.

B. The Proposed CDD Rule Would Impose New AML Requirements On the Securities Industry.

With the exception of the CIP requirement in CDD Element One, the remaining prongs are new requirements for the securities industry.[6] Several of the premises on which the ANPRM is based are inconsistent with our understanding of the AML requirements presently applicable to the securities industry.[7] Treasury itself recognized that inconsistency in the ANPRM.[8]

---

[6] Of course, if FinCEN clarifies that Element Four simply refers to the SAR Rule, then that Element would also not be a new requirement.

[7] As pointed out in the June 9th Letter, "[t]he term 'Customer Due Diligence' does not appear in the BSA or the regulations thereunder. It is not used in the preambles to the proposed or final rules requiring financial institutions to implement AML programs, file suspicious activity reports ('SARs'), or verify the identity of their customers. FinCEN has adopted specific rules requiring financial institutions to conduct due diligence on accounts established or maintained for certain non-U.S. persons, but these rules apply only to 'correspondent accounts' maintained for foreign financial institutions, and to 'private banking accounts' maintained for certain foreign persons." June 9th Letter at 2-3. The June 9th Letter sets forth in detail our position with respect to CDD as it presently applies in the securities, mutual fund and futures industries. *See* Attachment A. We incorporate those arguments herein by reference. We also join in the arguments submitted by the ICI on this issue in its May 4, 2012 letter to FinCEN regarding the ANPRM.

Aside from Section 312 of the PATRIOT Act, there is no specific obligation under the AML program requirements applicable to the securities industry to collect the information called for in Element Two. There is no present requirement to collect the purpose and intended nature of the account for purposes of the AML program. Nor is there an obligation under the AML rules to collect information related to expected activity outside the context of Section 312. In fact, the AML and Financial Crimes Committee has previously expressed its concern in writing (and in contemporaneous conversations with FinCEN Staff) about the application of the concept of expected or anticipated activity, even in the context of Section 312.[9]

With respect to Element Three, FinCEN already recognizes that the beneficial ownership requirement does not presently apply to securities firms.[10]

Finally, unless Element Four refers to the monitoring of suspicious activity under Section 356 of the PATRIOT Act (the existing SAR Rule), ongoing CDD is not presently required in the securities industry. (*See* discussion of Element Four below).

C. Risk-Based Requirements: Any proposed CDD rule should be risk-based.

Securities firms have been subject to various AML regulations for nearly a decade and thus are well-positioned to identify and assess risks presented by various customer types. Consistent with the risk-based concept that is embedded in AML regulations, any CDD requirements should also be risk-based. In particular, if the collection of beneficial ownership data is to be included in the CDD process, both the collection of the data and the verification requirement should be implemented on a risk-based basis, allowing for securities firms to make a meaningful assessment that is tailored to their business. The expense of verifying all beneficial owners will outweigh any gains. A blanket requirement to identify beneficial ownership for all Customers that disregards potential risks presented by the Customer needlessly increases the burden and costs of compliance, without evidence that it advances law enforcement efforts in any significant manner.

Such a requirement would also be inconsistent with the risk-based approach set forth in the FATF guidelines.[11] For example, FATF Recommendation 1 states in part that "countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified."[12] FATF Recommendation 10, which sets out recommended CDD measures, also has a beneficial

[8] ANPRM at 13048 n.16 (citing June 9th Letter).

[9] *See* Letter from Alan Sorcher, Securities Industry Association, and Barbara Wierzynski, Futures Industry Association to William Langford, FinCEN (Mar. 3, 2006) (on file with FinCEN).

[10] ANPRM at 13051.

[11] *See* Financial Action Task Force, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations," 11, 31 (Feb. 2012) (hereafter "The FATF Recommendations"), *available at* http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%20approved%20February%202012%20reprint%20March%202012.pdf.

[12] *Id.* at 11.

ownership component, but as in Recommendation 1, the recommendation is subject to a risk-based approach. [13]

Accordingly, a risk-based approach to a proposed CDD rule would be consistent with existing AML program procedures and international standards.

D. CDD Coverage: Only a Customer, as defined under the CIP Rule, should fall within the scope of any proposed CDD rule, and any proposed CDD rule should confirm that existing regulatory guidance with respect to the definition of Customer continues to remain in effect.

Currently, securities firms' AML programs are built upon the concept that an account is held by the Customer, as defined in the CIP Rule. Any new regulations relating to CDD should be applied only to Customers, build on the existing definition of Customer, and as discussed below, incorporate existing guidance. It is critical that these interpretations be preserved, and to the extent CDD requirements are proposed, they should incorporate the existing guidance into the proposed CDD rule. Certain of the more significant examples are addressed below. Any difference in approach would require major procedural and technological changes above and beyond those necessary to implement the proposed CDD requirements.

1. Intermediaries/Omnibus Relationships.

The role of the intermediary is integral to the efficient function of the securities industry, particularly in the institutional market place. The CIP Rule recognizes the intermediary as the broker-dealer's Customer.[14] Certain of these intermediaries may be large, well-regarded, publicly traded and highly regulated entities, and some may be subject to the PATRIOT Act or similar anti-money laundering laws and regulations. Regardless of whether the intermediaries are regulated for AML purposes, in *all* cases, they are better suited to perform due diligence functions with respect to their own customers.

Existing guidance related to the CIP Rule makes clear that where intermediaries are involved, the broker-dealer's "formal relationship" is with the intermediary, even where an omnibus relationship/account is involved. As Treasury recognized in the preamble to the CIP Rule, "with respect to an omnibus account established by an intermediary, a broker-dealer is not required to look through the intermediary to the underlying beneficial owners, if the intermediary is identified as the accountholder."[15] In short, under Treasury's existing guidance, as a general matter, a broker-dealer is permitted to treat the intermediary as its Customer and should not have to "look through" the intermediary to identify or verify the clients on whose behalf the intermediary is acting.

Consistent with the view that the intermediary is the Customer for purposes of the CIP Rule, the Staff of the Department of the Treasury and the SEC issued certain guidance to clarify that even where certain information is disclosed to the broker-dealer about the underlying

[13] *Id*. at 14-15.

