Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-128-2005
December 28, 2005

USA PATRIOT ACT
Final Regulation Implementing Section 312 of USA PATRIOT Act

Summary: The Financial Crimes Enforcement Network (FinCEN) has announced the final regulation implementing the international correspondent banking provisions and the private banking provisions of Section 312 of the USA PATRIOT Act. Concurrently, FinCEN has released a further notice of proposed rulemaking on one key issue regarding correspondent banking. To view the final and proposed rules, along with a press release and fact sheet from FinCEN, visit FinCEN's Web site at http://www.fincen.gov/section312.pdf.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
BSA Compliance Officer

Related Topics:
Bank Secrecy Act/Anti-Money Laundering Programs

Attachment:
None

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Note:
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Highlights:

- FinCEN released the final regulation implementing Section 312 of the USA PATRIOT Act on December 21, 2005. Upon its effective date, the final rule will replace the interim final rule imposed in 2002.
- The final regulation takes effect within 90 days from the date the regulation is published in the *Federal Register* (anticipated by January 4, 2006) for new accounts opened by U.S. financial institutions and 270 days from that date for existing accounts.
- The final rule requires certain U.S. financial institutions to apply due diligence to correspondent accounts maintained for certain foreign financial institutions and private banking accounts maintained for foreign individuals.
- With respect to correspondent banking, generally, the rule establishes the scope of U.S. financial institutions to which the rule applies and outlines general due-diligence requirements to mitigate exposure to potential money-laundering activities.
- With respect to private banking accounts, the rule outlines the due diligence and enhanced due diligence that is required and further clarifies duties with respect to accounts maintained for senior foreign political figures.
- Simultaneously, FinCEN has announced a related notice of proposed rulemaking involving one key provision of Section 312 that requires enhanced due diligence for correspondent accounts maintained for certain foreign banks.
- FinCEN has provided a press release, the final regulation, the notice of proposed rulemaking for enhanced due diligence procedures related to correspondent banking activities, and an informative fact sheet on its Web site at http://www.fincen.gov/section312.pdf.
- Please distribute this information to the appropriate personnel in your institution.

U.S. Department of the Treasury
Financial Crimes Enforcement Network
FinCENnews
FinCEN's web site is located at: http://www.fincen.gov

FOR IMMEDIATE RELEASE (703) 905-3770
December 21, 2005

Final Regulation Implementing Section 312 of the USA PATRIOT Act Announced

The Financial Crimes Enforcement Network announced today a final regulation implementing the international correspondent banking provisions and the private banking provisions of Section 312 of the USA PATRIOT Act. The final rule requires certain U.S. financial institutions to apply due diligence to correspondent accounts maintained for certain foreign financial institutions. Simultaneously, the Financial Crimes Enforcement Network has announced a related notice of proposed rulemaking involving one key provision of Section 312 that requires enhanced due diligence for correspondent accounts maintained for certain foreign banks.

The final rule takes effect within 90 days for new accounts opened by U.S. financial institutions and 270 days for existing accounts from the date the regulation is published in the *Federal Register*. The rules will be published in the *Federal Register* shortly after the beginning of the year.

Section 312 of the USA PATRIOT Act requires U.S. financial institutions to perform due diligence and, in some cases, enhanced due diligence, with regard to correspondent accounts established or maintained for foreign financial institutions and private banking accounts established or maintained for non-U.S. persons. "This rule reflects a significant milestone in our continued progress towards adding transparency to the financial system to help safeguard it from the financing of terror and other illicit money flows," said William J. Fox, Director of the Financial Crimes Enforcement Network. "Further, this regulation provides a platform from which additional, fact-specific guidance for the industry can flow."

The Final Rule **–** The final rule implements all of Section 312 with the exception of the provisions requiring enhanced due diligence in connection with certain foreign correspondent banks. With respect to correspondent banking generally, it limits the scope of U.S. financial institutions to which the rule applies and outlines the general due diligence requirements. With respect to private banking accounts, the final rule similarly limits the scope of U.S. financial institutions to which the rule applies, outlines the due diligence and enhanced due diligence that is required, and further clarifies duties with respect to accounts maintained for senior foreign

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political figures. Specifically, the general due diligence provisions and the private banking provisions will apply to depository institutions, securities broker-dealers, futures commission merchants and introducing brokers in commodities, and mutual funds.

The Notice of Proposed Rulemaking – The Financial Crimes Enforcement Network has also released a notice of proposed rulemaking regarding the key provision of Section 312 that requires enhanced due diligence for correspondent accounts maintained by certain foreign banks. The original proposed rulemaking issued in 2002 sought to create an exception to the enhanced due diligence requirement for those offshore banks that were branches of well-regulated foreign banks. Specifically, we proposed to exclude from enhanced due diligence those foreign banks operating under an offshore banking license that are branches of banks licensed in a jurisdiction where one or more banks had been determined by the Federal Reserve to be subject to comprehensive supervision or regulation on a consolidated basis.

The notice of proposed rulemaking focuses on clarifying that U.S. financial institutions have some flexibility in applying the enhanced due diligence procedures on a risk-assessed basis, tailoring the enhanced due diligence to the risks associated with the particular account. The issuance of the proposed rule opens a 60-day comment period, and the Financial Crimes Enforcement Network will take into consideration all comments before issuing the final rule.

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Attachments:

- **Final Regulation**
- **Notice of Proposed Rulemaking**
- **Fact Sheet**

Federal Register

Wednesday,
January 4, 2006

Part III

Department of the Treasury

31 CFR Part 103

Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts; Final Rule and Proposed Rule

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506–AA29

Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts

AGENCY: Financial Crimes Enforcement Network, Treasury.

ACTION: Final rule.

SUMMARY: The Financial Crimes Enforcement Network is issuing this final rule to implement the requirements contained in section 312 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act). Section 312 requires U.S. financial institutions to establish due diligence policies, procedures, and controls reasonably designed to detect and report money laundering through correspondent accounts and private banking accounts that U.S. financial institutions establish or maintain for non-U.S. persons. This final rule supercedes an interim final rule we issued on July 23, 2002. The interim final rule temporarily deferred application of the requirements contained in section 312 for certain financial institutions and provided guidance, pending issuance of a final rule, to those financial institutions for which compliance with section 312 was not deferred. We are publishing elsewhere in this separate part of the **Federal Register** a Notice of Proposed Rulemaking implementing section 312, and focusing exclusively on enhanced due diligence requirements.

DATES: This final rule is effective February 3, 2006.

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949–2732.

SUPPLEMENTARY INFORMATION:

I. Background

Section 312 of the Act amended the Bank Secrecy Act [1] to add new subsection (i) to 31 U.S.C. 5318. This provision requires each U.S. financial institution that establishes, maintains, administers, or manages a correspondent account or a private banking account in the United States for a non-U.S. person to subject such accounts to certain anti-money laundering measures. In particular, financial institutions must establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to enable the financial institution to detect and report instances of money laundering through these accounts.

In addition to the general due diligence requirements, which apply to all correspondent accounts for non-U.S. persons, section 5318(i)(2) specifies additional standards for correspondent accounts maintained for certain foreign banks. These additional standards apply to correspondent accounts maintained for a foreign bank operating under an offshore banking license, under a license issued by a country designated as being non-cooperative with international anti-money laundering principles or procedures by an intergovernmental group or organization of which the United States is a member and with which designation the United States concurs, or under a license issued by a country designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns. A financial institution must take reasonable steps to: (1) Conduct enhanced scrutiny of a correspondent account maintained for or on behalf of such a foreign bank to guard against money laundering and to report suspicious activity; (2) ascertain whether such a foreign bank provides correspondent accounts to other foreign banks and, if so, to conduct appropriate due diligence; and (3) identify the owners of such a foreign bank if its shares are not publicly traded.

Section 5318(i) also sets forth minimum due diligence requirements for private banking accounts for non-U.S. persons. Specifically, a covered financial institution must take reasonable steps to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, private banking accounts, as necessary to guard against money laundering and to report suspicious transactions. The institution must also conduct enhanced scrutiny of private banking accounts requested or maintained for or on behalf of senior foreign political figures (which includes family members or close associates). Enhanced scrutiny must be reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.

A. The 2002 Proposal

On May 30, 2002, we published in the **Federal Register** a notice of proposed rulemaking (2002 Proposal) to implement section 5318(i).[2] In the proposed rule, we sought to take the statutory mandate of section 5318(i) and to translate it into specific regulatory directives for financial institutions to apply. Following the statute, the rule we proposed required certain U.S. financial institutions to apply due diligence and enhanced due diligence procedures to foreign financial institutions [3] that maintain correspondent accounts as well as to non-U.S. persons who establish private banking accounts in the United States. The 2002 Proposal set forth a series of due diligence procedures that financial institutions covered by the rule may, and in some instances must, apply to correspondent accounts and private banking accounts for non-U.S. persons.

B. The Interim Final Rule

We received comments in response to the 2002 Proposal that raised many concerns regarding the numerous definitions in the 2002 Proposal, the scope of the requirements of this provision, and the institutions that would be subject to them. Section 312(b)(2) of the Act provides that section 5318(i) of the Bank Secrecy Act took effect on July 23, 2002, regardless of whether final rules had been issued by that date. In order to have adequate time to review the comments, to determine the appropriate resolution of the many issues raised, and to give clear directions to the affected financial institutions, we issued an interim final rule (the Interim Rule) [4] on July 23, 2002, and exercised our authority under 31 U.S.C. 5318(a)(6) to defer temporarily the application of 31 U.S.C. 5318(i) to certain financial institutions. For those financial institutions that were not subject to the deferral, we set forth interim guidance for compliance with the statute by delineating the scope of coverage, duties, and obligations under that provision, pending issuance of a final rule.

C. Consultation With Federal Functional Regulators

Section 312(b) of the Act provides that the Secretary of the Treasury (Secretary) shall issue implementing regulations under this section ''in consultation with the appropriate federal functional regulators (as defined

[1] Bank Secrecy Act, Pub. L. 91–508 (codified as amended at 12 U.S.C. 1829b, 12 U.S.C. 1957–1959, and 31 U.S.C. 5311–5314 and 5316–5332).

[2] Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 FR 37736.

[3] Foreign financial institutions were defined to include foreign banks and any other foreign person that, if organized in the United States, would be required to establish an anti-money laundering program pursuant to 31 CFR 103.120 to 103.169.

[4] Due Diligence Anti-Money Laundering Programs for Certain Foreign Accounts, 67 FR 48348.

in section 509 of the Gramm-Leach-Bliley Act) of the affected financial institutions.''[5] The 2002 Proposal was issued in consultation with staff at all of these federal functional regulators. The provisions of this final rule also reflect consultation with each of the federal functional regulators or their staff.

D. Further Notice of Proposed Rulemaking

Section 5318(i)(2) directs covered financial institutions to establish procedures for conducting enhanced due diligence with regard to correspondent accounts established or maintained for certain categories of foreign banks. In light of the extensive comments received, we are proposing a different approach toward the implementation of this provision than that set forth in the 2002 Proposal. To ensure adequate notice and opportunity for comment, we have re-noticed the regulation implementing the enhanced due diligence portion of section 312 with regard to correspondent accounts in its entirety. The proposed rulemaking is published elsewhere in this separate part of the **Federal Register.** Until a final rule is published and becomes effective, banks, savings associations, and federally insured credit unions must continue to apply the enhanced due diligence requirements of 31 U.S.C. 5318(i)(2), while securities broker-dealers, futures commission merchants, introducing brokers, mutual funds, and trust banks and trust companies that have a federal regulator, remain exempt from such requirements.

II. Summary of Comments

We received 33 comments regarding the 2002 Proposal. Commenters included U.S. banks, securities broker-dealers, other financial institutions, foreign banks, trade associations representing all the foregoing, a self-regulatory organization, an association of state banking supervisors, and a state gaming commission. Eleven financial institution trade associations jointly signed one of the comments. We also received a joint comment from three members of Congress.[6]

With respect to the correspondent account provisions, the greatest number of comments concerned the definition of correspondent account and the prescribed due diligence requirements for such accounts. Commenters also raised questions about the definitions of covered financial institution and foreign financial institution, as well as the enhanced due diligence requirements for correspondent accounts for certain foreign banks. With respect to the proposed provisions concerning private banking accounts, commenters raised concerns about the definitions of beneficial owner, private banking account, and senior foreign political figure, and sought clarification regarding the nature and extent of the due diligence required for these accounts. Many commenters also addressed the required timing for compliance with the various provisions. These issues and their resolution are discussed below in the section-by-section analysis.

III. Section-by-Section Analysis

A. Section 103.175—Definitions Relating to Correspondent Accounts

1. *Correspondent account.* The term correspondent account, as used in section 5318(i), is defined by reference to the definition in 31 U.S.C. 5318A, as added by section 311 of the Act. The definition in the 2002 Proposal was taken verbatim from section 5318A(e)(1)(B), which defines a correspondent account as ''an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution.''

Many commenters found the definition to be overly broad, extending beyond the commonly understood meaning of correspondent account (and even beyond the meaning of the term account). They objected to the phrase ''or handle other financial transactions related to such institution'' as potentially bringing under the rule not only every kind of account maintained for foreign financial institutions, but also any transaction performed by a covered institution on behalf of a foreign institution.[7] According to these commenters, adopting such an overly broad definition would be counterproductive, requiring U.S. financial institutions to devote limited resources to a broad range of accounts and transactions regardless of the level of risk associated with them. Some commenters urged us to narrow the definition of correspondent account to those accounts used to deposit or transfer customer funds. Other commenters argued that the definition should specifically exclude certain types of accounts that do not pose a meaningful risk of money laundering, including limited purpose accounts through which funds are received and disbursed under defined conditions to identified parties such as: escrow, clearing, and custody accounts; proprietary accounts where the foreign financial institution is acting as principal, such as foreign exchange accounts; and accounts held for foreign financial institutions subject to a robust anti-money laundering regime.

The congressional commenters urged us to retain the broad definition of correspondent account, stating that all categories of accounts falling within the definition should receive an appropriate level of due diligence.

After considering these comments, we have decided that the statutory definition of correspondent account contained in the 2002 Proposal is, in substance, appropriate for the final rule as well. The definition of a correspondent account under this final rule mirrors the definition used in the section 313/319 Rule, although additional U.S. financial institutions are subject to this final rule.[8] We are aware of the burden resulting from the application of this broad definition, and we acknowledge that accounts used to hold, transfer, or invest customer funds represent a greater money laundering risk than proprietary accounts or accounts used for certain specific purposes, such as custody accounts or escrow accounts. Nevertheless, we have concluded that a broad definition is

[5] Section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809) defines the federal functional regulators to include the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration Board, and the Securities and Exchange Commission. We also consulted with the Commodity Futures Trading Commission.

[6] Comments may be inspected at the Financial Crimes Enforcement Network reading room in Washington, DC between 10 a.m. and 4 p.m. Persons wishing to inspect comments submitted must request an appointment by telephone at (202) 354–6400 (not a toll-free number). The comment letters are also available on our Web site at *http://www.fincen.gov/reg_312commentsA.html.*

[7] Commenters representing depository institutions and securities broker-dealers in many cases reiterated the comments submitted in response to the proposed rule implementing sections 313 and 319(b) of the Act. See Anti-Money Laundering Requirements—Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks; 67 FR 60562, 60563–60564 (Sept. 26, 2002) (hereinafter ''section 313/319 Rule'').

[8] In this final rule we have made technical changes to conform the definition of correspondent account for purposes of this rule with the definition for purposes of the section 313/319 Rule. The definition for purposes of this final rule includes the phrase ''or other disbursements'' after ''payments,'' and the definition for purposes of the section 313/319 Rule is amended by deleting the redundant words ''a correspondent account is'' and the unnecessary words ''by a covered financial institution.'' Also, the definition from the section 313/319 Rule, which is limited to accounts for foreign banks, applies to paragraphs 103.176(b) and (c) of the final rule, which relate solely to accounts for foreign banks.

appropriate. Limiting the definition would undermine the purpose of the statute by eliminating from the scope of this rule a wide range of account relationships that may pose money laundering risks. Moreover, it may be difficult in some situations to know with certainty whether an account the covered financial institution believes to be proprietary is being used for customer transactions.[9]

We believe that the better approach is to retain the broad statutory definition of correspondent account while modifying the due diligence requirements under the final rule to be more risk-based in nature. This is in accord with the fact that many of the commenters, including the congressional commenters, supported the need for a risk-based due diligence program. This approach should provide covered financial institutions sufficient flexibility to allocate resources and their due diligence efforts in an appropriate manner consistent with the statutory goal.

We also understand that the statutory definition of a correspondent account could create uncertainty as to the types of relationships that are covered, particularly for non-bank covered financial institutions. The term correspondent account does not have an established meaning outside of the banking industry, nor does the statute define the term account for those institutions. Instead, it requires the term to be defined by regulation.[10]

Accordingly, in compliance with the statutory mandate, and to provide additional clarity as to the scope of the term correspondent account, we have added to the final rule specific definitions for the term account as they apply to the various non-bank covered financial institutions that are based on the definitions contained in the final rules issued under 31 U.S.C. 5318(l). When read in conjunction with the correspondent account definition, the industry-specific account definitions should give greater direction to covered financial institutions as to the types and scope of the relationships subject to this rule by addressing the functional differences among them. In addition, these account definitions, discussed in detail below under ''Account,'' make it clear that this rule does not apply to one-time, isolated, or infrequent transactions.

2. *Covered financial institution.* The 2002 Proposal defined covered financial institution to mean insured depository institutions (and their foreign branches), U.S. branches and agencies of foreign banks, Edge Act corporations, securities broker-dealers, and all other financial institutions subject to an anti-money laundering program requirement under the Bank Secrecy Act, which at that time included futures commission merchants and introducing brokers, mutual funds, certain money services businesses, casinos, and operators of credit card systems.[11] The 2002 Proposal also stated that, as additional financial institutions become subject to an anti-money laundering program requirement under 31 U.S.C. 5318(h), they would be included in the definition of covered financial institution.

As discussed in greater detail below, we have decided to limit the scope of covered financial institutions to those institutions that we believe offer correspondent services to foreign financial institutions. Those covered by this rule include federally regulated banks, savings associations, credit unions, and trust companies subject to an anti-money laundering program requirement; branches and agencies of foreign banks; Edge Act corporations; securities broker-dealers; futures commission merchants; introducing brokers; and mutual funds. Those not covered by the rule include foreign branches of insured depository institutions (which are defined as foreign banks under the final rule), money services businesses, casinos, and operators of credit card systems.

- Banking institutions.

