THE ASSOCIATION OF GLOBAL CUSTODIANS

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By Electronic Transmission

Jennifer Shasky Calvery
Director, Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, VA 22183

Re: Docket Number FINCEN-2014-0001; RIN 1506-AB25

Re: Association Comments Regarding Customer Due Diligence Requirements for Financial Institutions; Notice of Proposed Rulemaking RIN 1506-AB25 ("NPRM")

Dear Director Shasky Calvery:

We write on behalf of the members of the Association of Global Custodians[1] to provide members' views concerning the above-referenced proposals of the Financial Crimes Enforcement Network ("FinCen") that would introduce Customer Due Diligence Requirements ("CDD") that are broadly consistent with existing Customer Identification Program ("CIP") rules, but would establish a consistent and objective set of rules for the

[1] The Association is an informal group of 11 member banks, listed on the letterhead above, that provide securities safekeeping and related asset-serving functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investor-customers, including investment funds, pension funds, insurance companies and correspondent banks.

look-through of legal entity clients. While members applaud the effort to enhance the CIP process by establishing rules for CDD in the context of legal entity clients, members have concerns that the scope of the rule and narrowness of the exemptions may impair workability of the proposed CDD rule.

The association strongly supports FinCen's exemptions with respect to U.S. legal entities.[2] As indicated below, we would suggest only adding state regulated insurance companies as a class of exempt entities.

1. **Application of CDD to foreign legal entity customers**. As custodians and administrators of assets for non–U.S. financial institutions, funds and other institutional investors, Association members have a particular interest in the cross-border effects of the proposed CDD rules. While we understand that FinCen may be hesitant to accord exempt status to any but domestic U.S. legal entities, we would urge that there are broad classes of non-U.S. legal entity clients that present a low incidence of KYC-AML or sanctions risk that would be commensurate with the risk attendant to the exempted

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[2] *Legal entity customer* does not include: *(i)* A financial institution regulated by a Federal functional regulator or a bank regulated by a State bank regulator; *(ii)* A person described in§ 1020.315(b)(2) through (5) of this chapter;*(iii)*An issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that is required to file reports under section 15(d) of that Act; *(iv)* An investment company, as defined in section 3 of the Investment Company Act of 1940, that is registered with the Securities and Exchange Commission under that Act; *(v)*An investment adviser, as defined in section 202(a)(11) of the Investment Advisers Act of 1940, that is registered with the Securities and Exchange Commission under that Act; *(vi)*An exchange or clearing agency, as defined in section 3 of the of the Securities Exchange Act of 1934, that is registered under section 6 or 17A of the Securities Exchange Act of that Act; (vi)Any other entity registered with the Securities and Exchange Securities Exchange Act of 1934, that is registered under section 6 or 17A of the Securities Exchange Act of that Act; *(vii)*Any other entity registered with the Securities and Exchange Act of 1934; *(viii)* A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, each as defined in section 1a of the Commodity Exchange Act, that is registered with the Commodity Futures Trading Commission; *(ix)* A public accounting firm registered under section 102 of the Sarbanes-Oxley Act; and, (x) A charity or nonprofit entity that is described in sections 501(c), 527, or 4947(a)(1) of the Internal Revenue Code of 1986, has not been denied tax exempt status, and is required to and has filed the most recently due annual information return with the Internal Revenue Service.

U.S. entities. We believe that exemption of these entities from CDD requirements will allow appropriate focus and establish an effective scope for the new rules.

2. **Structure of the CDD Rules—Substitution of Risk Based Assessment with Categorical Treatment of Legal Entity Clients.** As proposed, the new CDD rules would apply to all "legal entity customers" save for those legal entities that are subject to express exemptions and would apply notwithstanding any determination as to the risk profile presented by the particular class of non-exempt legal entity. FinCen does not allow Covered Financial Institutions ("CFIs") to make a risk-based assessment with regard to the application of the CDD rules on any legal entity type that does not fall within the specific exemptions.

The new CDD requirements entail an ownership prong and a control prong. A CFI would be required to identify any individual who owns 25 percent or more of the equity interests of the legal entity customer, and in addition one individual who exercises significant managerial control of the legal entity customer. If no individual were to own 25 percent or more of the equity interests, then the CFI may identify an individual under the control prong only.

As FinCen has noted, the existing Bank Secrecy Act ("BSA") rules provide for a broad risk-based assessment process on the part of the CFI to determine the scope and focus of their customer due diligence program. The existing BSA rules mandate particular conduct as the rule on an exceptional basis only. This is where the BSA rules provide for the application of enhanced due diligence in certain express and limited situations[3].

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[3] For example see [FIN-2010-G001, Pg 5] "Under these regulations, enhanced due diligence is required for correspondent accounts established, maintained, administered, or managed in the United States, for *foreign banks* that operate under: (1) an offshore banking license; (2) a banking license issued by a country that has been designated as non-cooperative with international anti-money laundering principles or procedures; or (3) a banking license issued by a country designated by the Secretary of the Treasury (under delegation to the Director of FinCen, and in consultation with the Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission) as warranting special measures due to money laundering concerns. Enhanced due diligence is designed to be risk-based, with flexibility in its implementation to allow covered financial institutions to obtain and retain this information based on risk."