[14] *See generally* Customer Identification Programs for Broker-Dealers, 68 Fed Reg. 25113, 25116 (May 9, 2003).

[15] *Id*. at 25116.

Customer and sub-accounts are established, the intermediary can still be viewed as the broker-dealer's Customer. In those instances, if the four conditions set forth in the guidance are satisfied, "the financial intermediary (not the beneficial owner) should be treated as the customer" (the "Omnibus Guidance").[16]

By way of background, it is important to highlight the prevalence of such omnibus accounts in the securities industry. Virtually all securities firms establish omnibus accounts for a financial intermediary which, in turn, establishes sub-accounts for the intermediary's clients, whose information may or may not be disclosed to the broker-dealer. In some cases, the intermediary may identify the sub-accounts by number; in others, they may disclose the client's name and the name of the client's custodial bank or broker-dealer. In all cases, the sub-accounts are set up as DVP accounts and serve a purely administrative purpose, that is, they are set up, not to establish a customer relationship between the broker-dealer and the intermediary's client, but to facilitate the allocation of block trades and/or the delivery of securities or sales proceeds to the client's custodial bank or broker-dealer. In addition, most such sub-accounts are set up through the use of automatic data feeds from third-party vendors. Moreover, as noted above, the broker-dealer that maintains the DVP account does not maintain custody of the cash or securities and does not provide margin financing to the intermediary's underlying clients. Given that there is no real relationship between the broker-dealer and these non-custodial sub-accounts for the underlying clients, broker-dealers would be hard-pressed to apply CDD to the underlying sub-accounts.

Given the nature of the relationship and the prevalence of such omnibus relationships, the importance of the Omnibus Guidance cannot be overemphasized. Altering that guidance would have a detrimental effect on trading and the efficiencies of the market place. Where the relationship with the intermediary fits the criteria set forth in the Omnibus Guidance, firms should be permitted to continue to view the intermediary as the Customer. Moreover, as discussed below (*see* section H (3)), given the unique nature of omnibus relationships, even the proposed and "alternative" definitions of beneficial ownership create significant issues. Accordingly, we urge FinCEN to 1) reaffirm the Omnibus Guidance in the final CDD rule, and 2) make clear that the establishment of such institutional sub-accounts does not trigger any obligation by the firm to conduct CDD or otherwise identify or verify the intermediary's underlying clients.[17]

2. Clearing Firm Guidance.

Likewise, the relationship between introducing brokers and clearing firms presents unique circumstances. The guidance that FinCEN issued in the clearing firm context recognized the important function that clearing firms provide in the securities markets and the historical roles of both clearing firms and introducing brokers with respect to their Customers. An

[16] Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission, "Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 C.F.R. 103.122)" (Oct. 1, 2003), *available at* http://www.sec.gov/divisions/marketreg/qa-bdidprogram.htm.

[17] It is important to note that securities firms generally monitor activity in these accounts and follow-up on an event-driven basis, potentially including asking questions about the underlying owners of assets after detection of possible suspicious activity.

alteration or restriction of that guidance would have major and incalculable effects on the industry, without a demonstrated benefit to law enforcement's goals.

Among the guidance issued in the clearing firm context, FinCEN advised in March 2008 that, pursuant to a clearing arrangement that clearly allocates functions to an introducing broker, such as opening and approving of customer accounts and directly receiving orders from introduced Customers and where the functions of extending credit, safeguarding funds and securities and issuing confirms and statements are allocated to a clearing firm, only introducing brokers must comply with the CIP Rule with respect to Customers it introduces to clearing firms.[18]

Consistent with this guidance and well-established practice, any proposed CDD rule applied in the clearing firm context should take into account the allocations of AML functions between clearing firms and introducing brokers with respect to shared clients. Indeed, given that introducing brokers, not clearing firms, have a formal relationship with the customers and interact directly with them, such firms are uniquely and better suited to perform these functions.

3. Agency Lending Guidance.

Similar relief was also provided by FinCEN and the Staff of the SEC in the context of agency lending of securities. According to that guidance, where a U.S. bank or broker-dealer arranges a loan of securities to a broker-dealer under the Agency Lending Disclosure Initiative, the broker-dealer should treat only the agent lender as the person opening the account and is not required to look through an omnibus, trust or similar account to its beneficiaries.[19] That guidance is critical to the seamless application of securities lending in the institutional market place.

4. Other Guidance Relating to CIP Issued by FinCEN.

In addition, FinCEN has issued various guidance in the form of Frequently Asked Questions ("FAQs") with respect to the application of CIP.[20] This guidance has already been

[18] FinCEN Guidance, FIN-2008-G002, "Customer Identification Program Rule No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Agreements According to Certain Functional Allocations" (Mar. 4, 2008), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2008-g002.pdf; *see also* FinCEN Guidance, FIN- 2006-G009, "Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries" (May 10, 2006), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/312securities_futures_guidance.pdf (hereafter collectively referred to as "Clearing Firm Guidance").

[19] FinCEN Guidance, FIN-2006-G007, "Frequently Asked Question Customer Identification Program Responsibilities Under the Agency Lending Disclosure Initiative" (Apr 25, 2006), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/cip_faq.pdf.

[20] *See* Interagency Interpretive Guidance on "Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act, FAQs: Final CIP Rule" (April, 28, 2005) (hereafter referred to as "CIP FAQs") *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/faqsfinalciprule.pdf.

implemented into securities firms' AML programs and should be applied to the proposed CDD rule. [21]

E. CDD Element One: Any proposed CDD rule should make explicitly clear that Element One is satisfied by compliance with the existing and independent CIP Rule.