The banking institutions that addressed this definition urged us to remove their foreign branches from the definition. We agree that this change is appropriate for the reasons discussed in the section 313/319 Rule. These include the plain language of the statute, the historical approach taken in other Bank Secrecy Act rules, and the anti-competitive impact on foreign branches that could result from their inclusion.[12] Thus, consistent with the definition of foreign bank used in the section 313/319 Rule, for purposes of this rule, foreign branches of U.S. banks will be treated as foreign banks rather than as covered financial institutions.

We noted in the Interim Rule that we were evaluating whether to include uninsured national trust banks, non-federally regulated, state-chartered uninsured trust companies and trust banks, and non-federally insured credit unions under the rule, to the extent that these entities maintain correspondent accounts for foreign financial institutions or private banking accounts for non-U.S. persons.[13] We have decided to include, as covered financial institutions, uninsured trust banks and trust companies that are federally regulated and that are subject to an anti-money laundering program requirement. As for the remaining types of banking institutions, we do not believe that it is appropriate to subject them to the provisions of this rule until they are required to have anti-money laundering programs. We expect to issue in the future a proposed rule requiring credit unions, and trust companies that do not have a federal functional regulator, to establish anti-money laundering programs.[14] While we do not anticipate that a large number of these financial institutions conduct the types of international business or offer the types of accounts that would be affected by this rule, we will nonetheless amend this rule to include those institutions upon adoption of any final rule requiring those institutions to establish anti-money laundering programs.

For banks, correspondent accounts established on behalf of foreign financial institutions include any transaction account, savings account, asset account or account involving an extension of credit, as well as any other relationship with a foreign financial institution to provide ongoing services. These correspondent accounts include, but are not limited to, accounts to purchase, sell, lend, or otherwise hold securities, including securities repurchase arrangements; accounts that clear and settle securities transactions for clients; ''due to'' accounts; accounts for trading foreign currency; foreign exchange contracts; custody accounts for holding securities or other assets in connection with securities transactions as collateral; and over-the-counter derivatives contracts. These accounts are included even if the U.S. bank does not maintain a deposit account for the

[9] For example, although commenters argued that proprietary correspondent accounts where the foreign bank or institution is acting as principal should be excluded as being low risk for money laundering, these proprietary accounts can and have been abused to facilitate money laundering by commingling bank funds with individual customer funds in order to portray an individual's funds and account activity as being that of the foreign institution. See Minority Report on Correspondent Banking, *infra* note 24, Part IV, discussing the case of Guardian Bank and Trust.

[10] Section 311(e)(2) of the Act requires the Secretary to define by regulation the term ''account'' for non-bank financial institutions subject to sections 311, 312, and 313 of the Act. See 31 U.S.C. 5318A(e)(2).

[11] 2002 Proposal, *supra* note 2.

[12] Section 313/319 Rule, *supra* note 7, at 60565.

[13] Interim Rule, *supra* note 4, at 48349.

[14] These types of institutions are included in the definition of bank in the section 326 customer identification rule and are therefore required to establish customer identification programs. See 31 CFR 103.121(a)(2)(ii), and the related analysis at 68 FR 25090, 25109 (May 9, 2003).

foreign bank or other foreign financial institution.[15]

• Non-bank financial institutions.

Several commenters urged us to exclude from the proposed definition certain types of financial institutions, including mutual funds, non-bank funds transmitters, loan or finance companies, casinos, and credit card operators. In addition, several commenters objected that the 2002 Proposal was open-ended, extending this rule to additional financial institutions when they become subject to an anti-money laundering program requirement. The congressional comment, on the other hand, stated that the correspondent account definition in the Act was intentionally broad to ensure that the relationships maintained by a wide spectrum of U.S. financial institutions are subject to the statute's requirements.

The application of the correspondent account definition to non-bank financial institutions is one of the most difficult interpretative issues in this rulemaking. Because the Act has taken a term—correspondent account—that has been associated with the banking industry, and has extended it to other account and account-like relationships maintained by various financial institutions, the term's application to non-bank financial institutions is not readily apparent.

The goal of section 312 is to help prevent money laundering through accounts that give foreign financial institutions a base for moving funds through the U.S. financial system.[16] Thus, the non-bank financial institutions subject to the final rule should be those that offer accounts that provide foreign financial institutions a conduit for engaging in ongoing transactions in the U.S. financial system either on their own behalf or for their customers. Based on a review of the financial institutions identified in the Bank Secrecy Act, we have concluded that, for purposes of this rule, the financial institutions that offer customers correspondent accounts (as that term is defined in the Act) include, in addition to depository institutions: securities broker-dealers, Edge Act corporations, mutual funds, and futures commission merchants and introducing brokers.[17]

Securities broker-dealers are defined as covered financial institutions under section 313 of the Act and are subject to this final rule. Securities broker-dealers maintain accounts for foreign financial institutions to engage in securities transactions, funds transfers, or other financial transactions, whether for the financial institution as principal or for its customers. Such accounts, which would constitute correspondent accounts under the final rule, include: (1) Accounts to purchase, sell, lend, or otherwise hold securities, including securities repurchase arrangements; (2) prime brokerage accounts that clear and settle securities transactions for clients; (3) accounts for trading foreign currency; (4) custody accounts for holding securities or other assets in connection with securities transactions as collateral; and (5) over-the-counter derivatives contracts.

Mutual funds are also included as covered financial institutions under this rule. We understand that mutual funds maintain accounts for foreign financial institutions (including foreign banks and foreign securities firms) in which these foreign financial institutions may hold investments in such mutual funds as principals or for their customers, and which the foreign financial institution may use to make payments or to handle other financial transactions on the foreign institution's behalf. Therefore, we have determined that such accounts have sufficient similarities to correspondent accounts of banks that these entities also should be subject to the final rule.[18]

For futures commission merchants and introducing brokers, a correspondent account would include accounts for foreign financial institutions to engage in futures or commodity options transactions, funds transfers, or other financial transactions, including accounts for trading foreign currency and over-the-counter derivatives transactions, whether for the financial institution as principal or for its customers.[19] Such relationships can operate similarly to correspondent accounts of banks and securities broker-dealers in that they can be used to receive deposits from or make payments on behalf of foreign financial institutions. It is, therefore, appropriate to include these institutions as covered financial institutions in the final rule.

In both the securities and commodities context, introducing brokers have been included as covered financial institutions. We anticipate that introducing brokers may share accounts with clearing brokers and may realize efficiencies by apportioning functions associated with a due diligence program under the final section 312 rule pursuant to an agreement. To this end, these firms may consult and share information with each other to fulfill their due diligence obligations under this section.[20] Nonetheless, each financial institution is responsible for ensuring that the requirements of this rule are met.

We do not believe that the other financial institutions identified in the 2002 Proposal offer accounts that fall within the correspondent account definition. A commenter representing loan or finance companies stated that the definition of correspondent account should not include accounts payable or accounts receivable maintained for the purpose of recording loan and lease payments. We agree. Loan or finance companies that extend credit to foreign financial institutions would obviously maintain accounts receivable for such customers, but these are accounting entries that do not enable a loan or finance company to receive deposits, make payments, or handle other financial transactions on behalf of a foreign financial institution.

A commenter representing an operator of a credit card system noted that the industry does not maintain correspondent accounts and recommended that we exclude operators of credit card systems from the scope of the rule. We have decided that this is an appropriate change to make. Credit card operators, as described in the interim final rule establishing anti-money laundering programs for credit card operators, serve primarily as a clearinghouse through which debts are settled and payments are made or received. Credit card system operators

[15] We note that accounts maintained by foreign banks for covered financial institutions are not correspondent accounts subject to this rule, regardless of whether there are credit balances in such accounts.

[16] See 147 Cong. Rec. S10990, 11035 (Oct. 25, 2001) (statement of Sen. Levin).

[17] As set forth in the final rule, the foreign branches of these entities are treated as foreign financial institutions.

[18] Closed-end investment companies, as defined in section 5(a)(2) of the Investment Company Act of 1940 (15 U.S.C. 80a–5(a)(2)), are not included as covered financial institutions under this rule.

[19] Although orders for futures and options transactions may be transmitted through an introducing broker, the funds relating to introduced accounts are held with a futures commission merchant. Monthly confirmation statements reflecting such transactions must be issued by the futures commission merchant. Nevertheless, introducing brokers can play an important role in preventing money laundering in the futures industry because they are in a position to know the identity of customers they introduce to futures commission merchants and to perform due diligence on such customers, including monitoring trading activity (and are subject to suspicious activity reporting requirements) (see 31 CFR 103.17).

[20] For example, 31 CFR 103.110 sets forth voluntary procedures for information sharing among Bank Secrecy Act -defined financial institutions, which, if followed, entitle them to a safe harbor from liability arising under Federal, State, or local law or contract for such information sharing.

generally do not receive deposits or make payments; instead, the issuing and acquiring banks process, handle, and transfer funds in connection with the use of the credit card. Thus, we have determined that credit card operators do not have correspondent accounts and are not covered financial institutions for purposes of this rule.[21]

A state gaming commission commented that casinos offer various accounts to individual customers, but do not offer correspondent accounts. The commission recommended that casinos be excluded from the rule. We agree with this analysis, and have excluded casinos from the rule.

Finally, upon further consideration, we have decided to exclude money services businesses from the definition of a covered financial institution. Under existing Bank Secrecy Act regulations, money services businesses comprise five distinct types of financial services providers: (1) Currency dealers or exchangers; (2) check cashers; (3) issuers of traveler's checks, money orders, or stored value; (4) sellers or redeemers of traveler's checks, money orders, or stored value; and (5) money transmitters.[22] Money services businesses in the first four categories do not maintain account relationships with foreign financial institutions. They do not hold, transfer or transmit the funds of foreign financial institutions and/or their customers and, thus, are outside the scope of the definition of correspondent account adopted herein. With respect to money transmitters, we have determined that money transmitters' methods of operation and the attendant risks with respect to foreign financial institutions and their customers differ sufficiently from the concept and definition of a correspondent account envisioned by the statute and this rule that their inclusion would not achieve the desired result. Rather than attempting to equate the relationship between two money transmitters to the concept of a correspondent account, we instead have previously issued guidance which addressed the specific risks posed by the international flow of funds through money services businesses. Using this more precisely targeted tool, discussed below, we expect to achieve the same desired results.

Money transmitters, like the financial institutions that are subject to this rule, plainly facilitate the cross-border flow of funds into and out of the United States, but they do so in a manner that does not resemble the correspondent accounts that are the focus of section 312. There is a relationship that exists between the money transmitter and its foreign institutional counterparties (that is, the institutions on the other end of either a ''send'' or ''receive'' transaction). While such relationships facilitate the flow of funds on behalf of customers, as do correspondent relationships, there are significant differences that directly implicate the focus of this rule.

The vast majority of money transmitters in the United States operate through a system of agents throughout the world. In fact, we estimate that over 95 percent of all cross-border remittances that are done through money transmitters use this model. Other money transmitters operate through more informal relationships, such as the trust-based hawala system.[23] Regardless of the form the relationship takes, these money transmissions are all initiated by a third party seeking to send or receive funds and are not directed or controlled by the sending or receiving institutions. Unlike the case of a covered financial institution, the establishment of an agency or other counterparty relationship in the money transmitter industry neither gives the agent/counterparty a ''home'' in the U.S. financial institution through which it can carry out its own transactions on an ongoing basis, nor carries with it the potential for a hub of other parties to be ''nested'' within the agent/counterparty. Section 312 aims at two main congressional concerns with correspondent banking: the ability of corrupt foreign financial institutions to transact business in the United States,[24] and the ability of customers of a lax foreign correspondent to access the U.S. financial system through the correspondent account while shielding their identities.[25] Indeed, one of the statutory requirements for enhanced due diligence is the identification of nested correspondent accounts and the performance of due diligence on them.[26]

We recognize that criminals and terrorists might be able to use money transmitters to move money through the United States, and that it is imperative that money transmitters conduct due diligence on their foreign counterparties to enable them to perform the appropriate level of suspicious activity and risk monitoring. However, we have addressed this risk separately through the issuance of specific guidance, as set forth below.

We believe that the obligation for a money transmitter to know its foreign counterparties (as well as its domestic agents and counterparties) is a part of each money transmitter's obligation to have appropriate policies, procedures and internal controls to guard against money laundering and the financing of terrorist activities and to report suspicious activities.[27] To further delineate these obligations, on December 4, 2004, we issued Interpretive Release No. 2004–1, which addressed the due diligence obligations of a money transmitter with regard to its foreign counterparties/agents. This interpretative rule was issued to ensure that money transmitters place appropriate controls on cross-border relationships without attempting to force the relationship to fit within this rule relating to correspondent accounts.

3. *Account.* As noted earlier, we have added to the final rule individualized definitions of the term account for each type of non-bank covered financial institution listed above to tailor the term correspondent account to the functions of the various affected industries. These industry specific definitions are similar to those contained in the final rules issued under section 326 of the Act,[28] but with one primary modification.[29] Specifically, we have not adopted the transfer exception contained in the section 326 definition of account, which excludes accounts acquired by, but not opened at, a covered financial institution.

Further, the definition of account for each covered financial institution specifically includes the word regular to stress the fact that the scope of section 312 is intended to be limited to those

[21] Operators of credit card systems are subject to an anti-money laundering program requirement under section 352 of the Act that is specifically tailored to require increased due diligence regarding any foreign financial institution presenting a heightened risk of money laundering or terrorist financing. 67 FR 21121 (April 29, 2002).

[22] See 31 CFR 103.11 (uu).

[23] See Report to the Congress in accordance with section 359 of the Patriot Act, available at *http://www.fincen.gov*.

[24] See Minority Staff Report on Correspondent Banking: A Gateway to Money Laundering: Hearing Before the Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 107th Cong., 277–884 (2001).

[25] See section 302(a)(6) of the Act (finding that ''correspondent banking facilities are one of the banking mechanisms susceptible in some circumstances to manipulation by foreign banks to permit the laundering of funds by hiding the identify or real parties in interest to financial transactions.'').

[26] See section 312(a)(i)(2)(B)(iii) of the Act.

[27] See 31 CFR 103.125 and 103.20. We previously imposed a due diligence obligation on a money transmitter with respect to its domestic agents. See Matter of Western Union Financial Services, Inc., No. 2003–2 (March 6, 2003), available at *http://www.fincen.gov/western_union_assessment.pdf.*

[28] 31 CFR 103.121.

[29] See 31 CFR 103.122 for the definition of account in the broker-dealer context.

correspondent relationships where there is an arrangement to provide ongoing services, excluding isolated or infrequent transactions (although other obligations, such as suspicious activity reporting and funds transfer recordkeeping, apply to such transactions). Thus, for example, one time or infrequent securities transactions outside of the context of an established account relationship would not, by itself, constitute an account under the final rule.

With respect to banking institutions, we are adopting the same definition of account as contained in the section 313/319 Rule. Accordingly, for covered banking institutions, account shall mean ''any formal banking or business relationship established by a bank to provide regular services, dealings, and other financial transactions; and (B) includes a demand deposit, savings deposit, or other transaction or asset account and a credit account or other extension of credit.'' [30]

This definition is in substance very similar to the definition of account contained in the final rule issued under section 326 for banks. In this regard, we also note that the issuance by a bank of a funds transfer to, or receipt by a bank of a funds transfer from, a foreign bank does not, by itself, create an account relationship on behalf of the foreign bank under the final rule. This is consistent with the final rule issued under section 326 of the Act, which excludes wire transfers from the definition of an account.

As applied to securities broker-dealers, the term account shall mean ''any formal relationship established with a broker or dealer in securities to provide regular services to effect transactions in securities, including, but not limited to, the purchase or sale of securities and securities loaned and borrowed activity, and to hold securities or other assets for safekeeping or as collateral.''

For purposes of clarity and consistency, we are amending the definition of account in the section 313/319 Rule to incorporate this definition of account as applied to broker-dealers. Because this definition of account, which is specifically tailored to the securities industry, is no broader, and may well be somewhat narrower, than the definition currently applicable under that rule, there is no reason to delay the effectiveness of this amendment.

For purposes of futures commission merchants and introducing brokers, the term account shall mean ''any formal relationship established by a futures commission merchant to provide regular services, including, but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on any contract of sale of a commodity for future delivery, or options on a commodity.''

With respect to mutual funds, the term account shall mean ''any contractual or other business relationship established between a person and a mutual fund to provide regular services to effect transactions in securities issued by the mutual fund, including the purchase or sale of securities.'' [31]

4. *Foreign bank.* The 2002 Proposal defined foreign bank to mean an organization that: (1) Is organized under the laws of a foreign country; (2) engages in the business of banking; (3) is recognized as a bank by the bank supervisory or monetary authority of the country of its organization or principal operations; and (4) receives deposits in the regular course of its business. The definition contained certain exceptions, including foreign central banks or monetary authorities functioning as central banks and certain international financial institutions or regional development banks. In this final rule, we have adopted the existing Bank Secrecy Act definition of foreign bank [32] (which includes foreign branches of U.S. banks) as we did in the section 313/319 Rule.[33] We believe that the existing Bank Secrecy Act definition will include the appropriate foreign entities, will be more precise, will result in fewer interpretive issues, and will not require the exceptions contained in the 2002 Proposal for foreign central banks, foreign monetary authorities that function as central banks, and international financial institutions and regional development banks, since they would not fall within this definition. We, thus, confirm that the definition of foreign bank does not include any foreign central bank or monetary authority that functions as a central bank, or any international financial institution or regional development bank formed by treaty or international agreement.[34]

5. *Foreign financial institution.* The 2002 Proposal defined foreign financial institution to mean a foreign bank and any other person organized under foreign law which, if organized in the United States, would be required to establish an anti-money laundering program. Thus, the proposed definition of this term mirrored the definition of covered financial institution, but described entities organized outside the United States.

Commenters raised several objections to this proposed definition. Many noted that a definition tied to U.S. entities would be difficult to apply due to different terminology and licensing methods used in foreign countries. Others noted the difficulties raised by the open-ended nature of the definition, which would be extended to additional categories of financial institutions should they be required to establish anti-money laundering programs in the future. Several commenters expressed the view that the proposed definition is overly broad and should be limited to the entities typically licensed and regulated as financial institutions, such as depository institutions, securities and futures firms, mutual funds, and money transmitters. The congressional comment supported the broad proposed definition, stating that it captured the broad scope intended by Congress.