By contrast, the Association understands that the CDD rules as proposed in the NPRM would apply look-through to underlying owners/controllers as a rule in all situations where a client is a "legal entity customer". Instead of a risk based exception applied on a case by case basis by the CFI, the proposed CDD rules rely on certain express categorical exceptions to the definition of legal entity customer to achieve a balance between scope and focus.

3. **Importance of Exemptions in the Structure of the New CDD Rules**. Under this structure of regulation where CDD is mandated for a particular and very broad class of CFI customers, the exceptions to the application of CDD, which govern the practical scope of the rule, are critical to the establishment of an efficient rule. Considerations of efficiency in the scope of the CDD are important because at *any* given level of resource commitment to CDD compliance by CFIs, an increase in scope and volume attributable to relative low risk subjects dilutes focus on the most relevant subjects for due diligence review.

4. **Practical Implementation of CDD Rules**. The effect of the CDD rules are not incidental to operations of CFIs facilitating domestic and cross-border investment into the United States. They represent a significant and growing aspect of the administration of inward investment to U.S. markets and the U.S. economy. While acknowledging that the details of CDD compliance structures will vary from CFI to CFI, we would note, broadly speaking, that any application of the enhanced CDD rules as described in the NPRM would likely require four distinct functions on the part of a CFI: (i) Solicitation and collection; (ii) Review and assessment; (iii) Escalation; and (iv) Response, if appropriate. The inclusion of high volumes of low-risk entities will unavoidably dilute attention and resources that would be better concentrated on higher risk legal entities.

Each of these steps has its own challenges. Purely as an example, a requirement that a CFI that had a publicly registered EU UCITS as a customer might be faced with having to either secure access to the ownership records of the fund's transfer agent and monitor the same or otherwise require the UCITS to notify the CFI in the event that an underlying fund shareholder exceeded 25%, despite that this is an unlikely event. We would further note that achieving access and/or notification from such counterparty as to beneficial ownership will be difficult in the absence of compelling KYC-AML or Sanction rationale, given that this information will likely be subject to local privacy regimes from which exemption may be required.

5. **Suggestion for Expansion of Exemptions**. We therefore suggest that FinCen consider adding the following to the list of exemptions to the legal entity customer

definition. In each of the following cases, where a legal entity is widely held by unrelated entities, a record of ownership (for publicly exchange traded public companies) and management control (for regulated funds) are a matter of public record by virtue of public listing and/or regulatory filing. In the case of investment funds, these entities are generally subject to limitations as to purpose and business (e.g., prospectus limits in EU UCITS funds).

A. Foreign corporations publicly traded on an exchange in a FATF cooperative country. For purposes of this definition, the term publicly traded could be as defined in 31 CFR 1010.610(b)(iii)(B).[4]

B. Foreign collective investment vehicles registered for public distribution and regulated in FATF compliant countries.

C. Foreign banks regulated under the national banking regime of FATF compliant countries.

D. We suggest that regulated foreign investment funds should be subject to a control prong test similar to that suggested for non-exempt domestic investment funds.

We also suggest that insurance companies regulated by a state of the United States be similarly exempted.

In addition to the foregoing suggestion for expansion of exempt classes of legal entity customers, the Association wishes to express its support for the following aspects of the NPRM:

1. The Association strongly supports FinCen's treatment of intermediated relationships, which directs a financial institution to regard an intermediary as its

[4] "*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"

legal entity customer if the intermediary is treated as the financial institution's "customer" under the CIP rules and related guidance.[5]

2. The Association also strongly supports the idea that pooled investment vehicles operated by exempt legal entity types also be exempt and that non-exempt pooled investment vehicles be subject only to the management control prong of the proposed process.[6] Access to control/management information is likely to be less problematical under privacy laws and more stable than information as to equity ownership. We would urge that this accommodation also be accorded non-U.S. vehicles that are managed by regulated or exempt entities.

We appreciate the opportunity to comment on the CDD proposals. Members would be pleased to discuss the foregoing comments with you.

Sincerely yours,

Dan W. Schneider
Baker & McKenzie LLP
Counsel to the Association

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[5] "...for purposes of this beneficial ownership requirement, if an intermediary is the customer, and the financial institution has no CIP obligation with respect to the intermediary's underlying clients pursuant to existing guidance, a financial institution should treat the intermediary, and not the intermediary's underlying clients, as its legal entity customer. [NPRM at 45161.]

[6] FinCen is considering whether nonexempt pooled investment vehicles that are operated or advised by financial institutions that are proposed to be exempt should also be exempt from this requirement. Additionally, in the event that such institutions are not exempt, FinCen is considering whether covered financial institutions should only be required to identify beneficial owners of such non-exempt pooled investment vehicles under the control prong of the "beneficial owner" definition, as opposed to both the ownership prong and control prong, in order to alleviate the operational and logistical difficulties that would be associated with complying with the ownership prong. FinCen is also considering whether such an approach, if adopted, may best be addressed through inclusion of such vehicles within the scope of the rule with subsequent guidance or a specific exemption or exception from the application of the ownership prong of the requirement. [NPRM at 45161].