As we read the ANPRM, and based on additional information received from Treasury officials, it is our understanding that Element One is the equivalent of the existing CIP requirements for broker-dealers under Section 326 of the PATRIOT Act and its implementing regulations (the "CIP Rule"). The ANPRM states that "[i]f a financial institution is compliant with its current CIP obligations, a financial institution would be compliant with this part of the proposed CDD rule and therefore there will be no new or additional regulatory obligation."[22] In other sections of the ANPRM, however, the term "initial due diligence" is employed, although not defined, to summarize Element One. To make clear that Element One is satisfied by a broker-dealer's compliance with the CIP Rule, we respectively request that references to "initial due diligence" be clarified or removed.

F. CDD Element Two: Obtaining the purpose and nature of account and expected activity does not advance the detection of suspicious activity.

SIFMA believes that, given the nature of brokerage accounts, requiring the documentation of the nature, purpose and expected activity of an account (outside of Section 312) is not an effective means to identify and report suspicious activity.

Based on the types of securities account that are opened, the nature and purpose of the account are generally self-evident. For example, in the retail sector, an account is opened for the purpose of trading securities; an options account is opened for the specific purpose of trading options. In the institutional markets, an institutional client could open an account for the purpose of trading equity or fixed income products, and the account would be designated as such. In the institutional markets, the purpose and expected activity of an execution only (DVP) equities account would be to purchase and sell equities and deliver those shares to a prime broker or a

---

[21] Moreover, as many of our firms are dually registered as both broker-dealers and futures commission merchants ("FCMs"), it is important that the CIP guidance obtained in the context of the futures industry also be preserved *See, e.g.*, FinCEN Guidance, FIN-2006-G004, "Frequently Asked Question regarding Customer Identification Programs for Futures Commission Merchants and Introducing Brokers (31 C.F.R. 103.123)" (Feb. 14, 2006) (guidance relating to omnibus accounts in the futures industry), *available at* http://www.fincen.gov/statutes_regs/guidance/html/futures_omnibus_account_qa_final.html; FinCEN Guidance, FIN-2007-G001, "Application of the Customer Identification Program Rule to Futures Commission Merchants Operating as Executing and Clearing Brokers in Give-Up Arrangements" (Apr. 20, 2007) (guidance relating to give-up arrangements in the futures industry), *available at* http://www.fincen.gov/statutes_regs/guidance/html/cftc_fincen_guidance.html; FinCEN, Guidance From The Staffs of the U.S. Commodity Futures Trading Commission, Financial Crimes Enforcement Network, and the Department of the Treasury, "Questions And Answers Regarding Customer Identification Program Rule for Futures Commission Merchants And Introducing Brokers (31 C.F.R 103.123)," *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/CustomerID_QandA.pdf.

[22] ANPRM at 13050.

bank as a custodian. In other words, the nature and purpose of the account are generally evident by the type of client relationship and type of account that is established.

Further, outside of Section 312, firms are not presently collecting information with respect to expected activity. Indeed, in these instances, while securities firms will know that the activity in the account may involve equity trading or fixed income products, in none of these instances will the retail firm or the institutional firm be able to anticipate at the outset whether to expect occasional or frequent trades.

Moreover, the information relating to expected activity, if collected, may well change over time based on a number of factors. Because the decision as to what to trade and at what volumes is often driven by external news (*e.g.*, earning reports or unemployment reports), investor sentiments, or other market dynamics (*e.g.*, currency fluctuations or which firms offer better pricing or faster execution), assessing expected activity at account opening is not a reliable indicator of the client's future conduct nor a particularly effective means to identify suspicious activity. For example, the institutional client may not know how much of its business it has determined to give to one securities firm or another and may well change its mind based on the quality of trade executions or whether that institution is a market maker in the stock.

To the extent that FinCEN's expectation is that broker-dealers make a quantitative assessment of the expected activity of a securities account (*e.g.*, anticipated volume of trades per day or anticipated percentage of equity trades versus fixed income trades), such an assessment does not presently occur for AML purposes and is impossible to implement with any accuracy. As such, if the goal is to identify and report suspicious activity, risk-based transaction monitoring focused on actual client activity, in combination with human intelligence, is a much more effective means and use of resources to achieve this goal and is accomplished effectively under the systems and processes currently in place by broker-dealers to comply with the existing SAR Rule.

In the event that FinCEN still considers it necessary for securities firms to obtain information about the purpose and intended nature of the account and/or to identify expected activity, FinCEN should specifically define its expectations in the context of the securities industry, and specify the type of information that is required.

Finally, special attention should be paid to the effect of such obligations in the clearing firm and online firm context. Clearing firms are not presently expected to obtain anticipated activity (even for purposes of Section 312) with respect to introduced accounts. For this reason alone, it would make no sense to require them to obtain such information in the context of the proposed CDD rule.

Moreover, with respect to online firms, because there is no suitability requirement, any obligation for online firms to collect this information would be inconsistent with the nature of their customer relationships.

G. CDD Element Three: The Proposed Definition of beneficial ownership is vague, difficult to implement from an operational perspective, may cause confusion because it conflicts with other beneficial ownership definitions (*e.g.,* FATCA and Section 312) and does not fit all types of customer relationships (*e.g.,* trusts, omnibus relationships and pooled investment vehicles).

1. The Proposed Definition is vague and difficult to implement from an operational perspective.

While we commend FinCEN for seeking to clarify and harmonize expectations relating to CDD,[23] we believe that the Proposed Definition of beneficial ownership is unclear and would be difficult to implement. The Proposed Definition would present a number of challenges, including shifting ownership percentages, shifting individuals responsible for managing or directing the entity", and an inability to independently verify shareholder registers/corporate resolutions.

Moreover, the ANPRM does not clearly articulate how obtaining this information would meaningfully advance law enforcement efforts to fight money laundering. To implement the collection of beneficial ownership information, firms need a definition that is more precise, which can be readily understood by operations personnel, and capable of being executed without extensive interpretations. Otherwise, firms may take inconsistent approaches within their own firms and as compared to other firms. If AML officers and other compliance, legal and risk personnel do not understand the definition, the operations personnel most certainly will not understand it and the proposed CDD rule will be too complex to execute. This could also lead to cross-industry confusion, thereby eliminating the harmonizing benefit FinCEN is seeking to achieve. Customer understanding also is necessary for their prompt cooperation.