After careful consideration of the issues raised, we have decided to limit the definition of foreign financial institutions to those institutions that may pose a more significant risk for money laundering and, thus, will be subject to this requirement, in order to appropriately focus covered financial institutions' due diligence efforts on the risk posed by the foreign institution rather than on the mere form of the entity. Accordingly, in this final rule, foreign financial institutions are defined

[30] The phrase ''by a bank'' has been added to the definition of account to conform to the definitions of account applicable to the non-bank covered financial institutions. The phrase ''other financial transactions'' includes, but is not limited to, the purchase or sale of securities, securities lending and borrowing, and the holding of securities or other assets in connection with securities transactions for safekeeping or as collateral.

[31] We are aware that mutual funds do not offer the types of one-time services, or isolated or infrequent transactions, that other types of financial institutions may offer. The reference to providing regular services is included in the definition of account for mutual funds for the purpose of maintaining consistency between definitions.

[32] Current Bank Secrecy Act regulations define foreign bank as ''a bank organized under foreign law, or an agency, branch or office located outside the United States of a bank.'' The term does not include an agent, agency, branch, or office within the United States of a bank organized under foreign law. 31 CFR 103.11(o).

[33] Section 313/319 Rule, *supra* note 7, at 60566.

[34] Such institutions include, for example, the Bank for International Settlements, International Bank for Reconstruction and Development (World Bank), International Monetary Fund, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, International Finance Corporation, North American Development Bank, International Development Association, Multilateral Investment Guarantee Agency, European Investment Bank, Nordic Investment Bank, and Council of Europe Development Bank.

as foreign banks; the foreign offices of covered financial institutions; non-U.S. entities that, if they were located in the United States, would be a securities broker-dealer, futures commission merchant, or mutual fund;[35] and non-U.S. entities that are engaged in the business of, and are readily identifiable as, a currency dealer or exchanger or a money transmitter. This reflects our belief that such entities operate in a manner that both makes them readily identifiable[36] (despite differences in terminology or licensing[37]) and that poses a heightened risk of money laundering because they offer to money launderers outside the United States easy access to the U.S. financial system, as a result of their manner of operation and their offering of products with a high degree of liquidity. We, however, have included an exception to the definition of a foreign financial institution to exclude those entities that engage in currency exchange or money transmission only as an incidental aspect of their business. An example of this might be a hotel that exchanges small amounts of foreign currency for its guests or a tax service that cashes tax return checks as an accommodation. Although we specifically have excluded money services businesses from this rule as covered financial institutions, we have included foreign money transmitters and foreign currency dealers and exchangers as foreign financial institutions because of their role as consumers of correspondent services offered by covered financial institutions such as banks.

6. *Offshore banking license.* The 2002 Proposal proposed the same definition of offshore banking license as that contained in 31 U.S.C. 5318(i): A license to conduct banking activities that prohibits the licensed entity from conducting banking activities with the citizens of, or in the local currency of, the jurisdiction that issued the license. This final rule adopts the proposed definition without change.

B. Section 103.176—Due Diligence Programs for Correspondent Accounts for Foreign Financial Institutions

1. *General due diligence procedures.* Section 103.176(a) of the 2002 Proposal required that every covered financial institution maintain a due diligence program that includes policies, procedures, and controls reasonably designed to enable the financial institution to detect and report any known or suspected money laundering conducted through or involving any correspondent account that it maintains for a foreign financial institution. We have revised the language of the final rule to reflect the fact that the due diligence policies, procedures, and internal controls must be appropriate, specific, and risk-based, and that the rule applies to any correspondent account that is established, maintained, administered, or managed in the United States for a foreign financial institution. This change is consistent with the risk-based approach adopted herein, as well as with the congressional comment. The final rule also includes the requirement that the due diligence program be part of the covered financial institution's anti-money laundering program otherwise required by this subpart.

The 2002 Proposal further required that all due diligence programs maintained by covered financial institutions contain five specific procedures.[38] Many commenters urged us to adopt a risk-based rule that would enable covered financial institutions to better focus their attention and resources on the types of accounts that have a greater susceptibility to money laundering. In particular, some commenters suggested that only the first two elements contained in the 2002 Proposal should be included in the final rule, and that the remaining elements should be part of the institution's risk assessment program. Commenters noted in particular that the fifth proposed element—reviewing public information to ascertain whether the foreign institution has been the subject of criminal or regulatory action—is particularly problematic given the virtually limitless sources of public information. The comments suggested that, if a requirement to review public information is retained in the final rule, the financial institution's obligation be limited in some way (*e.g.*, information disseminated through print media that is readily available and is generally regarded as a leading publication and reliable). Commenters stressed that, if the definition of correspondent account is broad, financial institutions should be given flexibility in conducting due diligence, rather than being required to perform a specified list of inquiries for each account. The congressional comment also supported the adoption of a final rule incorporating the principle that the due diligence requirement should be risk-based.

We agree that this provision should be modified to incorporate a risk-based approach to the entire rule. Thus, each covered financial institution will be required to include in its due diligence program procedures for assessing the anti-money laundering risks posed by correspondent accounts it maintains for foreign financial institutions based upon a consideration of relevant factors, as appropriate to the particular jurisdiction, customer, and account. Given the breadth of the correspondent account definition, we believe that this requirement will permit covered financial institutions to assess the risks posed by their various non-U.S. customers and accounts and to direct their resources most appropriately at those accounts that pose a more significant money laundering risk. Relevant risk factors, which were not spelled out in detail in the 2002 Proposal, shall include, as appropriate:

- The nature of the foreign financial institution's business and the markets it serves, and the extent to which its business and the markets it serves present an increased risk for money laundering.
- The nature of the correspondent account, including the types of services to be provided (e.g., proprietary or customer), and the purpose and anticipated activity of the account.
- The nature and duration of the covered financial institution's relationship with the foreign financial institution (and, if relevant, with any

[35] For example, the European Union adopted a license regime throughout the European Union for ''undertakings for collective investment in transferable securities,'' similar to mutual funds in the United States, under the Directive on Undertakings for Collective Investment in Transferable Securities. *See* Council Directive 85/611/EE of December 20, 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, 1985 O.J. (L 375) 3.

[36] We note that the definitions of a currency dealer or exchanger and a money transmitter for purposes of inclusion as a foreign financial institution under the final rule do not correspond to the definitions of 31 CFR 103.11(uu). For purposes of this rule, we include only those businesses that are readily identifiable as such.

[37] We note that, except for mutual funds, the definition of foreign financial institution is not necessarily limited to the corresponding foreign institutions that are required by their chartering jurisdictions to register as such, but rather is a functional definition based on the entity's primary activity or activities.

[38] The five required procedures were: (1) Determining whether the correspondent account is subject to the enhanced due diligence requirements; (2) assessing whether the foreign financial institution presents a significant risk for money laundering; (3) considering information available from U.S. government agencies and multinational organizations with respect to supervision and regulation, if any, applicable to the foreign financial institution; (4) reviewing guidance we or the applicable federal functional regulator issued regarding money laundering risks associated with particular foreign financial institutions and correspondent accounts for foreign financial institutions generally; and (5) reviewing public information to ascertain whether the foreign financial institution has been the subject of criminal action of any nature or regulatory action relating to money laundering. The 2002 Proposal, *supra* note 2, at 37743.

affiliate of the foreign financial institution).

• The anti-money laundering and supervisory regime of the jurisdiction that issued the charter or license to the foreign financial institution, and, to the extent that information regarding such jurisdiction is reasonably available, of the jurisdiction in which any company that is an owner of the foreign financial institution is incorporated or chartered. This factor has been clarified to ensure that a covered financial institution considers, when appropriate, the anti-money laundering and supervisory regime of the foreign financial institution. In addition, the factor is designed to ensure that the covered financial institution considers, when appropriate and to the extent that information is reasonably available, the anti-money laundering and supervisory regime of the jurisdiction in which a corporate owner of the foreign financial institution is incorporated or chartered. Thus, for example, if a foreign financial institution is owned by an institution that is incorporated or chartered in a jurisdiction that has a robust anti-money laundering and supervisory regime, and the covered financial institution believes that this is relevant in assessing the risk posed by the foreign financial institution, then the covered financial institution should take this information into account in its risk assessment.

• Any information known or reasonably available to the covered financial institution about the foreign financial institution's anti-money laundering record, including public information in standard industry guides, periodicals, and major publications. The scope and depth of such a review will depend on the nature of the information uncovered. It should generally include a consideration of information that might be available from the Department of the Treasury or other federal governmental sources regarding the money laundering risks associated with particular foreign financial institutions and correspondent accounts for foreign financial institutions generally. This information could be contained in issuances stemming from action taken under section 311 of the Act, as well as determinations concerning comprehensive consolidated supervision made by the Federal Reserve in connection with applications from foreign banks or determinations concerning consolidated supervised entities or supervised investment bank holding companies by the Securities and Exchange Commission.

The final rule includes a new subparagraph (3) under the general due diligence paragraph (a) of section 103.176. This new provision states explicitly the requirement that was implicit in the 2002 Proposal: that covered financial institutions must apply ongoing risk-based procedures and controls to each correspondent account reasonably designed to detect and report money laundering.[39] We believe that, as part of ongoing due diligence, covered financial institutions should periodically review their correspondent accounts. We do not intend this review, in the ordinary situation, to mean a scrutiny of every transaction taking place within the account, but, instead, a review of the account sufficient to ensure that the covered financial institution can determine whether the nature and volume of account activity is generally consistent with information regarding the purpose and expected account activity and to ensure that the covered financial institutions can adequately identify suspicious transactions. For example, we understand that a number of covered financial institutions maintain account profiles for their correspondents in order to anticipate how the account might be used and the expected volume of activity. These profiles can serve as important baselines for detecting unusual activity.

We believe that an effective general due diligence program under section 103.176(a) will provide for a range of due diligence measures, based on a covered financial institution's risk assessment of a correspondent account. The starting point for financial institutions, therefore, should be a stratification of their money laundering risk based on a review of the relevant risk factors to determine which accounts may require increased measures. Section 103.176(a) does not prescribe the elements of increased due diligence that should be associated with specific risk factors, but a covered financial institution's general due diligence program should identify risk factors that would warrant the institution conducting additional scrutiny of a particular account. The covered financial institution's program under this rule should address these issues at a level of specificity and detail appropriate to that institution's foreign correspondent account operations and the types of accounts offered. In addition, the program should take into consideration the fact that some foreign correspondent bank accounts that a covered financial institution determines have a high risk of money laundering may necessitate increased due diligence even though they may not specifically fall within the statutory categories that would trigger enhanced due diligence. This due diligence may include, when appropriate, transaction testing or one or more of the elements of enhanced due diligence described in section 5318(i)(2).

Numerous commenters sought clarification from us on the extent to which covered financial institutions can rely on reputable foreign intermediaries to conduct due diligence of the intermediaries' customers because of concerns that the due diligence requirements under this section would be particularly burdensome. For example, one commenter noted that this requirement would be particularly onerous for mutual funds, which can have thousands of shareholders, some of which purchase their shares directly and some of which invest through intermediaries, including certain foreign financial institutions. These commenters misunderstand the requirements of 31 U.S.C. 5318(i) and this rule.

The due diligence requirement under this section of the Bank Secrecy Act generally requires an assessment of the money laundering risks presented by the foreign financial institution for which the correspondent account is maintained, and not for the customers of that institution. If, however, a covered financial institution's review of the account identifies activity inconsistent with what is expected, then, consistent with a risk-based due diligence program, the covered financial institution may need to review the account more carefully.

2. *Enhanced due diligence procedures.* Section 5318(i)(2) requires that a covered financial institution perform enhanced due diligence with regard to a correspondent account established or maintained for certain foreign banks. The 2002 Proposal proposed to implement these requirements in section 103.176(b), which specified minimum due diligence program requirements applicable to all foreign banks subject to enhanced due diligence.

In light of extensive comments received, we are proposing to take a different approach toward implementing this provision than that set forth in the 2002 Proposal. To ensure adequate notice and opportunity for comment, we have decided to re-notice the enhanced due diligence portion of section 312 with regard to

[39] Covered financial institutions that are not currently subject to suspicious activity reporting obligations under the Bank Secrecy Act rules (e.g., mutual funds) are encouraged to file voluntary reports of known or suspected violations of law conducted through or involving a correspondent account.

correspondent accounts in its entirety. The proposed rulemaking is published elsewhere in this separate part of the **Federal Register**.

3. *Special procedures.* Section 103.176(d) of the 2002 Proposal contained special procedures to be included in the covered financial institution's due diligence program. Those procedures addressed what the financial institution should do in situations where appropriate due diligence cannot be performed, including when the institution should refuse to open the account, suspend transaction activity, file a suspicious activity report, or close the account. There were no comments submitted regarding this provision, which is unchanged in this final rule.

4. *Effective dates.* Although the 2002 Proposal did not address the issue of an effective date, many commenters noted the difficulty of complying with the requirements of 31 U.S.C. 5318(i), especially with regard to its application to previously existing accounts, and also urged us to allow a sufficient transition period. We are mindful of the significant burden that will result from the statutory requirement that the provision applies to all correspondent accounts, regardless of when they were opened.

The final rule contains a new section 103.176(e)(1) that provides for the following effective dates for the obligations under this section: Effective 90 days after the date of publication of the final rule, the requirements of the final rule will apply to correspondent accounts opened on or after that date, and, effective 270 days after the date of publication of the final rule, the rule's requirements will apply to all correspondent accounts opened prior to the date that is 90 days after the date of publication of the final rule.[40]

Due to the fact that we are issuing a new Notice of Proposed Rulemaking (Notice) with regard to enhanced due diligence under section 5318(i)(2), it is necessary to ensure that there are no gaps in the relevant implementation periods. Consequently, we are deleting 31 CFR 103.181 through 103.183 set forth in the Interim Rule dealing with effective dates and are adding the following two paragraphs to take their place.

Paragraph 103.176(e)(2) contains a special implementation rule for banks. This paragraph requires that banks continue to comply with the due diligence requirements for correspondent accounts in 31 U.S.C. 5318(i) until the 90 and 270-day effective dates described in paragraph 103.176(e)(1) are triggered. This is consistent with the provisions of the Interim Rule found at 31 CFR 103.181. Moreover, consistent with the Interim Rule, paragraph (e)(2) provides that banks must continue to comply with the enhanced due diligence requirements of 31 U.S.C. 5318(i)(2) until a final rule based on the Notice is published.

Paragraph 103.176(e)(3) contains a special implementation rule for all other covered financial institutions to ensure consistency with the Interim Rule found at 31 CFR 103.182 and 103.183. Thus, this paragraph provides that securities broker-dealers, futures commission merchants, introducing brokers, mutual funds, and trust banks or trust companies that have a federal regulator (1) are not required to comply with the due diligence requirements of 31 U.S.C. 5318(i)(1) until the 90 and 270-day effective dates described in paragraph 103.176(e)(1) are triggered, and (2) are not required to comply with the enhanced due diligence requirements of 31 U.S.C. 5318(i)(2) until otherwise provided by us in a final rule issued regarding those requirements.

Finally, paragraph (e)(4) contains a general exemption from the due diligence requirements for correspondent accounts contained in 31 U.S.C. 5318(i) for all financial institutions that are not defined in the final rule as covered financial institutions. This exemption replaces without substantive change the provisions of the Interim Rule found at 31 CFR 103.183.

C. Section 103.178—Due Diligence Programs for Private Banking Accounts for Non-U.S. Persons—Definitions

Section 103.178 of the 2002 Proposal implemented the requirements in 31 U.S.C. 5318(i) regarding due diligence standards applicable to private banking accounts established, administered, managed, or maintained in the United States for or on behalf of non-U.S. persons.

a. Definitions—In General

The definitions relating to this section generated considerable comment and are discussed below.

1. *Beneficial ownership.* Proposed section 103.175(b) defined a beneficial ownership interest in an account generally as the legal authority to fund, direct, or manage the account or a legal entitlement to the assets of an account (excluding financial interests that do not amount to either $1,000,000 or five percent of either the corpus or income of the account).

Many commenters stated that the proposed definition was overly broad and unworkable in practice. They noted that the definition would expand the breadth of beneficial ownership to include all individuals with only a financial interest in an account (subject to the de minimis limitation). Such a definition, they argued, would be unworkable, primarily because it would mean that covered financial institutions would be required to identify, and perform due diligence on, any individual with anything other than an insubstantial interest in an account, even when such individuals do not assert control, direction, or management over the account.

Commenters offered various suggestions for narrowing the scope of the definition. Several commenters suggested that we incorporate the international best practices principles on beneficial ownership established by the Wolfsberg Group (Wolfsberg),[41] which stress the importance of control over the account in determining beneficial ownership.[42] The congressional comment suggested that we retain the definition as proposed, but clarify that beneficial ownership interest would apply only to individuals and not to legal entities.

We agree with commenters that the proposed definition is insufficiently tailored to the serious risks of money laundering, and that the term beneficial owner, for purposes of this rule, should apply only to individuals, not legal entities.[43] Individuals having a beneficial interest in the assets of an account without a corresponding ability to control the account should not be deemed beneficial owners.[44] Accordingly, this final rule defines the term beneficial owner (rather than ''beneficial ownership interest,'' the term defined in the 2002 Proposal) to mean ''an individual who has a level of control over, or entitlement to, the funds

[40] The due diligence program adopted pursuant to section 103.176 of the final rule, like all programs required by Bank Secrecy Act regulations, must be part of the covered financial institution's anti-money laundering program, and must be approved by its board of directors or an appropriate committee thereof, or senior management.

[41] The Wolfsberg Group is a consortium of 12 international banks that establishes global anti-money laundering guidelines for the financial services industry.

[42] Wolfsberg Group, ''Wolfsberg Anti-Money Laundering Principles: FAQs on Beneficial Ownership,'' (2005), Q. 1, (hereinafter ''FAQs on Beneficial Ownership''), available at *http://www.wolfsberg-principles.com/faq-ownership.html#2.*

[43] For a further discussion of this issue, see *infra* notes 54–55 and accompanying text.

[44] For example, under the proposed definition, minor children who are beneficiaries of a trust would have been considered to have a beneficial ownership interest despite the fact that they lack control over the account.

or assets in the account that, as a practical matter, enables the individual, directly or indirectly, to control, direct or manage the account. The ability to fund the account or the entitlement to the funds of the account alone, however, without any corresponding authority to control, manage or direct the account (such as in the case of a minor child beneficiary) does not cause the individual to be a beneficial owner.'' Individuals who have an entitlement to funds in an account or an ability to fund the account and who also have the ability to ''manage or direct'' the account have the requisite level of control and must be identified by the financial institution.[45]

We believe that the definition we are adopting in this final rule is consistent with the concept of beneficial ownership set forth in section 5318A(e)(3), as added by section 311 of the Act.[46] The rule also should provide covered financial institutions with a workable standard for assessing beneficial ownership for private banking accounts, thereby allowing covered financial institutions to focus their due diligence efforts in a risk-based fashion on those accounts and individuals posing a heightened risk of money laundering. Private banking accounts may be particularly vulnerable to money laundering because they may afford wealthy clients a large measure of anonymity, as well as access to the U.S. financial system.[47]

2. *Covered financial institution.* We are using the same definition of covered financial institution for both the private banking provisions of section 103.178 and the correspondent account provisions of section 103.176. We, however, understand that, at this time, private banking accounts are likely to be offered primarily by depository institutions, uninsured trust banks and trust companies that are federally regulated and are subject to an anti-money laundering program requirement, securities broker-dealers, and futures commission merchants and introducing brokers. Should any other covered financial institutions offer accounts that meet the definition of a private banking account in the future, they would be required to comply with this section of the rule.

3. *Non-U.S. person.* The 2002 Proposal defined non-U.S. person as an ''individual who is neither a United States citizen nor a lawful permanent resident as defined in 26 U.S.C. 7701(b)(6).'' The final rule defines the term more appropriately by reference to the Immigration and Nationality Act, but without any change in substance. We are clarifying that this definition shall apply only to section 103.178 and does not incorporate or change the definition of person as used in the other sections of this part.

4. *Private banking account.* Section 103.175(n) of the 2002 Proposal generally adopted the definition of private banking account that appears in 31 U.S.C. 5318(i). Section 5318(i) defines a private banking account as an account (or any combination of accounts) that: (1) Requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000; (2) is established on behalf of one or more individuals who have a direct or beneficial ownership interest in the account; and (3) is assigned to, or is administered or managed by, in whole or in part, an officer, employee, or agent of a financial institution acting as a liaison between the financial institution and the direct or beneficial owner of the account. Commenters generally sought further clarification as to the precise scope of this term, raising issues regarding all three elements of the definition.[48]

b. Required Minimum Deposit of $1,000,000

Many commenters sought clarification of the meaning of the clause ''requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000.'' Some commenters raised concerns that adopting a final rule containing the statutory threshold of $1,000,000 would mean that many high value accounts at covered financial institutions, that would otherwise meet the definition of a private banking account, would not be subject to this rule simply because the covered financial institution does not require a minimum deposit of at least $1,000,000.

Although some accounts may not be covered by this rule, we cannot broaden the statutory definition, which was the basis for the definition contained in the 2002 Proposal, in order to reach a different result.[49] The plain language of the statute, as well as the legislative history of section 5318(i),[50] upon which the 2002 Proposal was based, are unequivocal: a private banking account is an account (or combination of accounts) that requires a minimum deposit of not less than $1,000,000. Section 312 of the Act was intended to cover those accounts opened by wealthy foreign individuals making large deposits who can avail themselves of the services of a liaison,[51] and we may not depart in the final rule from the plain language of the statute. The final rule is thus unchanged from the 2002 Proposal, except that the rule uses the statutory term ''deposit'' in place of the term ''amount'' used in the 2002 Proposal.

Certain covered financial institutions may offer a wide range of services that are generically termed private banking, and an institution may require different minimum deposits that are commensurate with its various types of private banking services. If an institution offers more than one level of private banking service to its clients, then any account or combination of accounts that require a $1,000,000

[45] Both state and federal law generally impute the ownership of ''self-settled'' trusts—trusts where the settlor (the one who sets up and funds the trust) is also the beneficiary—to the settlor-beneficiary. This situation stands in sharp contrast to that in which minor children are simply the trust beneficiaries; their interests are, thus, properly excluded from the definition of beneficial ownership for purposes of the final rule. Individuals with the ability to fund an account by virtue of being the source of the assets, however, should be distinguished from individuals such as lawyers and liaisons who merely perform the ministerial functions of placing funds in various investment vehicles.

[46] Section 311(e)(3) of the Act provides, in relevant part, that the Secretary shall promulgate regulations defining beneficial ownership that shall address issues relating to an individual's ability to ''fund, direct or manage the account'' and shall ensure that the definition does not extend to any individual with an ''immaterial'' interest in the assets of the account. 31 U.S.C. 5318A(e)(3).

[47] See Hearings on Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities, Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 106th Cong., 872 (1999) (Minority Staff Report) (hereinafter ''Private Banking Report'').

[48] We note that, although this final rule applies to those private banking accounts meeting the definition in the rule, many covered financial institutions offer forms of private banking relationships that should be given a greater level of due diligence under the institution's risk-based anti-money laundering program than that generally afforded the institution's retail customers. This is primarily because of the large amounts of money that can be managed through such relationships and the personal contact that is created in connection with these relationships. See, e.g., Federal Financial Institutions Examination Council, Bank Secrecy Act Anti-Money Laundering Examination Manual, June 2005, available at *http://www.ffiec.gov/pdf/bsamanual.pdf* (hereinafter Bank Secrecy Act Exam Manual).

[49] We intend to review the extent to which the application of the statutory definition could result in money laundering risks, and, if warranted, initiate a rulemaking to require special due diligence for a broader range of private banking accounts than are subject to section 5318(i) and this final rule. Such a rulemaking would be based on our authority under sections 5318(a)(2) and (h)(2) of the Bank Secrecy Act.

[50] The legislative history of section 5318(i) supports the plain language reading of the definition. In explaining the definitional requirements for a private banking account, Senator Levin stated: ''First, the account in question must require a $1 million minimum aggregate of deposits.'' 147 Cong. Rec., *supra* note 16, at 11037.

[51] See *id.* at 11036.

aggregate minimum deposit, and also satisfy the other elements of the definition, including the services of a liaison, would be subject to the rule.

c. Liaison

Commenters also asked us to clarify the term liaison as it applies to private banking accounts because the term potentially could bring within its scope individuals who perform only administrative functions, such as account administrators or customer service representatives. In order to articulate the meaning of this term, it is helpful to describe briefly what is meant by private banking. Although there is no generally accepted definition of private banking, the term refers broadly to the provision of highly personalized financial and related services to wealthy clients, principally individuals and families. Moreover, it is not a single activity, but instead comprises a range of different products and services, including cash management, funds transfer, asset management, creation of offshore entities, financial planning, lending and custody services.[52] Private banking typically includes the following key components: Tailoring services to individual client requirements; anticipation of client needs; long-term relationship orientation; and personal contact.[53] These services may vary according to the size of a client's deposit or account and the institution's private banking program. Section 5318(i) was intended to cover those accounts opened by wealthy foreign individuals making large deposits, who avail themselves of the services of an employee of the financial institution who can transfer funds, create offshore corporations or accounts, or engage in other transactions carrying increased risks of money laundering.[54]

The liaison is the covered financial institution's employee who develops (or continues) a long-term relationship with the client and is actively involved in providing these services.[55] To that end, a liaison may, for example, coordinate the efforts of a team of specialists including investment managers, trust officers, and estate planners; open accounts on behalf of the client and manage and arrange transactions among those accounts; and conduct a variety of financial transactions to benefit the covered financial institution's client.[56] To provide this type of personalized service for the client and to understand the long-term goals and needs of the client, a liaison will routinely gather extensive information about the client, including the client's personal, professional, and financial history. Thus, the meaning of the term liaison in this rule should not be confused with, for example, a customer service representative or account manager who may be assigned to a large number of customers (sometimes for a geographical region) to respond to questions customers may have regarding the institution's products and services or to take orders for securities or futures transactions. Those persons do not provide the level of service or obtain the extent of client information characteristic of private banking.

d. Account Established on Behalf of One or More Direct or Beneficial Owners

Commenters also sought clarification regarding the requirement in section 5318(i) and the 2002 Proposal that the account be ''established on behalf of or for the benefit of one or more individuals who have a direct or beneficial ownership interest in the account.'' Reading this phrase in conjunction with the 2002 Proposal's definition of beneficial ownership interest, some commenters were concerned that section 5318(i) could apply to accounts maintained by public corporations, or by mutual funds or other collective investment vehicles, on behalf of numerous investors who could be viewed as having beneficial ownership interests in the account. These commenters claimed that the due diligence burdens resulting from such a reading of this provision would be excessive and impractical.[57]

We have addressed the concerns of these commenters by clarifying that the definition of beneficial owner is limited to individual(s) with control over the account (as opposed to passive investors with only financial interests).[58] Furthermore, as a general matter, we do not believe that accounts held by public corporations, mutual funds, or other collective investment vehicles would qualify as private banking accounts. Such accounts likely would not involve a liaison, would not be established on behalf of one or more individuals with beneficial ownership of (*i.e.*, control over) such an account, and would be viewed as institutional accounts managed by a different unit of the covered financial institution. On the other hand, a private banking account established in the name of a legal entity (such as a personal investment company or trust) [59] for the benefit of an individual owner would be subject to the final rule if it also met the other definitional requirements.

Some commenters asked us to clarify the language of section 5318(i)(1) that applies the statutory due diligence requirements to private banking accounts that a U.S. financial institution ''establishes, maintains, administers or manages'' in the United States for a non-U.S. person.[60] The phrase is intended to cover not only those accounts that are established or maintained in the United States, but also those accounts that are established and maintained outside of the United States but are administered or managed by employees within the United States.[61] Private banking accounts can be established (*i.e.*, opened) and maintained (*i.e.*, the records are kept) in branch offices outside of the United States, while the accounts are administered or managed by employees of the institution within the United States. For example, the records of a private banking client may be physically located at a foreign branch

[52] Bank Secrecy Act Exam Manual, *supra* note 48.

[53] D. Maude and P. Molyneau, Private Banking: Maximizing Performance in a Competitive Market at 18 (Euromoney Publications PLC 1996).

[54] 147 Cong. Rec. *supra* note 16, at 11036.

[55] See Private Banking Report, *supra* note 47, at 875. The Private Banking Report, which served as the basis for the private banking provisions of section 312 of the Act, illustrates the services that distinguish liaisons from traditional customer service employees of a financial institution.

[56] See Private Banking Report, *supra* note 47, at 875.

[57] As a means of creating a ''bright line'' test to avoid this result, one commenter recommended that the final rule exclude from the definition of private banking account hedge funds and other investment vehicles unless they have five or fewer investors, based on the standard suggested in section 356(c) of the Act, which requires the submission of an interagency report to Congress relating to investment companies. That section specifically requires the report to address the question of whether certain personal holding companies with five or fewer shareholders or beneficial owners should be treated as financial institutions under 31 U.S.C. 5312(a)(2)(I) and should be required to disclose their beneficial owners when opening accounts at U.S. financial institutions. The report was issued December 31, 2002. See *http://www.treas.gov/press/releases/po3721.htm*. As a result of the revised definition of beneficial ownership in the final rule, no such limit is necessary.

[58] We have modified this element of the private banking account definition in the final rule accordingly to require an account for those ''who are direct or beneficial owners of the account.'' We have also replaced ''individuals'' with ''non-U.S. persons'' to simplify the final rule.

[59] See Bank Secrecy Act Exam Manual, *supra* note 48.

[60] The same geographical scope applies in section 312 of the Act with respect to correspondent accounts, as well as in section 313 of the Act and the Section 313/319 Rule.

[61] For example, a covered financial institution may establish a personal investment company for a private banking client in an offshore jurisdiction, but may manage the account in a U.S. office. See Board of Governors of the Federal Reserve System, ''Private Banking Activities'' (SR Letter 97–19 (SUP), June 30, 1997), available at *http://www.federalreserve.gov* (hereinafter ''Federal Reserve Guidance''). Such a relationship would fall within the geographic requirement of the final rule.

of the covered financial institution, while an employee of the institution in the United States exercises control over, and manages the day-to-day activities of, the account.[62]

Senior foreign political figure. Commenters generally found the definition of senior foreign political figure,[63] set forth in § 103.175(o) of the 2002 Proposal, both far-reaching and difficult to implement. Commenters specifically criticized the inclusion of persons ''widely and publicly known'' to maintain a close personal or professional relationship with individuals holding senior official positions. They argued that such a definitional standard would require financial institutions to look beyond the professional and financial histories of their clients and into their personal relationships. For many commenters, the phrase ''widely and publicly known'' raised questions about the resource burdens entailed in reviewing the vast amounts of public information currently available to ascertain such association. Yet another commenter requested that we develop a list of senior foreign political figures similar to the list issued by the Department of the Treasury's Office of Foreign Assets Control in order to ensure that covered financial institutions apply the definition in a uniform fashion.

We continue to believe that the proposed definition of senior foreign political figure is generally appropriate. However, we are modifying the definition to specify that the definition includes a ''person who is widely and publicly known * * * to be a close associate of'' rather than a ''person who is widely and publicly known * * * to maintain a close personal or professional relationship with'' any such individual. This definition is consistent with similar standards adopted by the international community regarding politically exposed persons,[64] including the close associates aspect of the definition that was the primary focus of most commenters' objections.[65]

It should also be noted here that, prior to accepting any private banking client, especially one who will have a high dollar account, a covered financial institution should ordinarily perform sufficient due diligence to ensure that it is comfortable with the prospective customer and his or her source of funds. This type of due diligence should enable the covered financial institution to determine who the customer is, what his or her background is, and, specifically, whether he or she is a senior foreign political figure.

Senior official or executive. The 2002 Proposal defined senior official or executive to mean an individual with substantial authority over policy, operations, or the use of government-owned resources. The final rule adopts the proposed definition without change. We believe that the definition of a senior official or executive must remain sufficiently flexible to capture the range of individuals who, by virtue of their office or position, potentially pose a risk that their funds may be the proceeds of foreign corruption. But this flexibility, according to commenters, has come at the expense of specificity, and commenters have requested further guidance in identifying such individuals. Titles, while helpful, may not themselves provide sufficient information about the office because governments are organized differently from jurisdiction to jurisdiction and official titles and responsibilities may vary accordingly.

We believe covered financial institutions should consider a range of factors when determining whether a particular foreign official is a senior official. Relevant factors include examining the official responsibilities of the individual's office, the nature of the title (honorary or salaried political position), the level of authority the individual has over governmental activities and over other officials, and whether the position affords the individual access to significant government assets and funds. For example, as a general matter, we expect that individuals holding the equivalent of cabinet level positions with their government would fall within the definition of a senior official because of their ability to establish government policy and their access to government resources. However, a senior official could also include a governor or the mayor of a major city. If, for example, the city has importance nationally or internationally, the governor or mayor could have the same type of political influence and access to government resources as would an official holding the equivalent of a cabinet level position. Thus, where a covered financial institution's due diligence reveals that the nominal or beneficial owner of a private banking account holds some type of government position, the institution may need to make additional inquiries to determine whether that position or title qualifies as a senior official or executive.

In defining the terms senior foreign political figure and senior official or executive, we have sought to provide some guidance and flexibility because an overly precise and rigid definition is not feasible and would not adequately implement the statutory intent of this section. In addition, as noted previously, through the course of exercising the due diligence that is necessary and appropriate for reviewing the acceptability of a high dollar account for a potential senior foreign political figure or a senior official or executive, a covered financial institution should be able to gather the information necessary to comply with this rule.

Immediate family member. The 2002 Proposal defined immediate family member as ''a spouse, parents, siblings, children, and a spouse's parents or siblings.'' We did not receive comments on this proposed definition and are adopting it in the final rule without change.

D. Section 103.178—Due Diligence Programs for Private Banking Accounts

1. *Due diligence generally.* Section 103.178(a) of the 2002 Proposal required each covered financial institution to maintain a due diligence program that includes policies, procedures, and controls that are reasonably designed to detect and report any known or suspected money laundering or

[62] However, the fact that securities issued and traded in the United States are held in a private banking account would not by itself suggest that that the account is controlled, managed, or administered in the United States. On the other hand, if investment management decisions are made in the United States, this would constitute management of the account in the United States.

[63] The proposed rule defined senior foreign political figure as: ''(i) A current or former senior official in the executive, legislative, administrative or judicial branches of a foreign government (whether elected or not), a senior official of a major foreign political party, or a senior executive of a foreign government-owned commercial enterprise; (ii) a corporation, business or other entity that has been formed by, or for the benefit of, any such individual; (iii) an immediate family member of any such individual; and (iv) a person who is widely and publicly known (or is actually known by the relevant covered financial institution) to maintain a close personal or professional relationship with any such individual.'' 2002 Proposal, *supra* note 2, at 37743.

[64] See, *e.g.*, Basel Committee on Banking Supervision, ''Customer Due Diligence for Banks,'' (Oct. 2001) at 10, which defines politically exposed persons as ''individuals who are or have been entrusted with prominent public functions, including heads of state or of government, senior politicians, senior government, judicial, or military officials, senior executives of publicly owned corporations and important political party officials.''

[65] See Wolfsberg Group, ''Wolfsberg AML Principles on Private Banking,'' (1st revision, May 2002) at 2, available at *http://www.wolfsberg-principles.com*, which likewise defines politically exposed persons as ''individuals holding or having held positions of public trust, such as government officials, senior executives of government corporations, politicians, important political party officials, etc., as well as their families and close associates.''

suspicious activity conducted through or involving any private banking account that the financial institution establishes, maintains, administers, or manages in the United States for or on behalf of a non-U.S. person. This section of the final rule contains technical modifications,[66] and also includes the requirement that the due diligence program shall be part of the covered financial institution's anti-money laundering program otherwise required by the subpart.

2. *Minimum due diligence requirements.* Section 103.178(b) of the 2002 Proposal set forth minimum due diligence requirements for private banking accounts. This section required that the covered financial institution's due diligence program include reasonable steps to ensure that the institution: (1) Ascertain the identity of all nominal and beneficial owners,[67] as well as information on their lines of business and sources of wealth; (2) ascertain the source of funds deposited into the private banking account; (3) ascertain whether any account holder is a senior foreign political figure; and (4) report, in accordance with applicable law and regulation, any suspected money laundering or suspicious activity. Commenters generally raised concerns about the burdens involved in complying with section 103.178(b) in several respects. These included the difficulty of identifying the beneficial owners given the 2002 Proposal's definition; the difficulty of obtaining all the required information about such persons, and the level of intrusiveness required; the problems associated with identifying senior foreign political figures given the breadth of the definition; and the extent, if any, to which financial institutions could rely on due diligence conducted by well-regulated intermediaries to satisfy their obligations under this provision.

The final rule requires that covered financial institutions implement a risk-based due diligence program that incorporates the minimum standards set forth in section 103.178(b).[68] As discussed in the preamble to the 2002 Proposal, the nature and extent of the due diligence conducted will likely vary with each client depending on the presence of potential risk factors. More extensive due diligence, for example, may be appropriate for new clients; clients who operate in, or whose funds are transmitted from or through, jurisdictions with weak anti-money laundering controls; and clients whose lines of business may be cash-based (such as casinos or currency exchanges). Due diligence should also be commensurate with the size of the account. Accounts with relatively more deposits and assets should be subject to greater due diligence, requiring covered financial institutions to conduct more extensive investigation into the relevant factors. In addition, if the institution at any time learns of information that casts doubt on previous information, further due diligence would be appropriate.