- Among other things, the following aspects of the Proposed Definition should be addressed:

- The Proposed Definition requires the identification of individuals who, through documented means, such as a "contract," own or control an entity. While the term "contract" is easy to understand and implement, other terms used in the definition – such as "understanding" or "arrangement" – are vague and difficult to implement in procedures that can be understood and executed by operations personnel. At a minimum, FinCEN should make clear that any such arrangement must be in writing.

- Where there is no natural person who owns more than 25 percent of the entity, the ANPRM proposes identifying the individual who "has at least as great an equity interest in the entity as any other individual." As an operational matter, to identify such a person, firms would be required to ask Customers to identify all equity owners, regardless of the

[23] The issuance of the March 2010 Beneficial Ownership Guidance has contributed to great confusion in the industry about the requirements of CDD and obtaining beneficial ownership, and as a result created more variations in the securities industry approach to obtaining beneficial ownership as certain firms have adopt varied approaches intended to address the Guidance expectations. For this reason, the guidance should be withdrawn once the proposed or final CDD rule is issued.

percentage of ownership, in order to assess who has "as great an equity interest" as any other individual. Such a requirement would be challenging and burdensome to implement.

- The definition calls for "the individual with greater responsibility than any other individual for managing or directing the regular affairs" of the entity, but it is not clear what the term "greater responsibility" means. For example, it is unclear whether one would have to study the bylaws of a company to understand who has more responsibility. Thus, as presently drafted, this provision is far too difficult to implement.

- Identification of individuals with a "greater than 25 percent" interest will also present a challenge. If 25 percent is the relevant figure, the rule should read that it applies to individuals with a 25 percent or greater interest.

- There are also various terms used in the proposed definition ("tiered entities," "indirectly," and "regular affairs") that require greater clarification in the context of the definition.

2. The Proposed Definition may cause confusion because it conflicts with other beneficial ownership definitions (*e.g.*, FATCA and Section 312).

As a practical matter, the Proposed Definition may cause confusion because of the existing definitions of beneficial ownership already in use. For example, some firms have already adopted the definition of Section 312, either for private banking clients or other high net worth clients, and have already expended significant resources in implementing those procedures. While some firms may have a different group executing CIP functions than they do for Section 312 due diligence, it would be very confusing for any operations group that is responsible for implementing both areas to have to apply two different definitions. It is also confusing for the Customers who are being asked to provide the information.

Similarly, for these same purposes, some firms may have adopted the definitions in the FATF Recommendations[24] or the Wolfsberg Guidelines.[25] Furthermore, firms are in the process of implementing FATCA guidelines, which use a figure of ten percent in identifying beneficial ownership.

In developing a definition of beneficial ownership, FinCEN should attempt to harmonize these definitions in order to avoid confusion.

[24] *See* FATF Recommendations at 109.

[25] *See* Wolfsberg Group, The Wolfsberg AML Principles, "Frequently Asked Questions with Regard to Beneficial Ownership" (2003) ("Wolfsberg FAQs"), *available at* http://www.wolfsberg-principles.com/pdf/Wolfsberg_Beneficial_Owner_FAQs_(2003).pdf#1; *see also* The Wolfsberg AML Principles, "Frequently Asked Questions with Regard to Beneficial Ownership in the Context of Private Banking" (2012); "Wolfsberg Anti-Money Laundering Principles for Private Banking (2012)" (2012).

3. The Proposed Definition does not fit all types of customer relationships (*e.g.*, trusts, omnibus relationships and pooled investment vehicles).

With respect to certain categories of Customers, the application of the Proposed Definition is too difficult to implement from an operational perspective and appears to us to add minimal value from a law enforcement perspective. For example, as discussed above (*see* section D), the application of the Proposed Definition to an omnibus relationship poses significant impediments that, if not addressed adequately, would have large and detrimental consequences to the securities industry and the efficiency of the U.S. capital markets. In contrast, the intermediary would be better suited to obtain that information for law enforcement purposes. Therefore, SIFMA proposes that, should Element Three of the proposed CDD rule apply to omnibus relationships, the Proposed Definition of beneficial ownership apply to the broker-dealer's Customer, *i.e.,* the intermediary, and not the intermediary's underlying clients.

The ANPRM notes that in the context of omnibus accounts, "an alternative definition" of beneficial ownership may be appropriate and proposes an alternative definition that focuses on the beneficial owners of assets in an account, rather than the owners of the legal entity. This definition, if implemented in the context of omnibus accounts, would have an incalculably negative impact on the securities industry, would irreparably interfere with the efficiencies of the U.S. capital markets and has not been demonstrated to add value to law enforcement efforts.

Even if the wording of the alternative definition were modified, the nature of omnibus relationships is such that it is virtually impossible to implement CDD requirements relating to the intermediary's clients. As discussed more extensively above, in the omnibus context, a broker-dealer takes instructions from and interacts directly with its Customer, *i.e.*, the financial intermediary, and not the intermediary's clients. Moreover, for legitimate proprietary reasons, financial intermediaries are often hesitant to disclose information relating to these underlying clients to the broker-dealer whom the intermediary may regard as a competitor.

To the extent that law enforcement is seeking to identify the financial intermediary's clients, as noted, the financial intermediaries themselves are better suited to provide this information. For this reason, we commend Treasury for its efforts to propose AML programs for investment advisors.[26] Without corresponding measures that require financial intermediaries either to provide this information directly to regulators or law enforcement, or indirectly, through broker-dealers, any CDD requirement relating to the financial intermediary's clients is, in our view, impossible to implement and an inappropriate use of limited resources.