We have largely retained the language of section 103.178(b) as contained in the 2002 Proposal, but have clarified the requirements of paragraph (b)(2). This paragraph will now require covered financial institutions to ascertain for private banking accounts information regarding the purpose of the account as well as the anticipated account activity. To assist covered financial institutions in meeting their compliance obligations, we are providing additional guidance regarding the specific requirements set forth below.

a. Nominal and Beneficial Owners

Section 103.178(b)(1) of the 2002 Proposal required covered financial institutions to take reasonable steps to ascertain the identity of all nominal (*i.e.*, named) holders and any beneficial owners of the private banking account, as well as information on those holders' lines of business and sources of wealth. The final rule modifies this provision to more accurately reflect the wording of the statute, which does not refer to lines of business or sources of wealth. However, to comply with the requirement that a covered financial institution perform sufficient due diligence with regard to its private banking accounts to guard against money laundering and to report any suspicious activity, part of an institution's due diligence may often include a review of the individual's lines of business and sources of wealth. The final rule is also modified by employing the term beneficial owner instead of beneficial ownership interest so that it is consistent with the definition as it appears in section 103.175(b) of the final rule. Accordingly, this final rule requires covered financial institutions to take reasonable steps to ascertain the identity of all nominal and beneficial owners of private banking accounts and to apply due diligence measures to those individuals.

Commenters maintained that the compliance burdens under this provision would be excessive, particularly as it is applied to all beneficial owners of private banking accounts. As this final rule adopts a narrower definition of beneficial owner than that contained in the 2002 Proposal, we anticipate that the compliance burdens associated with this section will be reduced. The definition of beneficial owner centers on actual rather than nominal control. Therefore, covered financial institutions will need to make a specific factual determination as to the beneficial owners (*i.e.*, individuals with actual control) of an account on a case-by-case basis. We expect that covered financial institutions will look through the nominal owner of the account to determine who has effective control over the account. For example, when an account is opened by a natural person, the financial institution should establish whether the client is acting on his or her own behalf and should perform additional diligence if doubt exists as to the identity of the beneficial owner(s).[69] For an account holder that is a legal entity that is not publicly traded (such as a private investment company), a financial institution should ensure that it has sufficient information about the structure of the entity, including its directors, shareholders, and those with control over the account, and should determine which individual (or individuals) constitutes the beneficial owner(s) for purposes of due diligence.[70] Likewise, in the case of a

[66] For example, the clause ''by or on behalf of a non-U.S. person'' has been deleted because that limitation has been included in the final rule's definition of a private banking account. Because the final rule applies to private banking accounts for non-U.S. persons, covered financial institutions will need to determine whether a client is a non-U.S. person. We do not believe that such a determination should be difficult given the amount of information that private bankers typically obtain about their clients.

[67] Covered financial institutions also are required to implement a customer identification program pursuant to section 326 of the Act and its implementing regulations; private banking accounts opened after October 1, 2003, are generally subject to that requirement as well. See 68 FR 25089–25162 (May 9, 2003).

[68] As with correspondent accounts, where multiple financial institutions maintain a private banking account for a customer—*e.g.*, securities clearing and introducing brokers and futures commission merchants and introducing brokers—each is independently responsible for ensuring the requirements of this rule are met. Any apportionment of functions between such entities should include adequate sharing of information to ensure that each institution can satisfy its obligations under this rule. For example, an introducing firm would be responsible for informing the clearing firm of the customers holding private banking accounts and for obtaining the necessary information from and about these customers, while both firms would be responsible for establishing adequate controls to detect suspicious activity.

[69] See, *e.g.*, Wolfsberg Group, ''FAQs on Beneficial Ownership,'' *supra* note 42, at 2–3; Federal Reserve Guidance, *supra* note 61, Part III.

[70] *Id.*

trust, the financial institution should ascertain which individual (or individuals) controls the funds of the trust, should identify the source of the funds, and should perform due diligence as appropriate.[71] The reason for the focus on nominal and beneficial owners is to ensure that covered financial institutions are adequately and comprehensively addressing the risk involved in accepting and handling a large dollar private banking account for a non-U.S. person.

Some commenters suggested that we allow covered financial institutions to rely on the due diligence conducted by well-regulated foreign intermediaries (*e.g.*, institutions regulated by jurisdictions that are members of the Financial Action Task Force) that open private banking accounts on behalf of their clients. We have determined that covered financial institutions may not rely on foreign intermediaries to satisfy their due diligence obligations under this rule. Because of the unique vulnerabilities for money laundering that exist in the private banking context, it is critical that covered financial institutions conduct their own due diligence with respect to the beneficial owners of private banking accounts.[72] In the event that an intermediary maintains a single private banking account on behalf of two or more foreign individuals, due diligence would be required with regard to all individuals that meet the definition of beneficial owner.[73]

In addition, we note that due diligence is an ongoing obligation. Covered financial institutions will be in the best position to monitor accounts for suspicious transactions and possible money laundering if they are involved in obtaining information about their clients directly. Further, the very nature of a private banking relationship requires that financial institutions obtain extensive information about their clients in order to provide them with personalized financial services.

b. Source of Funds and Purpose and Expected Use of Account

Section 103.178(b)(2) of the 2002 Proposal required covered financial institutions to take reasonable steps to ascertain the source of funds deposited into the private banking account. The final rule retains this language, but adds the requirement that covered financial institutions take reasonable steps to ascertain the purpose for which the private banking account is being established, as well as the anticipated account activity. As discussed below, we believe that the additional obligations of ascertaining the purpose and expected account activity are elements of the 2002 Proposal's requirement to verify the source of funds in an account and to monitor for suspicious activity, and, more generally, are fundamental elements of a sound due diligence program.[74] Such information, which we believe most covered financial institutions currently obtain in the normal course of business when opening a private banking account, establishes a baseline for account activity that will enable a covered financial institution to better detect suspicious activity and to assess situations where additional verification regarding the source of funds may be necessary.

Commenters sought explanation of the due diligence requirement to ascertain the source of funds deposited into the private banking account, and specifically questioned the extent to which verification was required. We do not expect covered financial institutions, in the ordinary course, to verify the source of every deposit placed into every private banking account. However, they should monitor deposits and transactions as necessary to ensure that the activity is consistent with information the institution has received about the client's source of funds and with the stated purpose and expected use of the account, as needed to guard against money laundering, and to report any suspicious activity. Such monitoring will facilitate the identification of accounts that warrant additional scrutiny. For example, a single, large deposit may warrant additional scrutiny if it is unusual, given the information a client has provided about the account's purpose and anticipated activity and other expected sources of funds. Likewise, a deposit that comes from an unusual source, such as a charitable fund or foreign government agency trust funds or aid grants, may also warrant further scrutiny. In addition to contacting the client, the financial institution may consider contacting the financial institution that transmitted the funds and the organization that was the source of the funds.

c. Senior Foreign Political Figures

Section 103.178(b)(3) of the 2002 Proposal required covered financial institutions to take reasonable steps to ascertain whether any nominal or beneficial account owner may be a senior foreign political figure.[75] Many commenters argued that the definition of a senior foreign political figure was vague and overly broad and that the 2002 Proposal failed to provide sufficient guidance on implementing the definition. Commenters particularly found the requirement to ascertain a client's close association with senior foreign political figures burdensome, and questioned whether the phrase ''widely and publicly known'' would require financial institutions to review vast amounts of public information. One commenter suggested waiving altogether the enhanced due diligence requirements for senior foreign political figures from Financial Action Task Force member countries, while allowing covered financial institutions to rely on a certification from citizens of non-Financial Action Task Force member countries regarding whether they are senior foreign political figures unless information to the contrary is received.

We recognize that the term senior foreign political figure is broadly defined in the Act to include immediate family members and close associates, and that reasonable efforts to ascertain an individual's status within this category will require robust due diligence procedures that need to go beyond reliance on a certification. We believe that the due diligence that covered financial institutions currently conduct with respect to private banking clients usually incorporates (or can readily incorporate) reasonable steps to ascertain a client's status as a senior

[71] See, *e.g.*, Wolfsberg Group, ''FAQs on Beneficial Ownership,'' *supra* note 42, at 3.

[72] Senator Levin specifically discussed accounts opened in the name of investment advisers, shell corporations, or trusts on behalf of other persons, noting that ''[they] are exactly the types of accounts that terrorists and criminals use to hide their identities and infiltrate U.S. financial institutions. And thus they are exactly the accounts for which U.S. financial institutions need to verify and evaluate the real beneficial owners.'' 147 Cong. Rec., *supra* note 16, at 11036. See also Federal Reserve Guidance, *supra* note 61, n. 2.

[73] We understand that some financial institutions do not permit intermediaries to open pooled accounts for unrelated persons within the private banking units; instead, they treat the account as an institutional account. If a covered financial institution chooses to allow intermediaries to open these types of accounts within the private banking unit (and if they fall within the definition of private banking account in the final rule), it may want to require the intermediary to establish separate accounts in the name of each beneficial owner to ease the logistical burdens involved in conducting due diligence.

[74] See Basel Committee on Banking Supervision, *supra* note 64 at 6: ''The bank should always ask itself why the customer has chosen to open an account in a foreign jurisdiction.'' See also, Wolfsberg AML Principles on Private Banking, *supra* note 65, at 2, which identifies the ''purpose and reasons for opening the account'' and ''anticipated account activity'' among the elements of an effective due diligence program.

[75] The final rule adopts this provision without change, other than substituting ''is'' for ''may be'' for clarity.

foreign political figure.[76] We also believe that institutions that provide private banking services as defined in this rule, particularly to foreign individuals, currently obtain considerable information about their clients. For example, in conducting related due diligence on a client's financial and professional background, a financial institution typically will review the sources of income of a client, which may entail reviewing past[77] and present employment history and references from professional associates. This information should generally uncover the client's status as a current or former senior official.

We understand that ascertaining a client's close association with a senior foreign political figure will be more difficult than identifying whether the client holds a senior political position. However, in our view, the term ''widely and publicly known'' serves as a reasonable limitation on a covered financial institution's obligation to identify close associates who would be readily apparent from a review of publicly available information, as discussed below. Certainly, if a covered financial institution has actual knowledge of such a close associate, the individual also falls within the definition. Covered financial institutions, in fact, may become aware of a client's close association with a senior official simply in the course of gathering financial and professional information about a client.[78] However, we do not expect a covered financial institution to undertake an unreasonable amount of due diligence or to be aware of unknown associations that could not be expected to have been uncovered through the exercise of due diligence ordinarily undertaken when opening or monitoring a private banking account as defined by this rule.

Covered financial institutions, thus, should be guided by the following basic procedures when drafting their due diligence procedures to identify senior foreign political figures. As we believe most covered financial institutions already do, the procedures should require obtaining information regarding employment and other sources of income. First, the institution should seek information directly from the individual regarding possible senior foreign political figure status. Second, the institution should check references, as appropriate, to determine whether the individual holds or has previously held a senior political position or may be a close associate of a senior foreign political figure. Third, the institution should also make reasonable efforts to review public sources of information in meeting this obligation.

Many commenters sought clarification as to the 2002 Proposal's reference to publicly available sources of information, and as to what would constitute reasonable steps to review such information. The range of publicly available sources that should be consulted will vary depending upon the circumstances of the particular case. In virtually all cases, covered financial institutions will have an obligation to check the name of the prospective private banking client against databases of public information that are reasonably accessible and available. These include U.S. Government databases, major news publications and commercial databases available on the Internet, and fee-based databases, as appropriate. The country of residence of the private banking client is also relevant. We do not expect that, as a general procedure, a covered financial institution will need to review the local language newspapers in every country in which its private banking clients reside, although reviewing such newspapers could be prudent in an unusual situation, such as when the financial institution is not familiar with the country that the private client is from and the country is not generally covered in the press. Finally, we note that there are existing and developing databases of foreign political figures that may assist covered financial institutions with this inquiry.[79]

In the event that the covered financial institution learns (either during the initial establishment of the account or thereafter) of information indicating that a client may be a senior foreign political figure as defined in the rule, it should exercise additional, reasonable diligence in seeking to confirm whether the individual is, in fact, a senior foreign political figure. One of the first steps is to seek confirmation from the individual. If the individual denies holding or having held a political position or being closely associated with or in the immediate family of someone who has held or currently holds a political position, it still may be necessary to take further reasonable steps. These additional steps may include, for example, making more pointed inquiries of other references, obtaining additional information from branches of the covered financial institution that may be operating in the home country of the client, and making reasonable efforts to consult publicly available sources of information, as described above. If, after reasonable diligence, the covered financial institution does not learn of any information indicating that a nominal or beneficial owner may be a senior foreign political figure, it may conclude that the individual is not a senior foreign political figure.[80]

The Act and this final rule require that covered financial institutions establish controls and procedures that include reasonable steps to ascertain the status of an individual as a senior foreign political figure and to conduct enhanced scrutiny of accounts held by these individuals. We recognize that covered financial institutions applying reasonable due diligence procedures in accordance with this rule may not be able to identify in every case individuals who qualify as senior foreign political figures, and, in particular, their close associates (nor does the rule require that they detect this fact in every case), and thus may not apply enhanced scrutiny to all such accounts. Rather, the rule requires a program that ensures that the institution take reasonable steps to ascertain whether a private banking account client is a senior foreign political figure.

[76] The Department of the Treasury, the Federal banking regulators, and the Department of State jointly issued ''Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption'' in January 2001, available at *http://www.treas.gov/press/releases/ls1123.htm.*

[77] Past employment history may be relevant in determining source of income to the extent a client is receiving a pension or some other income.

[78] For example, when conducting due diligence on a client and his or her lines of business, a covered financial institution may uncover the fact that a client is a business partner of a senior official. This would likely qualify the individual as a close associate. Likewise, foreign clients may be referred to a covered financial institution by an existing client. If the existing client is a senior foreign political figure, that may be an indication that the prospective client is a close associate.

[79] For example, a list of high level foreign officials is available at: *http://www.odci.gov/cia/publications/chiefs/index.html.*

[80] Section 103.178(c)(1) of the 2002 Proposal stated that, in performing the required due diligence,

''(i) If a covered financial institution learns of information indicating that a particular individual may be a senior foreign political figure, it should exercise reasonable diligence in seeking to determine whether the individual is, in fact, a senior foreign political figure.

(ii) If a covered financial institution does not learn of any information indicating that an individual may be a former senior foreign political figure, and the individual states that he or she is not a former senior foreign political figure, the financial institution may rely on such statement in determining whether the account is subject to the due diligence requirements of paragraph (c)(2) of this section.'' 2002 Proposal, *supra* note 2, at 37744.

Because the substance of this subparagraph is in effect subsumed within a covered financial institution's obligations under section 103.178(b)(2), it has been eliminated from the text of the final rule.

Moreover, if the institution's program is reasonably designed to make this determination, and the institution administers the program effectively, then the institution should generally be able to detect, report, and take appropriate action where suspected money laundering is occurring with respect to these accounts, even in cases where the financial institution has not been able to identify the account holder as a senior foreign political figure warranting enhanced scrutiny.

d. Reporting Known or Suspected Money Laundering

Section 103.178(b)(4) of the 2002 Proposal required that the due diligence program of covered financial institutions ensure that the institution take reasonable steps to report, in accordance with applicable law and regulation, any known or suspected violation of law conducted through or involving a private banking account with a non-U.S. citizen. For example, if a covered financial institution detects activity that is unusual for the account and client, and cannot obtain a satisfactory response from the client and/or other sources, it may ''know, suspect, or have reason to suspect'' that money laundering or activity with ''no apparent lawful purpose'' is occurring, prompting the filing of a suspicious activity report.[81] Other appropriate action may include suspending account activity or closing the account.

In accord with the modification and clarification discussed above pertaining to source of funds in connection with section 103.178(b)(2), we have similarly clarified section 103.178(d). Specifically, we have incorporated the fact that, in order to adequately review for possible money laundering and suspicious activity, a covered financial institution must take reasonable steps to ensure that the information it obtains about the source of funds, as well as about the stated purpose and the expected use of the account, is consistent with the actual activity in the account. This paragraph otherwise remains unchanged in the final rule, except that the phrase ''money laundering or suspicious activity'' replaces the phrase ''violation of law'' for consistency with section 103.178(a) and with 31 U.S.C. 5318(i).

3. *Enhanced scrutiny.* Section 103.178(c) of the 2002 Proposal established certain special requirements with respect to senior foreign political figures. Section 103.178(c)(2) generally required covered financial institutions to establish due diligence programs for accounts held by senior foreign political figures that included policies and procedures reasonably designed to detect transactions that may involve the proceeds of foreign corruption. As noted in the preamble to the 2002 Proposal, covered financial institutions should involve senior management when deciding to accept a senior foreign political figure as a private banking client and should ensure that information regarding the account is available for review not only by the liaison but also by senior management.

Such internal controls are particularly important in the private banking context because of the potentially close relationships managers may develop with private banking customers. In fact, money laundering has been shown to occur through private banking accounts established for senior foreign political figures when financial institutions have failed to apply internal controls, allowing liaisons to apply insufficient, non-impartial scrutiny to the activities of their private banking clients.[82]

We received two comments on this section. One commenter sought specific guidance as to how covered financial institutions can detect the proceeds of foreign corruption, while a congressional commenter asked us to specify in the rule that covered financial institutions are required to conduct enhanced scrutiny of accounts held by senior foreign political figures in accordance with the statutory provisions of 31 U.S.C. 5318(i). In response to the latter comment, we have amended the text of this provision (redesignated as section 103.178(c)(1) of this final rule) to specifically require enhanced scrutiny, as follows ''In the case of a private banking account for which a senior foreign political figure is a nominal or beneficial owner, the due diligence program required by paragraph (a) of this section shall include enhanced scrutiny of such account that is reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.''

As with the minimum due diligence program prescribed under section 103.178(b), we expect that covered financial institutions will apply a risk-based enhanced scrutiny program. Reasonable steps to perform enhanced scrutiny may include the following: consulting publicly available information regarding the home jurisdiction of the client;[83] contacting, where applicable, branches of the U.S. financial institution operating in the home jurisdiction of the client to obtain additional information about the client and the political environment; and conducting greater scrutiny of the client's employment history and sources of income. For example, wire transfers from a government account to the personal account of a government official with signature authority over the government account should raise an institution's suspicions of possible political corruption.[84] If a covered financial institution's review of major news sources indicates that a client may be or is involved in political corruption, the institution should review that client's account for unusual activity.

In addition, when the client is a former senior foreign political figure, a risk-based program should involve weighing such factors as the length of time the client has been out of office, the size of the account, and any information obtained from public sources, as well as other information obtained through the due diligence process. Thus, if a former official has been out of office for a substantial length of time, and a review of major news publications provides no indication of political corruption or continued involvement in politics, then less scrutiny would be reasonable.

Section 103.178(c)(3) of the 2002 Proposal set forth the definition of ''proceeds of foreign corruption.'' No comments were submitted regarding this proposed definition, and it (redesignated as section 103.178(c)(2)) is unchanged in the final rule.

4. *Special procedures.* Section 103.178(d) of the 2002 Proposal contained special procedures to be included in the covered financial institution's due diligence program for private banking accounts, addressing situations where appropriate due diligence cannot be performed,

[81] *See* 31 CFR 103.17 to 103.19.

[82] We recently imposed a civil penalty against a bank for, among other things, its failure to implement internal controls in its private banking department. Lax supervision by the bank enabled the relationship manager to engage in suspicious transactions involving a private banking account held by a senior foreign political figure. *See* Matter of Riggs Bank, N.A., No. 2004–01 (May 13, 2004), available at *http://www.fincen.gov/riggsassessment3.pdf.* In another publicized case, a liaison pled guilty to helping to launder over $11 million in narcotics proceeds through private banking accounts she managed for an influential Mexican governor. The liaison admitted to helping to disguise the identity of her client and the source of these funds by establishing accounts in the names of fictitious nominee account holders. She also admitted to intentionally avoiding asking questions of her client or informing her superiors regarding these activities. *U.S.* v. *Madrid, et al.*, No. 02 CR 0414 (S.D.N.Y. August 25, 2005).

[83] For example, AAA FLASH, a weekly electronic newsletter sponsored by United States Agency for International Development, details corruption around the world and can be accessed at *http://www.respondanet.com/english.*

[84] See Matter of Riggs Bank, *supra* n. 82.

including when the institution should refuse to open the account, suspend transaction activity, file a suspicious activity report, or close the account. No comments were submitted regarding this provision, which is unchanged in this final rule.

5. *Effective dates.* Although the 2002 Proposal did not address the issue of an effective date, as with correspondent accounts, many commenters noted the difficulty of complying with the requirements of 31 U.S.C. 5318(i) pertaining to private banking accounts, especially with regard to their application to previously existing accounts, and urged us to allow a sufficient transition period. We are mindful of the burden that will result from the statutory requirement that the provision applies to all private banking accounts, regardless of when they were opened. The final rule contains a new section 103.176(e) that provides for the effective dates of the obligations under this section: effective 90 days after the date of publication of the final rule, the requirements of the final rule will apply to private banking accounts opened on or after that date; and, effective 270 days after the date of publication of the final rule, the rule's requirements will apply to all private banking accounts opened prior to the date that is 90 days after the date of publication of the final rule.

For all of the reasons explained above in section III.B.4., the final rule contains additional applicability rules to ensure consistency with the requirements of the Interim Rule until the effective dates of the final rule are triggered.

Paragraph 103.178(e)(2) contains special applicability dates requiring banks, broker-dealers, futures commission merchants, and introducing brokers to continue to apply the requirements of 31 U.S.C. 5318(i)(3) to private banking accounts until the 90 and 270-day implementation dates of paragraph 103.178(e)(1) are triggered. This preserves the status quo created by the provisions of the Interim Rule found at 31 CFR 103.181 and 103.182 until the provisions of this final rule go into effect.

Paragraph 103.178(e)(3) continues to exempt trust banks or trust companies that have a federal regulator, and mutual funds from the requirements of 31 U.S.C. 5318(i)(3) until the 90 and 270-day implementation dates of paragraph 103.178(e)(1) are triggered.

Finally, paragraph 103.178(e)(4) contains a general exemption from the due diligence requirements for private banking accounts contained in 31 U.S.C. 5318(i)(3) for all financial institutions which are not defined in the final rule as covered financial institutions. This exemption replaces without substantive change the provisions of the Interim Rule found at 31 CFR 103.183.

In light of the special implementation provisions contained in the text of the final rule, the Interim Rule, codified at 31 CFR 103.181 through 31 CFR 103.183 will no longer be effective on February 3, 2006.

IV. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. 610 *et seq.*), it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule provides guidance to financial institutions concerning the mandated due diligence and enhanced due diligence requirements in section 312 of the Act. Moreover, most of the financial institutions covered by the rule tend to be larger institutions. Accordingly, a regulatory flexibility analysis is not required.

V. Executive Order 12866

This final rule is not a ''significant regulatory action'' as defined in Executive Order 12866, and, as such, a regulatory assessment is not required.

List of Subjects in 31 CFR Part 103

Banks and banking, Brokers, Counter money laundering, Counter-terrorism, Currency, Foreign banking, Reporting and recordkeeping requirements.

Authority and Issuance

■ For the reasons set forth in the preamble, 31 CFR part 103 is amended as follows:

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

■ 1. The authority citation for part 103 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951–1959; 31 U.S.C. 5311–5314 and 5316–5332; title III, secs. 311, 312, 313, 314, 319, 326, 352, Public Law 107–56, 115 Stat. 307.

■ 2. Section 103.120 of Subpart I of part 103 is amended as follows:

■ a. Paragraph (b) is amended by adding ''the requirements of §§ 103.176 and 103.178 and'' immediately after the words ''complies with''.

■ b. Paragraph (c)(1) is amended by adding ''the requirements of §§ 103.176 and 103.178 and'' immediately after the words ''complies with''.

■ 3. Subpart I of part 103 is amended by revising § 103.175 to read as follows:

§ 103.175 Definitions.

Except as otherwise provided, the following definitions apply for purposes of §§ 103.176 through 103.185:

(a) *Attorney General* means the Attorney General of the United States.

(b) *Beneficial owner* of an account means an individual who has a level of control over, or entitlement to, the funds or assets in the account that, as a practical matter, enables the individual, directly or indirectly, to control, manage or direct the account. The ability to fund the account or the entitlement to the funds of the account alone, however, without any corresponding authority to control, manage or direct the account (such as in the case of a minor child beneficiary), does not cause the individual to be a beneficial owner.

(c) *Certification and recertification* mean the certification and recertification forms described in appendices A and B, respectively, to this subpart.

(d) *Correspondent account.* (1) The term *correspondent account* means:

(i) For purposes of § 103.176(a), (d) and (e), an account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution; and

(ii) For purposes of §§ 103.176(b) and (c), 103.177 and 103.185, an account established for a foreign bank to receive deposits from, or to make payments or other disbursements on behalf of, the foreign bank, or to handle other financial transactions related to such foreign bank.

(2) For purposes of this definition, the term *account:*

(i) As applied to banks (as set forth in paragraphs (f)(1)(i) through (vii) of this section):

(A) Means any formal banking or business relationship established by a bank to provide regular services, dealings, and other financial transactions; and

(B) Includes a demand deposit, savings deposit, or other transaction or asset account and a credit account or other extension of credit;

(ii) As applied to brokers or dealers in securities (as set forth in paragraph (f)(1)(viii) of this section) means any formal relationship established with a broker or dealer in securities to provide regular services to effect transactions in securities, including, but not limited to, the purchase or sale of securities and securities loaned and borrowed activity, and to hold securities or other assets for safekeeping or as collateral;

(iii) As applied to futures commission merchants and introducing brokers (as set forth in paragraph (f)(1)(ix) of this section) means any formal relationship established by a futures commission merchant to provide regular services, including, but not limited to, those established to effect transactions in contracts of sale of a commodity for future delivery, options on any contract of sale of a commodity for future delivery, or options on a commodity; and

(iv) As applied to mutual funds (as set forth in paragraph (f)(1)(x) of this section) means any contractual or other business relationship established between a person and a mutual fund to provide regular services to effect transactions in securities issued by the mutual fund, including the purchase or sale of securities.

(e) *Correspondent relationship* has the same meaning as correspondent account for purposes of §§ 103.177 and 103.185.

(f) *Covered financial institution* means: (1) For purposes of §§ 103.176 and 103.178:

(i) An insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)));

(ii) A commercial bank;

(iii) An agency or branch of a foreign bank in the United States;

(iv) A federally insured credit union;

(v) A savings association;

(vi) A corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*);

(vii) A trust bank or trust company that is federally regulated and is subject to an anti-money laundering program requirement;

(viii) A broker or dealer in securities registered, or required to be registered, with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), except persons who register pursuant to section 15(b)(11) of the Securities Exchange Act of 1934;

(ix) A futures commission merchant or an introducing broker registered, or required to be registered, with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), except persons who register pursuant to section 4(f)(a)(2) of the Commodity Exchange Act; and

(x) A mutual fund, which means an investment company (as defined in section 3(a)(1) of the Investment Company Act of 1940 (''Investment Company Act'') (15 U.S.C. 80a–3(a)(1))) that is an open-end company (as defined in section 5(a)(1) of the Investment Company Act (15 U.S.C. 80a–5(a)(1))) and that is registered, or is required to register, with the Securities and Exchange Commission pursuant to the Investment Company Act.

(2) For purposes of §§ 103.177 and 103.185:

(i) An insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)));

(ii) A commercial bank or trust company;

(iii) A private banker;

(iv) An agency or branch of a foreign bank in the United States;

(v) A credit union;

(vi) A savings association;

(vii) A corporation acting under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*); and

(viii) A broker or dealer in securities registered, or required to be registered, with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), except persons who register pursuant to section 15(b)(11) of the Securities Exchange Act of 1934.

(g) *Foreign bank.* The term *foreign bank* has the meaning provided in § 103.11(o).

(h) *Foreign financial institution.* (1) The term *foreign financial institution* means:

(i) A foreign bank;

(ii) Any branch or office located outside the United States of any covered financial institution described in paragraphs (f)(1)(viii) through (x) of this section;

(iii) Any other person organized under foreign law (other than a branch or office of such person in the United States) that, if it were located in the United States, would be a covered financial institution described in paragraphs (f)(1)(viii) through (x) of this section; and

(iv) Any person organized under foreign law (other than a branch or office of such person in the United States) that is engaged in the business of, and is readily identifiable as:

(A) A currency dealer or exchanger; or

(B) A money transmitter.

(2) For purposes of paragraph (h)(1)(iv) of this section, a person is not ''engaged in the business'' of a currency dealer, a currency exchanger or a money transmitter if such transactions are merely incidental to the person's business.

(i) *Foreign shell bank* means a foreign bank without a physical presence in any country.

(j) *Non-United States person or non-U.S. person* means a natural person who is neither a United States citizen nor is accorded the privilege of residing permanently in the United States pursuant to title 8 of the United States Code. For purposes of this paragraph (j), the definition of *person* in § 103.11(z) does not apply, notwithstanding paragraph (m) of this section.

(k) *Offshore banking license* means a license to conduct banking activities that prohibits the licensed entity from conducting banking activities with the citizens of, or in the local currency of, the jurisdiction that issued the license.

(l) *Owner.* (1) The term *owner* means any person who, directly or indirectly:

(i) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities or other voting interests of a foreign bank; or

(ii) Controls in any manner the election of a majority of the directors (or individuals exercising similar functions) of a foreign bank.

(2) For purposes of this definition:

(i) Members of the same family shall be considered to be one person.

(ii) The term *same family* means parents, spouses, children, siblings, uncles, aunts, grandparents, grandchildren, first cousins, stepchildren, stepsiblings, parents-in-law, and spouses of any of the foregoing.

(iii) Each member of the same family who has an ownership interest in a foreign bank must be identified if the family is an owner as a result of aggregating the ownership interests of the members of the family. In determining the ownership interests of the same family, any voting interest of any family member shall be taken into account.

(iv) *Voting securities or other voting interests* means securities or other interests that entitle the holder to vote for or to select directors (or individuals exercising similar functions).

(m) *Person* has the meaning provided in § 103.11(z).

(n) *Physical presence* means a place of business that:

(1) Is maintained by a foreign bank;

(2) Is located at a fixed address (other than solely an electronic address or a post-office box) in a country in which the foreign bank is authorized to conduct banking activities, at which location the foreign bank:

(i) Employs one or more individuals on a full-time basis; and

(ii) Maintains operating records related to its banking activities; and

(3) Is subject to inspection by the banking authority that licensed the foreign bank to conduct banking activities.

(o) *Private banking account* means an account (or any combination of accounts) maintained at a covered financial institution that:

(1) Requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000;

(2) Is established on behalf of or for the benefit of one or more non-U.S. persons who are direct or beneficial owners of the account; and

(3) Is assigned to, or is administered or managed by, in whole or in part, an officer, employee, or agent of a covered financial institution acting as a liaison between the covered financial institution and the direct or beneficial owner of the account.

(p) *Regulated affiliate.* (1) The term *regulated affiliate* means a foreign shell bank that:

(i) Is an affiliate of a depository institution, credit union, or foreign bank that maintains a physical presence in the United States or a foreign country, as applicable; and

(ii) Is subject to supervision by a banking authority in the country regulating such affiliated depository institution, credit union, or foreign bank.

(2) For purposes of this definition:

(i) *Affiliate* means a foreign bank that is controlled by, or is under common control with, a depository institution, credit union, or foreign bank.

(ii) *Control* means:

(A) Ownership, control, or power to vote 50 percent or more of any class of voting securities or other voting interests of another company; or

(B) Control in any manner the election of a majority of the directors (or individuals exercising similar functions) of another company.

(q) *Secretary* means the Secretary of the Treasury.

(r) *Senior foreign political figure.* (1) The term *senior foreign political figure* means:

(i) A current or former:

(A) Senior official in the executive, legislative, administrative, military, or judicial branches of a foreign government (whether elected or not);

(B) Senior official of a major foreign political party; or

(C) Senior executive of a foreign government-owned commercial enterprise;

(ii) A corporation, business, or other entity that has been formed by, or for the benefit of, any such individual;

(iii) An immediate family member of any such individual; and

(iv) A person who is widely and publicly known (or is actually known by the relevant covered financial institution) to be a close associate of such individual.

(2) For purposes of this definition:

(i) *Senior official or executive* means an individual with substantial authority over policy, operations, or the use of government-owned resources; and

(ii) *Immediate family member* means spouses, parents, siblings, children and a spouse's parents and siblings.

(s) *Territories and Insular Possessions* has the meaning provided in § 103.11(tt).

(t) *United States* has the meaning provided in § 103.11(nn).

■ 4. Subpart I of part 103 is amended by adding § 103.176 to read as follows:

§ 103.176 Due diligence programs for correspondent accounts for foreign financial institutions.

(a) *In general.* A covered financial institution shall establish a due diligence program that includes appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to enable the covered financial institution to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such covered financial institution in the United States for a foreign financial institution. The due diligence program required by this section shall be a part of the anti-money laundering program otherwise required by this subpart. Such policies, procedures, and controls shall include:

(1) Determining whether any such correspondent account is subject to paragraph (b) of this section;

(2) Assessing the money laundering risk presented by such correspondent account, based on a consideration of all relevant factors, which shall include, as appropriate:

(i) The nature of the foreign financial institution's business and the markets it serves;

(ii) The type, purpose, and anticipated activity of such correspondent account;

(iii) The nature and duration of the covered financial institution's relationship with the foreign financial institution (and any of its affiliates);

(iv) The anti-money laundering and supervisory regime of the jurisdiction that issued the charter or license to the foreign financial institution, and, to the extent that information regarding such jurisdiction is reasonably available, of the jurisdiction in which any company that is an owner of the foreign financial institution is incorporated or chartered; and

(v) Information known or reasonably available to the covered financial institution about the foreign financial institution's anti-money laundering record; and

(3) Applying risk-based procedures and controls to each such correspondent account reasonably designed to detect and report known or suspected money laundering activity, including a periodic review of the correspondent account activity sufficient to determine consistency with information obtained about the type, purpose, and anticipated activity of the account.

(b) *Enhanced due diligence for certain foreign banks.* [Reserved]

(c) *Foreign banks to be accorded enhanced due diligence.* [Reserved]

(d) *Special procedures when due diligence cannot be performed.* The due diligence program required by paragraph (a) of this section shall include procedures to be followed in circumstances in which a covered financial institution cannot perform appropriate due diligence with respect to a correspondent account, including when the covered financial institution should refuse to open the account, suspend transaction activity, file a suspicious activity report, or close the account.

(e) *Applicability rules.* The provisions of this section apply to covered financial institutions as follows:

(1) *General rules*—(i) *Correspondent accounts established on or after April 4, 2006.* Effective April 4, 2006, the requirements of this section shall apply to each correspondent account established on or after such date.

(ii) *Correspondent accounts established before April 4, 2006.* Effective October 2, 2006, the requirements of this section shall apply to each correspondent account established before April 4, 2006.

(2) *Special rules for certain banks.* The enhanced due diligence requirements of 31 U.S.C. 5318(i)(2) shall continue to apply to any covered financial institution listed in § 103.175(f)(1)(i) through (vi). In addition, until the requirements of this section become applicable as set forth in paragraph (e)(1) of this section, the due diligence requirements of 31 U.S.C. 5318(i)(1) shall continue to apply to any covered financial institution listed in § 103.175(f)(1)(i) through (vi).

(3) *Special rules for all other covered financial institutions.* The due diligence requirements of 31 U.S.C. 5318(i)(1) shall not apply to a covered financial institution listed in § 103.175(f)(1)(vii) through (x) until the requirements of this section become applicable as set forth in paragraph (e)(1) of this section. The enhanced due diligence requirements of 31 U.S.C. 5318(i)(2) shall not apply to any covered financial institution listed in § 103.175(f)(1)(vii) through (x) until otherwise provided by the Financial Crimes Enforcement Network in a final rule published in the

Federal Register with respect to these requirements.

(4) *Exemptions*—(i) *Exempt financial institutions.* Except as provided in this section, a financial institution defined in 31 U.S.C. 5312(a)(2) or (c)(1), or § 103.11(n) is exempt from the due diligence and enhanced due diligence requirements of 31 U.S.C. 5318(i)(1) and (2) pertaining to correspondent accounts.

(ii) *Other compliance obligations of financial institutions unaffected.* Nothing in paragraph (e)(4) of this section shall be construed to relieve a financial institution from its responsibility to comply with any other applicable requirement of law or regulation, including title 31, United States Code, and this part.

■ 5. Subpart I of part 103 is amended by adding § 103.178 to read as follows:

§ 103.178 Due diligence programs for private banking accounts.