Similarly, where a Customer is a pooled investment vehicle, such as a mutual fund or a hedge fund, obtaining information about persons who hold a certain ownership percentage, which could fluctuate on a daily basis, creates unreasonable and insurmountable operational and logistical challenges for information that is accurate only for a limited period of time. In addition, because such shareholders and investors do not exercise control over investment decisions or strategies or the day-to-day operations of the fund, requiring securities firms to

[26] *See* James H. Freis, Jr., Remarks at the American Bankers Association/American Bar Association Money Laundering Conference, at 10 (Nov. 15, 2011), *available at* http://www.fincen.gov/news_room/speech/pdf/20111115.pdf.

obtain information about these persons, in our experience, adds no demonstrable value from a law enforcement perspective, particularly where there are other entities, such as transfer agents, fund administrators or investment advisors, who exercise control and are better suited to identify or verify the underlying shareholders and investors.

Likewise, because the Proposed Definition focuses solely on entities, it does not adequately explain how to apply the definition to certain types of legal vehicles, such as trusts, which present unique challenges.[27] For example, there are usually, but not always, multiple parties involved in the formation of a trust and in the oversight of a trust. Providers of funds (*e.g.*, settlors/grantors), those who have control over the funds (*e.g.*, the trustees), and any individuals who have the power to add or remove the trustees may meet the Proposed Definition of beneficial owner. There are also beneficiaries of the trust, who can change over time based on the terms of the trust, and may not even know that they have been named as trust beneficiaries.

As a practical matter, and consistent with guidance from FinCEN,[28] because the trust is usually the Customer, securities firms conduct CIP on the trust itself. They also identify the trustee but may or may not verify that identity because the trustee is not the Customer. Grantors and settlors are usually identified, and in high risk jurisdictions, firms will sometimes verify the identity of the grantor/settlor. However, passive beneficiaries of trusts, contingent or otherwise, should not be part of the "beneficial ownership" definition. Given the complexity of this relationship, FinCEN should simply identify the information required for a trust and not try to squeeze every entity into the above definition. Based on our own experience, requiring the identification and verification of beneficiaries (in contrast to beneficial ownership) provides little benefit to law enforcement and is very burdensome to obtain and to maintain, because, among other things, the information can shift over time.

4. Proposed Definition Suggested by SIFMA.

Given these challenges, if FinCEN is determined to propose a new definition, we suggest the following revised definition with respect to the beneficial ownership of legal entities:

> (1) Each of the individuals who, directly or indirectly, through any *written* contract, arrangement or relationship or through another entity, owns 25 percent or more of the equity interests in the entity; **or**
> (2) An individual who holds a senior management position or senior executive title (*e.g.*, President, CEO or CFO) or who otherwise has responsibility for managing or directing the entity.

SIFMA proposes that securities firms be given the flexibility to determine, on a risk-based basis, whether to identify the owner or the controller of the entity, based on the customer type and other risk factors. SIFMA's proposed definition, particularly as it relates to identifying an individual who holds a senior position or executive title, is more consistent with

[27] Similar issues arise with vehicles such as foundations and charities.

[28] CIP FAQs at 7, Question 9.

internationally recognized standards promulgated by FATF,[29] and would promote FinCEN's goal of harmonizing the definition and practices relating to CDD.

H. The identification of beneficial ownership should be risk-based. Where such identification is deemed by the financial institution to be appropriate, verification of beneficial ownership should be limited to verifying the identity of the beneficial owner, and not verifying beneficial ownership status.

As noted above, SIFMA believes that whether or not a firm obtains beneficial ownership information should be left to the financial institution to determine based on its assessment of risk and consistent with a firm's AML processes and it's CIP. For the same reasons, as well as the difficulties inherent in independently verifying that information, we believe that verification of beneficial ownership information should also be risk-based.

As a general matter, most securities firms do not obtain information relating to the beneficial ownership of all Customers that are entities. Rather, based on our experience, there does not seem to be any benefit from an AML perspective to obtaining that information, other than on a risk-based basis. And where that information is obtained, as a matter of practice, securities firms do not generally consider it necessary to verify beneficial ownership, other than on a risk-based basis.

As FinCEN is aware, it is not possible to independently verify the accuracy and completeness of beneficial ownership information provided by the Customer either orally or on an application or questionnaire, even if supported by separate documentation provided by the Customer (*e.g.*, relevant excerpts of a trust agreement). For entities required to register with the government (*e.g.*, corporations, LLCs), firms rely on the self-reporting of beneficial ownership information provided by the Customer because there is no record maintained by the government against which to compare this information. For this reason, we applaud Treasury's efforts to encourage states to require beneficial ownership at company formation and to make that information publicly available.

However, given that there is generally no independent means available to verify the beneficial ownership of entities, the verification requirement should remain risk-based and should be limited, at most, to verifying the identity of the beneficial owner, not his or her status as a beneficial owner. Accordingly, to the extent that FinCEN is contemplating such a requirement, it should be postponed until such time that legislation is in effect that requires disclosure of beneficial ownership at the incorporation stage, or until such time public corporate data or some other means to independently corroborate the status of beneficial ownership is available.

Where beneficial ownership is obtained on a risk-based basis, firms should be permitted to collect the information they deem appropriate and necessary for the goal of screening the beneficial owners. Nor should verification be required unless the firm considers it appropriate based on its risk-based assessment. Finally, we recommend that where a firm determines to verify the identity of the beneficial owner, the firm be permitted to follow the same methodology

[29] *See* FATF Recommendations at 61.

as is permissible under the CIP Rule for collecting documentary and non-documentary verification. If there are divergent requirements or processes for CIP and CDD, it will not be practicable for operations personnel responsible for performing the identification and verification to implement them.

I. CDD Element Four: The Term "Ongoing Due Diligence" Requires Additional Clarification.

SIFMA seeks clarification as to what is required under Element Four. The term "ongoing due diligence" should be clarified to explain 1) whether it is addressing monitoring for suspicious activity pursuant to the existing SAR Rule 2) whether it pertains to an expectation that broker-dealers will periodically update CDD or 3) whether FinCEN expects that CDD information gathered as the result of Elements Two and Three should be tied to suspicious activity monitoring.

- To the extent that "ongoing due diligence" relates to suspicious activity monitoring, securities firms conduct various types of manual and automated transaction monitoring on an ongoing basis consistent with the existing SAR Rule. If that is what FinCEN means, any proposed CDD rule should make clear that Element Four is satisfied by compliance with the SAR Rule.