(a) *In general.* A covered financial institution shall maintain a due diligence program that includes policies, procedures, and controls that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving any private banking account that is established, maintained, administered, or managed in the United States by such financial institution. The due diligence program required by this section shall be a part of the anti-money laundering program otherwise required by this subpart.

(b) *Minimum requirements.* The due diligence program required by paragraph (a) of this section shall be designed to ensure, at a minimum, that the financial institution takes reasonable steps to:

(1) Ascertain the identity of all nominal and beneficial owners of a private banking account;

(2) Ascertain whether any person identified under paragraph (b)(1) of this section is a senior foreign political figure;

(3) Ascertain the source(s) of funds deposited into a private banking account and the purpose and expected use of the account; and

(4) Review the activity of the account to ensure that it is consistent with the information obtained about the client's source of funds, and with the stated purpose and expected use of the account, as needed to guard against money laundering, and to report, in accordance with applicable law and regulation, any known or suspected money laundering or suspicious activity conducted to, from, or through a private banking account.

(c) *Special requirements for senior foreign political figures.* (1) In the case of a private banking account for which a senior foreign political figure is a nominal or beneficial owner, the due diligence program required by paragraph (a) of this section shall include enhanced scrutiny of such account that is reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.

(2) For purposes of this paragraph (c), the term *proceeds of foreign corruption* means any asset or property that is acquired by, through, or on behalf of a senior foreign political figure through misappropriation, theft, or embezzlement of public funds, the unlawful conversion of property of a foreign government, or through acts of bribery or extortion, and shall include any other property into which any such assets have been transformed or converted.

(d) *Special procedures when due diligence cannot be performed.* The due diligence program required by paragraph (a) of this section shall include procedures to be followed in circumstances in which a covered financial institution cannot perform appropriate due diligence with respect to a private banking account, including when the covered financial institution should refuse to open the account, suspend transaction activity, file a suspicious activity report, or close the account.

(e) *Applicability rules.* The provisions of this section apply to covered financial institutions as follows:

(1) *General rules*—(i) *Private banking accounts established on or after April 4, 2006.* Effective April 4, 2006, the requirements of this section shall apply to each private banking account established on or after such date.

(ii) *Private banking accounts established before April 4, 2006.* Effective October 2, 2006, the requirements of this section shall apply to each private banking account established before April 4, 2006.

(2) *Special rules for certain banks and for brokers or dealers in securities, futures commission merchants, and introducing brokers.* Until the requirements of this section become applicable as set forth in paragraph (e)(1) of this section, the requirements of 31 U.S.C. 5318(i)(3) shall continue to apply to a covered financial institution listed in § 103.175(f)(1)(i) through (vi), (viii), or (ix).

(3) *Special rules for federally regulated trust banks or trust companies, and mutual funds.* Until the requirements of this section become applicable as set forth in paragraph (e)(1) of this section, the requirements of 31 U.S.C. 5318(i)(3) shall not apply to a covered financial institution listed in § 103.175(f)(1)(vii), or (x).

(4) *Exemptions*—(i) *Exempt financial institutions.* Except as provided in this section, a financial institution defined in 31 U.S.C. 5312(a)(2) or (c)(1) or § 103.11(n) is exempt from the requirements of 31 U.S.C. 5318(i)(3) pertaining to private banking accounts.

(ii) *Other compliance obligations of financial institutions unaffected.* Nothing in paragraph (e)(4) of this section shall be construed to relieve a financial institution from its responsibility to comply with any other applicable requirement of law or regulation, including title 31, United States Code, and this part.

■ 6. Subpart I of part 103 is amended by removing §§ 103.181, 103.182, and 103.183.

Dated: December 15, 2005.

William J. Fox,

Director, Financial Crimes Enforcement Network.

[FR Doc. 06–5 Filed 1–3–06; 8:45 am]

BILLING CODE 4810–02–P

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506–AA29

Financial Crimes Enforcement Network; Anti-Money Laundering Programs; Special Due Diligence Programs for Certain Foreign Accounts

AGENCY: Financial Crimes Enforcement Network, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Financial Crimes Enforcement Network is issuing this proposed Bank Secrecy Act regulation to implement section 312 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 ("Act"), which requires U.S. financial institutions to conduct enhanced due diligence with regard to correspondent accounts established, maintained, administered, or managed for certain types of foreign banks. We originally published a notice of proposed rulemaking seeking to implement section 312 in its entirety on May 30, 2002. Due to the significant number of issues raised during the comment period, we have determined that it is necessary and appropriate to issue another notice of proposed rulemaking ("Proposal") to address issues associated with the enhanced due diligence provisions. A final rule implementing all other provisions of section 312 is published elsewhere in this separate part of the **Federal Register**.

DATES: Written comments must be submitted on or before March 6, 2006.

ADDRESSES: You may submit comments, identified by Regulatory Information Number 1506–AA29, by any of the following methods:

- Federal e-rulemaking portal: *http://www.regulations.gov*. Follow the instructions for submitting comments.
- E-mail: *regcomments@fincen.treas.gov*. Include "Regulatory Information Number 1506–AA29" in the subject line of the message.
- Mail: Financial Crimes Enforcement Network, P.O. Box 39, Vienna, VA 22183. Include "Regulatory Information Number 1506–AA29" in the body of the text.

Instructions: It is preferable for comments to be submitted by electronic mail because paper mail in the Washington, DC, area may be delayed. Please submit comments by one method only. All submissions received must include the agency name and the Regulatory Information Number for this rulemaking. All comments received will be posted without change to *http://www.fincen.gov*, including any personal information provided. We will consider all comments postmarked before the close of the comment period in developing a final regulation. Comments received after the close of the comment period will be considered if possible, but their consideration cannot be assured. Comments may be inspected at the Financial Crimes Enforcement Network between 10 a.m. and 4 p.m. in the Financial Crimes Enforcement Network reading room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephone at (202) 354–6400 (not a toll-free number).

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949–2732.

SUPPLEMENTARY INFORMATION:

I. Background

Section 312 of the Act amended the Bank Secrecy Act to add a new subsection (i) to 31 U.S.C. 5318. This provision requires each U.S. financial institution that establishes, maintains, administers, or manages a correspondent account or a private banking account in the United States for a non-U.S. person to subject such accounts to certain anti-money laundering measures. In particular, financial institutions must establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to enable the financial institution to detect and report instances of money laundering through these accounts.

In addition to the general due diligence requirements, which apply to all correspondent and private banking accounts for non-U.S. persons, section 5318(i)(2) requires enhanced due diligence measures for correspondent accounts established, maintained, managed, or administered for a foreign bank operating under an offshore banking license,[1] operating under a license issued by a country designated as being non-cooperative with international anti-money laundering principles or procedures by an intergovernmental group or organization of which the United States is a member and with which designation the United States concurs, or operating under a license issued by a country designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns. This Proposal addresses these enhanced due diligence requirements.

A. The 2002 Proposal

On May 30, 2002, we published in the **Federal Register** a notice of proposed rulemaking ("2002 Proposal") to implement section 5318(i).[2] In the 2002 Proposal, we sought to take the broad statutory mandate of section 5318(i) and to translate it into specific regulatory directives for financial institutions to apply. The 2002 Proposal set forth a series of due diligence procedures that financial institutions subject to the rule must apply to correspondent accounts and private banking accounts for non-U.S. persons.

B. The Interim Rule

We received comments in response to the 2002 Proposal that raised many significant concerns regarding the numerous definitions in the 2002 Proposal, the scope of the requirements of section 5318(i), and the financial institutions that would be subject to them. Section 312(b)(2) of the Act provides that section 5318(i) of the Bank Secrecy Act took effect on July 23, 2002, regardless of whether final rules had been issued by that date. In order to have adequate time to review the comments, to determine the appropriate resolution of the many issues raised, and to give direction to the affected financial institutions, we issued an interim final rule ("Interim Rule")[3] on July 23, 2002, in which we exercised our authority under 31 U.S.C. 5318(a)(6) to defer temporarily the application of 31 U.S.C. 5318(i) to certain financial institutions. For those financial institutions that were not subject to the deferral, we set forth interim guidance for compliance with the statute by delineating the scope of coverage, duties, and obligations under that provision, pending issuance of a final rule.

C. The Final Rule

Published elsewhere in this separate part of the **Federal Register** is a final rule implementing all of the provisions of section 5318(i) with the exception of section 5318(i)(2)'s enhanced due

[1] "Offshore banking license" is defined in 31 CFR 103.175(k) (which was adopted in the final rule published elsewhere in this separate part of the **Federal Register**) to mean a license to conduct banking activities that prohibits the licensed entity from conducting banking activities with the citizens of, or in the local currency of, the jurisdiction that issued the license.

[2] See 67 FR 37736 (May 30, 2002).

[3] 67 FR 48348 (July 23, 2002).

diligence requirement for correspondent accounts established or maintained for certain foreign bank customers.

Due to the issuance of this Proposal, the final rule maintains the status quo that existed under the Interim Rule with respect to the enhanced due diligence provisions of section 5318(i)(2). Specifically, until otherwise provided in a final rule issued pursuant to this Proposal, most banking organizations must continue to comply with 31 U.S.C. 5318(i)(2), which requires enhanced due diligence for certain correspondent accounts. However, securities broker-dealers, futures commission merchants, introducing brokers, and mutual funds, as well as trust banks and trust companies that have a federal regulator, continue to be exempt from compliance with the enhanced due diligence provisions for correspondent accounts until a final rule is issued pursuant to this Proposal.

II. The Proposed Rule

A. Overview

Section 5318(i) generally requires U.S. financial institutions to apply appropriate, specific, and, where necessary, enhanced due diligence to correspondent accounts established or maintained for foreign banks. Section 5318(i)(2) specifies enhanced due diligence procedures that must be performed with regard to foreign banks operating under any of the following three types of licenses: (1) An offshore banking license; (2) a license issued by a foreign country designated as non-cooperative with international money laundering principles or procedures by an intergovernmental group or organization of which the United States is a member and with which designation the U.S. representative to that group or organization concurs; or (3) a license issued by a country designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns. The enhanced due diligence procedures required by section 5318(i)(2) include taking reasonable steps to: (1) Conduct enhanced scrutiny of the correspondent account to guard against money laundering and to report suspicious activity; (2) ascertain whether the foreign bank provides correspondent accounts to other foreign banks that use in any way the correspondent account established or maintained by the covered financial institution, and, if so, conduct appropriate due diligence; and (3) identify the owners of the foreign bank if the foreign bank's shares are not publicly traded.

The 2002 Proposal recommended the exclusion of certain foreign banks operating under offshore banking licenses from the enhanced due diligence requirements. Specifically, we recommended excluding from the enhanced due diligence requirements offshore-licensed branches of foreign banks chartered in a jurisdiction where one or more foreign banks have been determined by the Board of Governors of the Federal Reserve System ("Federal Reserve") to be subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in that jurisdiction ("the Consolidated Exception"), so long as such foreign banks did not fall within either of the other two categories of foreign banks for which the enhanced due diligence requirements apply.[4]

Commenters were strongly divided over the Consolidated Exception. A joint comment letter from several members of Congress urged us to eliminate the Consolidated Exception, calling it unfounded and contrary to the legislative intent of section 5318(i), which, in the congressional commenters' view, did not provide for any exceptions. The congressional comment letter reiterated concerns about the money laundering risks associated with offshore banks, such as the lack of regulatory oversight, excessive secrecy laws, and the general lack of transparency. Other commenters supported the Consolidated Exception as a reasonable basis to focus anti-money laundering programs on higher-risk offshore banks, but suggested that the exception was not broad enough because a determination by the Federal Reserve that one or more foreign banks are subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in a jurisdiction is limited to those foreign banks that have sought to establish U.S. banking operations since 1991. These commenters asked that we address this potential inequity by, for example, expanding the jurisdictions included in the exception or by implementing a process for evaluating the level of supervision in other jurisdictions and determining whether banks chartered in such jurisdictions should also be exempted from mandatory enhanced due diligence. In addition, some commenters requested that we extend the Consolidated Exception to offshore-licensed subsidiaries and affiliates, in addition to the branches, of foreign banks that are chartered in a jurisdiction where one or more foreign banks have been determined to be subject to comprehensive supervision on a consolidated basis.

We recognize, as reflected in many of the comments, that most categorical exemptions, including the proposed Consolidated Exception, may be both over- and under-inclusive, thereby creating anomalies in the level of scrutiny to be applied to offshore banks. Further, we have some concerns as to whether the Consolidated Exception sufficiently accounts for the risks associated with offshore banking. We also understand that the Federal Reserve's determination that a foreign bank is subject to comprehensive supervision on a consolidated basis in its home jurisdiction does not focus primarily on the quality, risks, or appropriateness of the foreign jurisdiction's anti-money laundering regime, although those factors are taken into consideration as a general matter.

Consequently, we have not adopted the Consolidated Exception as described in the 2002 Proposal. Under the current Proposal, all correspondent accounts for foreign banks set forth in 5318(i)(2) would be subject to a certain degree of enhanced due diligence.

At the same time, we recognize that not all such correspondent accounts present the same type or level of risk, and that to impose an obligation of applying the same enhanced due diligence procedures in every case would require covered financial institutions to allocate limited resources inefficiently, thereby undermining the effectiveness of their anti-money laundering programs and the objectives of this statutory provision. Accordingly, we have determined that it is appropriate to propose a final rule that makes it clear that covered financial institutions should apply enhanced due diligence with regard to the three categories of foreign banks on a risk-basis, as contemplated by the statute.

Under this risk-based approach, covered financial institutions would determine the nature and extent of the risks posed by the correspondent accounts for the foreign banks identified in 31 U.S.C. 5318(i)(2)(A) and the corresponding extent of the enhanced due diligence that is necessary and appropriate to apply to control those risks. Such an approach tailors the

[4] As of October 2005, the Federal Reserve has made a determination that one or more foreign banks in the following jurisdictions are subject to comprehensive supervision or regulation on a consolidated basis: Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Finland, France, Germany, Greece, Hong Kong Special Administrative Region, Ireland, Israel, Italy, Japan, Korea, Mexico, the Netherlands, Norway, Portugal, Spain, Switzerland, Taiwan, Turkey, and the United Kingdom.

required due diligence to the specific risks, enhancing protection and avoiding the problems created by a categorical exemption. This approach is consistent with the overall risk-based approach of the Bank Secrecy Act's anti-money laundering program and suspicious activity reporting rules and is consistent with the plain language and legislative intent of the statute.

B. Enhanced Due Diligence

Pursuant to the proposed rule, a covered financial institution must establish procedures to assess the risks involved with each correspondent account that is subject to enhanced due diligence and must take reasonable steps to accomplish the following.

i. Enhanced scrutiny to guard against money laundering. Section 103.176(b)(1) requires that a covered financial institution's due diligence program ensure that the institution takes reasonable steps to conduct certain risk-based enhanced scrutiny of any correspondent account statutorily deemed to be high-risk in order to guard against money laundering and to report any suspicious transactions. The enhanced due diligence will vary based on the covered financial institution's assessment of the money laundering risk posed by the particular correspondent account established or maintained for a foreign correspondent bank.

Pursuant to section 103.176(b)(1)(i) and (ii), the covered financial institution, shall, when appropriate based on its risk assessment, obtain and review documentation relating to the foreign correspondent bank's anti-money laundering program, and shall consider and evaluate the extent to which that program appears to be reasonably designed to detect and prevent money laundering. We do not contemplate that the covered financial institution would conduct an audit of the foreign correspondent bank's anti-money laundering program. Rather, we expect that the covered financial institution would conduct, as appropriate, a review of the foreign correspondent bank's written anti-money laundering program (or a description of the program) to determine whether the program appears to be reasonably designed to accomplish its purpose. With regard to this requirement, we have determined that it may not be necessary in every instance, especially with a well-regulated foreign correspondent bank that the covered financial institution knows well and has been doing business with for an extended time, for the covered financial institution to actually obtain and analyze that foreign bank's anti-money laundering program.

Under section 103.176(b)(1)(iii), the covered financial institution shall, as appropriate, monitor transactions to, from or through the correspondent account in a manner reasonably designed to detect money laundering and other suspicious activity. This requirement means that, at a minimum, a covered financial institution should have reasonable procedures to monitor the overall activity through the account and to enable the covered financial institution to detect unusual and suspicious activity, including activity that is not in accord with the type, purpose, and anticipated activity of the account. In some cases, covered financial institutions will be expected to apply greater due diligence, as appropriate, in accordance with their risk assessment. Monitoring accounts is an important element of an enhanced due diligence program, and the covered financial institution must determine, on a risk-basis, the most effective scope and manner for such monitoring (e.g., computerized or manual, on an individual account basis or a product activity level). The monitoring procedures must be designed to reflect the additional risk posed by these categories of accounts above and beyond those posed by accounts not subject to the enhanced due diligence requirement.

Section 103.176(b)(1)(iv) requires a covered financial institution to obtain information about the identity of persons with authority to direct transactions through the correspondent account and the sources and beneficial ownership of funds or other assets in the account. This obligation, however, applies only to payable-through accounts.[5]

The extent to which enhanced scrutiny may be appropriate will depend on the covered financial institution's risk assessment of the particular correspondent account. For example, foreign banks operating under an offshore banking license pose a range of money laundering risks, and covered financial institutions will need to consider a variety of factors in determining the appropriate level of enhanced scrutiny. Such factors could include whether such banks are branches or affiliates of financial institutions that are subject to supervision in their home jurisdiction, which might reduce the risks of money laundering, or whether they are offshore banks unaffiliated with any other supervised financial institution, in which case the risks may well be greater.

ii. Foreign Bank Customers. Section 103.176(b)(2) requires that a covered financial institution determine whether the foreign correspondent bank in turn maintains correspondent accounts for other foreign banks ("nested banks") for which the U.S. correspondent account is used to process transactions. If so, the covered financial institution must take reasonable steps to obtain information relevant to assess and minimize money laundering risks associated with the nested banks, including, as appropriate, obtaining the identity of the nested bank customers and conducting due diligence with regard to them.

Under this provision, reasonable steps would include collecting information sufficient to describe the foreign bank customers of the foreign correspondent bank. We expect that a covered financial institution will request its foreign correspondent banks to provide information about their foreign bank customer base and will consult readily available banking reference guides. Such information will enable covered financial institutions to identify potential risks and to determine whether it is necessary to take the additional steps of identifying and conducting due diligence with regard to individual nested banks. Monitoring wire transfer activity originating from the foreign correspondent bank, for example, can be an important component of a robust program, as U.S. banks may be able to identify nested correspondent account activity through a review of wire transfers and payment instructions.