- If "ongoing due diligence" is intended to refer to the periodic updating or refreshing of CDD information, as noted above, this requirement would impose a new obligation on the securities industry and should be, at most, limited to event-driven situations. Notwithstanding that firms do not apply Elements Two Through Four of the proposed CDD rule, and that not all firms may conduct ongoing due diligence on all Customers, FinCEN should understand that in the securities industry, it has long been the practice to conduct vendor screening on a risk-based basis for many, though not all, Customers for negative news media, both at the initiation of a relationship and on an ongoing basis.[30] Firms have found this to be a productive way of identifying issues relating to Customers, both at the on-boarding stage and during the life of the account.

- If "ongoing due diligence" means that FinCEN expects that information it proposes to be gathered with respect to CDD (*i.e.*, purpose and intended nature of the account and expected activity, which, as noted, is not presently being collected), would somehow feed into suspicious activity monitoring, that too is not currently taking place in the securities industry.[31] Moreover, based on the technology presently available in the securities industry, it would be very difficult to do so. More importantly, we are not

[30] Additionally, pursuant to SEC Rule 17a-3, certain broker-dealers may have an obligation, among other things, to attempt to update certain account information every 36 months regarding accounts for which the broker-dealers were required to make suitability determinations. SEC Books and Records Rule, 17 C.F.R. § 240.17a-3 (2012). As a result, online firms might be excluded from this obligation.

[31] Nor is there an existing requirement that firms use "customer risk profiles," as assumed by FinCEN. *See* ANPRM at 13047, 13053. And, while some of our member firms, on their own, have adopted their own concept of a customer risk profile, there are many broker-dealers that have not.

aware of any evidence that there is a benefit from a law enforcement purpose to linking these different pieces of information.

Thus, if FinCEN is contemplating Element Four to be something other than suspicious activity monitoring or negative news searches, we seek clarification as to what is intended by Element Four. Apart from vendor screening, FinCEN should recognize that implementation of Element Four is a monumental task, with significant costs involved in implementing these enhancements.

J. Existing Customers: All four elements (unless Element Four pertains to compliance with the SAR Rule) of any proposed CDD rule should not apply to existing Customers, unless they are limited to event-driven situations.

- The application of any proposed CDD rule to existing Customers is a costly, and in our view, not particularly efficient use of limited resources.

- Similar to the CIP Rule, which explicitly excludes from the definition of Customer any person that has an existing account with the broker-dealer, existing Customers should be exempt from the proposed CDD rule.

- If deemed absolutely necessary, the application of these procedures to existing Customers should be adopted on an event-driven basis, as appropriate, or limited solely to existing Customers determined by the firm to present elevated money laundering risks.

With respect to existing Customers where the history of dealing with that client has not indicated any problems, law enforcement has not pointed to any evidence that would justify the expense of obtaining beneficial ownership information, unless an event triggers a look back. In contrast, if suspicious activity occurs, this would be an appropriate opportunity to ask more questions about the Customer and potentially obtain additional documentation. To require firms to update beneficial ownership information on a proactive basis, instead of on an event-driven basis, would be very onerous, and unnecessarily costly. Thus, if FinCEN determines to require ongoing CDD for new accounts opened after a proposed CDD rule becomes effective, neither initial ("look back") or ongoing CDD should be required for Customers existing before a proposed CDD rule becomes effective. Instead, for existing accounts, beneficial ownership should only be required to be ascertained under the proposed CDD rule on an event-driven basis.

K. Exemptions: Existing exceptions from the CIP Rule should be applied to the proposed CDD rule and any beneficial ownership requirement, and expanded to include certain lower risk entities.

SIFMA believes that the present CIP exemptions[32] should apply to any new CDD requirements, as well as any requirement for obtaining beneficial ownership. For many of these CIP-exempt entities, such as U.S. banks or publicly held companies that are listed on U.S. exchanges, information about beneficial ownership is readily available to regulators and law

[32] *See generally* 31 C.F.R. § 1020.315(b) (2011).

enforcement. Moreover, given the nature of these entities, the identification information of such beneficial owners is not particularly relevant to the money laundering risks associated with such entities. Additionally, the identification of shareholders in publicly traded companies and pooled investment vehicles like mutual funds is of little value, because ownership percentages could fluctuate on a daily basis, creating unreasonable challenges. In these latter situations, the more relevant person is the person with control over the relationship.

Based on the evidence presented, requiring firms to collect beneficial ownership on such CIP-exempt Customers adds little value to law enforcement efforts, while unnecessarily increasing the burden and costs of compliance for the securities industry. In fact, from our own experience, we do not believe that beneficial ownership is particularly relevant to the analysis of any potential suspicious activity by these exempt Customers.

- First, SIFMA believes that Customers who are currently exempt from the CIP Rule should be exempt from the proposed CDD rule, including Element Three of the proposed CDD rule.

- Second, additional exemptions should also be adopted for CDD purposes.

- For example, as FinCEN is aware, Representatives Carolyn Maloney and Barney Frank introduced a bill, entitled the *Incorporation Transparency and Law Enforcement Assistance Act*, H.R. 6098,[33] which was designed to strengthen incorporation practices by requiring persons who form corporations in the United States to disclose the beneficial owners of those corporations and requiring formation agents to verify the identity of such beneficial owners. Drafted with substantial input from the staff of the Treasury Department ("Treasury") and with broad support from law enforcement agencies, H.R. 6098 proposes to exempt certain types of entities from the beneficial ownership disclosure and verification requirements. SIFMA supports efforts to require disclosure and verification of beneficial ownership at the incorporation stage and believes that such requirements would increase transparency and greatly assist law enforcement in their efforts to combat money laundering. Consistent with these efforts, SIFMA proposes that the same set of entities that are exempted from H.R. 6098, including investment advisers and other operating companies, be exempted from the proposed CDD rule, including Element Three.