The covered financial institution's due diligence program should contain procedures for assessing when the covered financial institution will identify nested banks and for assessing the risk posed by any such nested accounts. Relevant factors may include the type of nested bank, the anti-money laundering and supervisory regime of the nested bank's home jurisdiction, and the activity taking place through the U.S. correspondent account. The program should also contain procedures for determining the circumstances when due diligence with regard to the nested bank would be appropriate. Further, the covered financial institution should consider the extent to which the foreign correspondent bank's anti-money

[5] Section 311 of the Act defines a payable-through account as "an account * * * opened at a depository institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage, either directly or through a subaccount, in banking activities usual in connection with the business of banking in the United States." 31 U.S.C. 5318A(e)(1)(C).

laundering program appears adequate to prevent the nested bank account from being used for money laundering. If the program does not appear adequate, then the covered financial institution may itself need to perform due diligence on the nested bank.

Finally, if a foreign correspondent bank refuses to provide information about its nested banks, the covered financial institution will have to determine whether, in light of the reasons given for such refusal and the risk associated with the foreign correspondent bank, it is prudent to establish or maintain the correspondent account.

iii. Identification of foreign correspondent banks' owners. Pursuant to section 103.176(b)(3), the covered financial institution must obtain the identity of owners of any foreign correspondent bank whose shares are not publicly traded. The 2002 Proposal defined the term "owner" for this purpose to mean any person who directly or indirectly owns, controls, or has the power to vote five (5) percent or more of any class of securities of a foreign bank, and defined the term "publicly traded" to mean shares that are traded on an exchange or an organized over-the-counter market that is regulated by a foreign securities authority, as defined in the Securities Exchange Act of 1934. Several commenters suggested that the definition of ownership should be consistent with the definition contained in the rule implementing sections 313 and 319 of the Act, which requires a 25 percent threshold for ownership. Others thought that the threshold should be at least 10 or 15 percent. In our view, because this requirement applies to foreign banks that are deemed to present a high risk of money laundering by virtue of their location or the license under which they operate, the threshold should be lower than the threshold that applies for determining the ownership of foreign banks having correspondent accounts with covered financial institutions under the rules implementing sections 313 and 319 of the Act. However, we agree that a five (5) percent threshold is too low. Accordingly, we propose a 10 percent threshold in this Proposal.

C. Foreign Banks To Be Accorded Enhanced Due Diligence

Pursuant to 103.176(c), a covered financial institution would be required to apply enhanced due diligence measures to three categories of foreign banks listed in 31 U.S.C. 5318(i)(2). These categories consist of foreign banks operating under three types of licenses: (1) An offshore banking license; (2) a license issued by a foreign country designated as non-cooperative with international money laundering principles or procedures by an intergovernmental group or organization, of which the United States is a member, and with which designation the U.S. representative concurs;[6] or (3) a license issued by a country that the Secretary of the Treasury has designated as warranting special measures due to money laundering concerns.

D. Special Procedures

We are proposing to modify 103.176(d) slightly simply to take into account that the special procedures required in this paragraph must be incorporated into the covered financial institution's enhanced due diligence program as well as its general due diligence program.

III. Request for Comments

We invite comments on all aspects of this proposal.

IV. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. 610 *et seq.*), it is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. This proposed rule provides guidance to financial institutions concerning certain mandated enhanced due diligence requirements in section 312 of the Act. Moreover, most of the financial institutions covered by the rule tend to be larger institutions. Accordingly, a regulatory flexibility analysis is not required.

V. Executive Order 12866

This proposed rule is not a "significant regulatory action" as defined by Executive Order 12866. Accordingly, a regulatory assessment is not required.

VI. Paperwork Reduction Act

The collection of information contained in this proposed rule is being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent (preferably by fax (202–395–6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to *ahunt@omb.eop.gov*), with a copy to the Financial Crimes Enforcement Network by mail or the Internet at the addresses previously specified. In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3506(c)(2)(A), and its implementing regulations, 5 CFR 1320, the following information concerning the collection of information is presented to assist those persons wishing to comment on the information collection.

The collection of information in this proposed rule is in 31 CFR 103.176(b)(i) and 103.176(b)(iv)(A). The information will be used by federal agencies to verify compliance by covered financial institutions with the provisions of 31 CFR 103.176. The collection of information is mandatory. The likely recordkeepers are mostly banking institutions; (2) securities broker-dealers; (3) futures commission merchants and introducing brokers in commodities; and (4) mutual funds.

Description of Recordkeepers: Covered financial institutions as defined in 31 CFR 103.175(f)(1);

Estimated Number of Recordkeepers: There are approximately 28,163 covered financial institutions, consisting of 9,000 commercial banks and savings associations, 10,000 credit unions, 2,400 mutual funds, 1,452 introducing brokers, 151 futures commission merchants, 5,160 securities broker-dealers.

Estimated Average Annual Burden Hours Per Recordkeeper: The estimated average burden associated with the recordkeeping requirement in this proposed rule is one hour per recordkeeper.

Estimated Total Annual Recordkeeping Burden: 28,163 annual burden hours.

We specifically invite comments on: (a) Whether the proposed recordkeeping requirement is necessary for the proper performance of the mission of the Financial Crimes Enforcement Network, and whether the information shall have practical utility; (b) the accuracy of our estimate of the burden of the proposed recordkeeping requirement; (c) ways to enhance the quality, utility, and clarity of the information required to be maintained; (d) ways to minimize the burden of the recordkeeping requirement, including through the use of automated collection techniques or other forms of information technology;

[6] The only intergovernmental organization that currently designates countries as non-cooperative with international anti-money laundering standards is the Financial Action Task Force on Money Laundering. The Financial Action Task Force designation of non-cooperative jurisdictions can be found on the Financial Action Task Force Web site (*www.oecd.org/fatf*). The United States has concurred in all Financial Action Task Force designations made to date.

and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

List of Subjects in 31 CFR Part 103

Banks, Banking, Brokers, Counter money laundering, Counter-terrorism, Currency, Foreign banking, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth above, we are proposing to amend subpart I of 31 CFR part 103 as follows:

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

1. The authority citation for part 103 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951–1959; 31 U.S.C. 5311–5314 and 5316–5332; title III, secs. 311, 312, 313, 314, 319, 326, 352, Pub. L. 107–56, 115 Stat. 307.

2. In subpart I, amend § 103.176 as follows:

a. Revise paragraph (b),

b. Revise paragraph (c), and

c. Revise paragraph (d).

The revisions read as follows:

§ 103.176 Due diligence programs for correspondent accounts for foreign financial institutions.

* * * * *

(b) *Enhanced due diligence for certain foreign banks.* In the case of a correspondent account established, maintained, administered, or managed in the United States for a foreign bank described in paragraph (c) of this section, the due diligence program required by paragraph (a) of this section shall include enhanced due diligence procedures designed to ensure that the covered financial institution, at a minimum, takes reasonable steps to:

(1) Conduct enhanced scrutiny of such correspondent account to guard against money laundering and to identify and report any suspicious transactions in accordance with applicable law and regulation. This enhanced scrutiny shall reflect the risk assessment of the account and shall include, as appropriate:

(i) Obtaining and reviewing documentation relating to the foreign bank's anti-money laundering program;

(ii) Considering whether such program appears to be reasonably designed to detect and prevent money laundering;

(iii) Monitoring transactions to, from, or through the correspondent account in a manner reasonably designed to detect money laundering and suspicious activity; and

(iv)(A) Obtaining information from the foreign bank about the identity of 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.

(B) For purposes of paragraph (b)(1)(iv)(A) of this section, a *payable-through account* means a correspondent account maintained by a covered financial institution for a foreign bank by means of which the foreign bank permits its customers to engage, either directly or through a subaccount, in banking activities usual in connection with the business of banking in the United States.

(2) Determine whether the foreign bank for which the correspondent account is established or maintained in turn maintains correspondent accounts for other foreign banks that use the foreign correspondent account established or maintained by the covered financial institution, and, if so, take reasonable steps to obtain information relevant to assess and minimize money laundering risks associated with the foreign bank's correspondent accounts for other foreign banks, including, as appropriate, the identity of those foreign banks.

(3)(i) Determine, for any correspondent account established or maintained for a foreign bank whose shares are not publicly traded, the identity of each owner of the foreign bank and the nature and extent of each owner's ownership interest.

(ii) For purposes of paragraph (b)(3)(i) of this section:

(A) *Owner* means any person who directly or indirectly owns, controls, or has the power to vote 10 percent or more of any class of securities of a foreign bank. For purposes of this paragraph (b)(3)(ii)(A):

(*1*) Members of the same family shall be considered to be one person; and

(*2*) *Same family* has the meaning provided in § 103.175(l)(2)(ii).

(B) *Publicly traded* means shares that are traded on an exchange or an organized over-the-counter market that is regulated by a foreign securities authority as defined in section 3(a)(50) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(50)).

(c) *Foreign banks to be accorded enhanced due diligence.* The due diligence procedures described in paragraph (b) of this section are required for any correspondent account maintained for a foreign bank that operates under:

(1) An offshore banking license;

(2) A banking license issued by a foreign country that has been designated as non-cooperative with international anti-money laundering principles or procedures by an intergovernmental group or organization of which the United States is a member and with which designation the U.S. representative to the group or organization concurs; or

(3) A banking license issued by a foreign country that has been designated by the Secretary as warranting special measures due to money laundering concerns.

(d) *Special procedures when due diligence or enhanced due diligence cannot be performed.* The due diligence program required by paragraphs (a) and (b) of this section shall include procedures to be followed in circumstances in which a covered financial institution cannot perform appropriate due diligence or enhanced due diligence with respect to a correspondent account, including when the covered financial institution should refuse to open the account, suspend transaction activity, file a suspicious activity report, or close the account.

* * * * *

Dated: December 15, 2005.

William J. Fox,

Director, Financial Crimes Enforcement Network.

[FR Doc. 06–6 Filed 1–3–06; 8:45 am]

BILLING CODE 4810–02–P

Financial Crimes Enforcement Network
Department of the Treasury

FACT SHEET
Section 312 of the USA PATRIOT Act
Final Regulation and Notice of Proposed Rulemaking

December 2005

The Financial Crimes Enforcement Network today sent for publication in the *Federal Register* a final regulation implementing the foreign correspondent account provisions and the private banking provisions of section 312 of the USA PATRIOT Act. Simultaneously, the Financial Crimes Enforcement Network sent for publication a related notice of proposed rulemaking relating to one key provision of section 312 that requires enhanced due diligence for correspondent accounts maintained for certain foreign banks. The *Federal Register* will publish both regulations after January 1, 2006. This Fact Sheet summarizes the basic requirements of the final rule and the proposed rule as well as the effective dates of the final rule.

Overview

Section 312 of the USA PATRIOT Act requires U.S. financial institutions to perform due diligence and, in some cases, enhanced due diligence, with regard to correspondent accounts established or maintained for foreign financial institutions and private banking accounts established or maintained for non-U.S. persons. The final rule issued today implements the general due diligence requirements pertaining to foreign financial institutions as well as the due diligence and enhanced scrutiny requirements pertaining to private banking accounts. The notice of proposed rulemaking addresses the enhanced due diligence requirements pertaining to correspondent accounts maintained for certain foreign banks.

I. International Correspondent Banking Provisions

General Due Diligence – the Final Rule

The final rule implementing section 312 requires certain U.S. financial institutions to apply due diligence to correspondent accounts maintained for certain foreign financial institutions.

(1) What is a correspondent account?

The final rule retains the statutory definition of a correspondent account found in the USA PATRIOT Act, which defines a correspondent account broadly to include any

account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution. While this is a relatively broad definition, it requires a formal relationship through which the financial institution provides regular services.

(2) Which U.S. financial institutions are covered by the correspondent banking portion of the final rule?

The following U.S. financial institutions are covered by the correspondent banking provisions of the final rule: (1) banking institutions; (2) securities broker-dealers; (3) futures commission merchants and introducing brokers in commodities; and (4) mutual funds.

(3) Which foreign financial institutions are subject to the due diligence required by the correspondent banking portion of the final rule?

The final rule applies to correspondent accounts maintained for the following foreign financial institutions: (1) a foreign bank; (2) a foreign branch of a U.S. bank; (3) a business organized under a foreign law that, if it were located in the United States, would be a securities broker-dealer, futures commission merchant, introducing broker in commodities, or a mutual fund; and (4) a money transmitter or currency exchanger organized under foreign law.

(4) What are the general due diligence requirements of the correspondent banking portion of the final rule?

U.S. financial institutions covered by the final rule must establish a due diligence program that includes appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to detect and report known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed in the United States.

At a minimum, the due diligence program must: (1) determine whether the account is subject to enhanced due diligence under section 312 (see discussion of the notice of proposed rulemaking below); (2) assess the money laundering risk posed, based on a consideration of relevant risk factors; and (3) apply risk-based policies, procedures, and controls to each such correspondent account reasonably designed to detect and report known or suspected money laundering activity, including a periodic review of the correspondent account activity. The final rule provides guidance to financial institutions in assessing the risks posed by a correspondent relationship by outlining several risk factors to be considered as appropriate.

Enhanced Due Diligence Requirements – The Notice of Proposed Rulemaking

Section 312 contains a provision requiring U.S. financial institutions to apply enhanced due diligence when establishing or maintaining a correspondent account for a foreign bank that is operating: (1) under an offshore license; (2) in a jurisdiction found to be non-cooperative with international anti-money laundering principles; or (3) in a jurisdiction found to be of primary money laundering concern under section 311 of the USA PATRIOT Act. With regard to correspondent accounts for such banks, the statute requires U.S. financial institutions to take reasonable steps to: (1) conduct appropriate enhanced scrutiny; (2) determine whether the foreign bank itself offers correspondent accounts to other foreign banks (*i.e.*, nested accounts) and, as appropriate, identify such foreign bank customers and conduct additional due diligence on them; and (3) identify the owners of such foreign bank, if its shares are not publicly traded;

The original proposed rulemaking issued in 2002 sought to create an exception to the enhanced due diligence requirement for those offshore banks that were branches of well-regulated foreign banks. Specifically, we proposed to exclude from enhanced due diligence those foreign banks operating under an offshore banking license that are branches of banks licensed in a jurisdiction where one or more banks had been determined by the Federal Reserve to be subject to comprehensive supervision or regulation on a consolidated basis. The notice of proposed rulemaking issued today takes a different approach, focusing instead on clarifying that U.S. financial institutions have some flexibility in applying the enhanced due diligence procedures on a risk-assessed basis, tailoring the enhanced due diligence to the risks associated with the particular account. Comments are sought on all aspects of this proposed rulemaking.

II. Private Banking Provisions

The final rule requires certain U.S. financial institutions to establish and maintain a due diligence program for private banking accounts that is reasonably designed to detect and report any known or suspected money laundering or suspicious activity. Included in this requirement is the duty to conduct enhanced scrutiny of any private banking account that is maintained for senior foreign political figures, their immediate family members, or persons widely and publicly known to be close associates of such individuals.

(1) What is a private banking account?

The final rule reflects the statutory definition found in the USA PATRIOT Act, which defines a private banking account as an account that is established or maintained for the benefit of one or more non-U.S. persons, requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000, and is assigned to a bank employee who is a liaison between the financial institution and the non-U.S. person.

Significantly, if an account otherwise satisfies the definition of a private banking account as described above, but the institution does not ***require*** a minimum balance of $1,000,000, then the account does not qualify as a private banking account under this

rule. However, the account is subject to the internal controls and risk-based due diligence included in the institution's general anti-money laundering program.

(2) Which U.S. financial institutions are covered by the private banking portion of the final rule?

The private banking rule covers the same financial institutions as the correspondent banking final rule, namely: (1) banking institutions; (2) securities broker-dealers; (3) futures commission merchants and introducing brokers in commodities; and (4) mutual funds (although the Financial Crimes Enforcement Network understands that mutual funds do not currently offer private banking accounts).

(3) What are the general due diligence requirements of the private banking portion of the final rule?

U.S. financial institutions covered by the final rule are required to establish and maintain a due diligence program that includes policies, procedures, and controls that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving any private banking account that is established, maintained, administered, or managed in the United States.

Specifically, financial institutions covered by the final rule must take reasonable steps to: (1) determine the identity of all nominal and beneficial owners of the private banking account; (2) determine whether any such owner is a senior foreign political official and, thus, is subject to enhanced scrutiny (described below); (3) determine the source(s) of funds deposited into the private banking account and the purpose and expected use of the account; and (4) review the activity of the account to ensure that the activity is consistent with the information obtained about the source of funds, the stated purpose and the expected use of the account, as needed to guard against money laundering, and to report any suspicious activity.

(4) Who are Senior Foreign Political Figures?

The final rule defines a "senior foreign political figure" as: a current or former senior official in the executive, legislative, administrative, military, or judicial branches of a foreign government, whether or not they are or were elected officials; a senior official of a major foreign political party; and a senior executive of a foreign government-owned commercial enterprise. This definition also includes a corporation, business, or other entity formed by or for the benefit of such an individual. Senior executives are individuals with substantial authority over policy, operations, or the use of government-owned resources.

Also included in the definition of a senior foreign political figure are immediate family members of such individuals, and those who are widely and publicly known (or actually known) close associates of a senior foreign political figure.

(5) Enhanced scrutiny for Senior Foreign Political Figures.

The final rule requires the application of enhanced scrutiny to private banking accounts maintained for senior foreign political figures. Enhanced scrutiny must include procedures reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption. The final rule defines "proceeds of foreign corruption" to include any asset acquired by, through, or on behalf of a senior foreign political figure through misappropriation, theft, or embezzlement of public funds, the unlawful conversion of property of a foreign government, or through acts of bribery or extortion, and include any other property into which any such assets have been transformed or converted.

III. Implementation

Financial institutions covered by the final rule have ***90 days*** from the time the regulation is published in the *Federal Register* to establish and apply the due diligence requirements to "new" correspondent and private banking accounts. A new account is one established at least 90 days after the date of the regulation's publication. For existing accounts and those accounts established before the 90-day time frame described above, the final rule takes effect ***270 days*** from the time the regulation is published in the *Federal Register*.

Special note: In July of 2002, the Financial Crimes Enforcement Network issued an interim rule requiring banking institutions to apply the correspondent and private banking due diligence provisions of section 312 pending issuance of a final rule. Additionally, the interim rule requires securities broker-dealers and futures commission merchants and introducing brokers in commodities to apply the private banking due diligence provisions of section 312 pending issuance of a final rule. Those statutory requirements remain effective until the final rule takes effect in 90 and 270 days, respectively, as described above. Furthermore, banking institutions must continue to apply the enhanced due diligence provisions of section 312 to their correspondent accounts until a final rule relating to enhanced due diligence is issued and becomes effective.