- Also, consistent with the approach of HR 6098, and an AML program's risk-based approach, SIFMA suggests that any requirement to obtain the identification of beneficial ownership be focused on non-operating companies. Given that operating companies produce a product or service and generally can substantiate the source of the monies funding the account through balance sheets and other financial statements, a financial institution's efforts and resources should, in our view, more appropriately be directed at those entities. Thus, where a company is identified as a non-operating entity, such as a shell company that has no active business or employees, it would make sense to obtain such beneficial ownership because these entity types exist mainly on paper, have no physical presence and do not produce anything. While we

[33] H.R. 6098, 111th Cong. (2d Sess. 2010).

recognize that non-operating companies can have a number of legitimate purposes, we believe that having securities firms focus their efforts on obtaining beneficial ownership of non-operating companies would more effectively identify potential AML risks.

- Third, other low-risk entities should also be exempt from the proposed CDD rule. For example, there are a number of accounts that, while not technically legal entities, have historically been considered to be low risk and not likely, in our view, to be the subject of law enforcement concerns. For example, ERISA-governed plans are not subject to the CIP Rule.[34] For the same reason, non-ERISA retirement plans should be exempted from the CIP requirements. These plans, which are frequently established as trusts, are often "established by governmental entities to administer retirement or benefit plans or by employers to administer stock option or restricted stock plans"[35]; as a result, they are at low risk for money laundering activities. FinCEN has already recognized that the underlying participants are not the Customers for purposes of CIP, and should consider exempting these retirement and stock option plans from the CIP and CDD process.[36]

- It is our view, based on our experience with the implementation of the CIP program, that these exemptions should be broadened rather than restricted, to include other substantial well-known entities, such as insurance companies, publicly held companies traded outside of the United States on a stock exchange recognized by the International Organization of Securities Commissions ("IOSCO"), and those financial institutions, including Central Banks, subject to regulation in a FATF jurisdiction. Expenditure of firm resources even from a CIP perspective for this type of institution is an inefficient use of resources. Accordingly, these entities should also not be subject to CDD requirements.

- Moreover, FinCEN should ensure that any final CDD rule procedures and exemptions take into account the approaches taken by other FATF jurisdictions with respect to exemptions, so that clients doing business with the same financial institutions, both in the U.S. and abroad, have a globally harmonized experience. The proposed CDD rule should seek to avoid any disparate impact on a Customer trading with the same financial institution both in Europe and in the U.S., thereby potentially discouraging trading in the U.S.

- Finally, although not an exemption *per se*, FinCEN has issued industry guidance that CIP requirements (as well as Section 312 requirements) should not ordinarily be

[34] CIP FAQs at 6, Question 7.

[35] *Id.*

[36] FinCEN should also evaluate whether it is efficient to continue to subject limited purpose broker-dealers (*e.g.*, distributing broker-dealers and joint back office broker-dealers that have no traditional Customers and who deal primarily with counterparties) to the CIP Rule and to extend the proposed CDD requirements to them. Requiring these limited purpose broker-dealers to comply with the CIP Rule already appears to be an inefficient expenditure of resources; adding a CDD requirement to this effort would compound the problem.

imposed on clearing firms with respect to introduced accounts.[37] It is very important that clearing firms not be required to conduct CDD on an introduced account, as they are not required to conduct CIP on that same account.

Thus, the current CIP-exempted entities and accounts should be utilized, and the categories expanded as discussed above.

L. Proposed CDD Rule Timing: Any proposed CDD rule should 1) include a sufficient time period to implement the rule, 2) provide for a reasonable time period to perform CDD consistent with the CIP Rule, and 3) provide for an effective implementation date for the CDD rule going forward, as material aspects of any proposed CDD rule will be new requirements.

SIFMA requests that FinCEN provide sufficient time for broker-dealers to implement any proposed CDD rule. Given the procedural and technological developments involved, a time period of eighteen (18) months to two years would be reasonable. We also request that any proposed CDD rule make clear the effective date of the regulation on a going forward basis.

Moreover, we request that FinCEN adjust the compliance date until such time as there is additional clarity with respect to FATCA. As FinCEN is aware, FATCA, which was issued by Treasury and the Internal Revenue Service, proposes a different definition of beneficial ownership, uses a different threshold, and applies under different circumstances than those contemplated by the ANPRM. Given the enormous costs associated with changing compliance systems, controls and processes, we request that the industry not be forced to make such costly changes multiple times.

Should the proposed CDD rule extend to existing Customers, at a minimum, we request that FinCEN allow sufficient time beyond the initial implementation period to enable the industry to review its existing accounts and make any necessary changes. It is important to emphasize that systems changes and modifications to processes and controls relating to existing Customers require significant costs and resources, in addition to the substantial costs and resources that would be required to implement changes that are applicable to new or prospective Customers.

Finally, like the CIP Rule, any proposed CDD rule should provide that securities firms have a reasonable period after the opening of an account for a Customer to comply with Elements Two and Three.

III. **Cost Considerations**: **Costs will be substantial. FinCEN should therefore conduct a cost-benefit analysis as the ANPRM does not clearly articulate the benefits to law enforcement from the proposed CDD rule that would outweigh the costs to the industry, and should evaluate whether the proposed CDD rule will mitigate the risks that FinCEN is attempting to address.**

[37] *See* Clearing Firm Guidance, *supra* note 18.

Although securities firms have been assessing the changes that would be required to comply with the proposed CDD rule, compliance systems, processes and controls cannot be finalized until the final terms of the proposed CDD rule are known. Without this clarity, it is difficult to estimate the costs involved in complying with the proposed CDD rule. However, it is clear that, other than with respect to Element One, at a minimum, significant costs would include any necessary technology enhancements, and updates to relevant documentation (*e.g.*, revising new account forms, other applications and/or questionnaires to elicit information regarding CDD and beneficial ownership information). Among other things, there would be costs associated with making modifications to on-boarding systems; adding new fields to existing systems and paper documents to capture the purpose and nature of the account, expected activity, and beneficial ownership information; and enhancing existing document retention capabilities, including the ability to store collected information for non-customer data, such as beneficial ownership.

Securities firms would also have to significantly enhance systems for building feeds to vendors and to increase their headcount to address the expanded workload, including subjecting additional names of beneficial owners to identification/verification processes, resolving possible matches to the OFAC SDN list, PEP databases, PATRIOT Act Section 314(a) information sharing requests, adverse media, and any additional due diligence/monitoring that must be done. Monitoring tools and scenarios would also have to be developed to account for implementation of CDD processes.

In addition to these significant costs, there are also costs associated with enhancing internal policies and procedures and providing training to all relevant employees on the new CDD rule.

These changes will be extremely expensive, and there will undoubtedly be downstream costs passed to the consumer -- all, in our view, without a clear demonstrable benefit to law enforcement.

Although we have not been able to accurately anticipate all of the relevant costs, some of our firms historically incurred significant costs simply to implement the CIP program, which is a far less subjective process. Moreover, even if firms have the budget to pay for these enhancements, we do not believe firms presently have the technology resources/developers to work on any systems enhancements, as they may currently be dedicated to other projects, including non-AML regulatory projects (*e.g.*, FATCA/Dodd-Frank[38] enhancements).

A. Other Considerations.

1. No Additional Procedures Are Necessary With Respect To The Use Of Agents.

On the retail side, agents are generally identified, often through a power of attorney (sometimes notarized, depending on firm practice and the state of issuance). Unless disclosed by

[38] *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

the Customer or agent, it is challenging for firms to identify undisclosed agency arrangements, other than where red flags present themselves at on-boarding or at some point in the course of the relationship. Moreover, we are unaware of any articulated pattern of activity in this regard that would warrant the necessity of requiring all Customers to make representations that they are not acting on behalf of another undisclosed party.

On the institutional side, institutional Customers frequently operate through multiple agents, i.e. traders, who often change based on the trading needs of the institutional customer. At the time of the issuance of the CIP Rule, industry members commented extensively on this issue and the difficulties of requiring institutional traders to be treated as Customers. FinCEN responded appropriately by eliminating from the CIP Rule the requirement for obtaining information on these traders. It would be very burdensome and disruptive, and difficult to implement, if securities firms were required to obtain such information on institutional traders.

2. Reliance for purposes of the proposed CDD rule should be allowed.

Currently, reliance on another financial institution is permitted pursuant to requirements set forth in the CIP Rule with respect to shared accounts. CIP is unique in that it affords the benefit of safe harbor protection to a firm, should it choose to rely on another financial institution to perform CIP obligations under Section 326 of the PATRIOT Act with respect to the shared account. There is no similar opportunity for reliance under the BSA pursuant to which a securities firm's ultimate compliance responsibility is discharged.

To the extent that a firm is relying on another financial institution with respect to its CIP obligations for a shared client, it would be appropriate for that financial institution to also perform CDD on the same client, including identification/verification of its beneficial owners. Extending Section 326 reliance would allow the financial institution being relied on for purposes of CIP to carry out these additional AML obligations more efficiently and seamlessly. The alternative would result in a bifurcated process, whereby the same client would need to respond to both financial institutions in order to satisfy all elements of CIP and CDD. In addition to any potential confusion, this would impose an unnecessary burden on the shared client and result in unnecessary delay in the account opening process.

If a proposed CDD rule with the beneficial ownership sub-requirement is proposed, we recommend that Section 326 CIP reliance be broadened to cover CDD, including the requirements relating to beneficial owners. To do otherwise would vitiate the reliance provisions of the CIP Rule. It would make no sense for a financial institution to be required to identify/verify the beneficial owners of a Customer for purposes of CDD but not the Customer itself because it is subject to a reliance agreement.

* * *

For the reasons set forth above, SIFMA believes that the Proposal requires further refinement and modification before it is implemented. To that end, we are available to meet with FinCEN staff to discuss these complicated issues, as well as other ways to improve AML compliance.

Thank you for giving SIFMA the opportunity to comment on the Proposal. We look forward to the continued partnership between government and industry to strengthen the regulatory structure surrounding securities firms and other U.S. financial institutions. If you have any questions regarding this comment or any related issues, please contact SIFMA staff advisor Ryan Foster, at (202) 962-7388 or rfoster@sifma.org.

Sincerely,

Ryan D. Foster
Vice President & Assistant General Counsel
SIFMA

Attachment

cc: David W. Blass, Esq.
Chief Counsel and Associate Director
SEC Division of Trading and Markets

Attachment A

June 9, 2010

Mr. James H. Freis, Director
Mr. Jamal El-Hindi, Associate Director for Regulatory Policy and Programs
Financial Crimes Enforcement Network
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Ms. Lourdes Gonzalez
Mr. John J. Fahey
Ms. Emily Westerberg Russell
Office of the Chief Counsel
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Ladies and Gentlemen:

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

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

---

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

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

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

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

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

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

I. Customer Due Diligence

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

---

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

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

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

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

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

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

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

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

---

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

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

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

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

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

II. Beneficial Ownership

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

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

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

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

---

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

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

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

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

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

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

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

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

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

---

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

16 *Id.* § 103.175(o).

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

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

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

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

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

---

18 31 U.S.C. §§ 5318A.

19 *Id.* § 5318(e)(3).

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

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

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

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

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

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

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

---

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

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

25 *See* 31 C.F.R. § 103.175(b).

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

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

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

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

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

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

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

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

---

27 31 C.F.R. § 103.178(b).

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

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

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

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

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

---

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

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

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel
Investment Company Institute

/s/ Ira D. Hammerman

Ira D. Hammerman
General Counsel
Securities Industry and Financial Markets Association

/s/ Barbara Wierzynski

Barbara Wierzynski
General Counsel
Futures Industry Association

cc:

Robert E. Plaze
Associate Director
Division of Investment Management
U.S. Securities and Exchange Commission

Lori Price
Assistant General Counsel
U.S. Securities and Exchange Commission

Helene D. Schroeder
Special Counsel
Division of Clearing and Intermediary Oversight
Commodity Futures Trading Commission

John Walsh
Chief Counsel
Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission