THE ASSOCIATION OF GLOBAL CUSTODIANS

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VIA AIR COURIER

Attn : Mr. Dae-Young Kwon
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Re: US-Korea FATCA Agreement – Definition of "Account Holder" in the Context of Sub-Custody Accounts

Dear Mr. Kwon:

We write on behalf of the Association of Global Custodians[1] to convey members' views on the manner in which the FATCA[2] concept of "Account Holder" is to be interpreted in the context of Korean sub-custody accounts under the US-Korea Intergovernmental Agreement (IGA) on FATCA currently under negotiation. Members believe that under a proper implementation of FATCA principles, in the case of a sub-custody account maintained with a sub-custodian in Korea and opened by a global custodian on behalf of an investor who holds a custodial account with the global custodian, the global custodian, and not the investor, should effectively be treated as the Account Holder (as that concept has been defined in the FATCA context) for

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

[2] FATCA refers to the US domestic statutory provisions commonly known as the Foreign Account Tax Compliance Act, which introduced a reporting regime for financial institutions with respect to certain accounts (i.e., sections 1471-1474 of the US Internal Revenue Code).

purposes of determining the sub-custodian's customer due diligence (CDD) and reporting obligations under the IGA.

We appreciate that certain aspects of Korean domestic law, such as the Real Name Act, require such a sub-custody account to reflect the name of the investor, and we understand that this fact has caused some observers to conclude that the investor is the party issuing instructions on the sub-custody account, which is not the case, and that the investor is required to be treated as the Account Holder of the sub-custody account under US FATCA rules and the corresponding provisions of a Model I IGA such as that expected to be finalized between Korea and the United States, which is also not the case. The sub-custody account is operated solely by the global custodian.

This misunderstanding of the operation of sub-custody accounts and the resulting treatment of the investor as the Account Holder of the sub-custody account for FATCA purposes would obligate the sub-custodian bank to conduct FATCA CDD on the investor in a manner that has already been done by the global custodian bank. This would involve expensive and duplicative efforts for no useful purpose. As explained in detail in the Annex to this letter, it would undermine the explicit objective identified by the US Internal Revenue Service (IRS) in its development of FATCA regulations "to avoid requiring multiple entities to document, withhold, and report with respect to a financial account". This same objective and approach is already reflected in the guidance being issued by the United Kingdom and other FATCA partner jurisdictions in their implementation of their IGAs with the United States, as outlined in the Annex. Having an internationally consistent approach to this kind of issue is critically important, particularly now that Korea and other members of the G20 have endorsed the OECD's efforts to develop a single, global "Common Reporting Standard" to facilitate the automatic exchange of financial account information among tax authorities.

By aligning its approach to this issue under its IGA implementation with the domestic US FATCA rules and the IGA implementation guidance being developed by other jurisdictions, Korea would better reflect its own strong efforts to adhere to international standards and its status as a member of the OECD and G20. Despite the challenges involved in coping with the complexities of new regimes that often have broad extraterritorial impact -- whether it be the Dodd-Frank Act, the European Market Infrastructure Regulation (EMIR), or FATCA -- Korea has repeatedly shown itself willing and able to comply with new global regulations and to keep in step with its international partners. We urge a similar consistency here.

Requiring Korean sub-custodian banks to perform FATCA CDD with respect to the underlying investor would also fail to recognize well-established anti-money laundering/know your customer (AML/KYC) policies which allow a sub-custodian bank to rely on the AML/KYC procedures carried out by the global custodian, who has the direct customer relationship with the investor and who, according to standard and authorized practice, provides the sub-custodian with a master confirmation that it has

performed the proper CDD on the investor. It would similarly fail to recognize the extent to which FATCA rules have been designed to harmonize with AML/KYC requirements in order to minimize the FATCA compliance burden. The AGC members hold sub-custody accounts in Korea for over 38,000 separate investors, and it would be a considerable undertaking to require full investor-level FATCA CDD to be conducted by the Korean sub-custodian banks, necessitating burdensome work on the part of the intermediary global custodians

Finally, it would raise the issue of duplicative FATCA reporting on the sub-custody account, since it would mean that both the global custodian and the Korean sub-custodian would be reporting on the account. As mentioned above and as explained in greater detail in the Annex, this would be contrary to one of the fundamental objectives of the FATCA rules, which is to avoid such duplicative reporting in order to avoid the needless cost and administration involved for financial institutions , as well as for tax authorities and taxpayers, in identifying and cancelling out the effects of the duplicative reporting, including potential mistaken claims by the IRS of underreported income by taxpayers.

We have set forth in detail in the Annex to this letter our analysis on these points. That discussion includes information about the guidance being developed by other countries that have IGAs, which further demonstrates that Korea would be deviating from the general and prevailing international interpretation and practice if it did not recognize the direct, sole role of the global custodian in operating the sub-custody account and in having the status of Account Holder of the sub-custody account for purposes of FATCA. Indeed, we are not aware of any other FATCA partner jurisdiction which has failed to recognize that direct, sole role of the global custodian with respect to sub-custody accounts.

We appreciate your willingness to consider this submission as you continue your work on developing guidance that will be relevant to the implementation of the anticipated US-Korea IGA. The Association stands ready to respond to any follow-up inquiries you may have, and our members would welcome the chance to meet with you,

as necessary, to further explain these issues and resolve any questions. For additional information, please contact the undersigned as an initial matter.

Sincerely yours on behalf of the Association,

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ANNEX

This Annex sets forth the Association's analysis in support of its recommendation that the global custodian's role as the sole operator of the sub-custody accounts maintained with Korean sub-custodians banks be fully recognized for purposes of implementing the FATCA regime under the anticipated US-Korea IGA. The following analysis describes the nature of the sub-custody account relationship, the manner in which know your customer (KYC) rules apply to sub-custody accounts, the relevant FATCA rules, and the relevant interpretations being adopted by other countries that have entered into intergovernmental agreements (IGAs) relating to FATCA and corresponding regimes.

Executive Summary

Our reading of the FATCA regulations, in light of their purpose and the drafters' underlying intent, demonstrates that the global custodian, and not the investor client that is the Investment Registration Certificate (IRC) holder, should be treated for FATCA purposes as the "account holder" with respect to local sub-custody accounts established in Korea, notwithstanding that Korean domestic law requires the sub-custody account to be opened in the name of the investor client. The global custodians, all of which we expect will be PFFIs, IGA FFIs, or USFIs, will be conducting due diligence and carrying out information reporting with respect to the accounts they maintain for their investor clients. This will include the portion of those accounts represented by the local Korean sub-custody accounts. Furthermore, because they can provide the local Korean sub-custodian with appropriate confirmation of their fulfillment of those obligations, the local Korean sub-custodian should not be treated, for purposes of either FATCA or Korea's implementation of an eventual US-Korea IGA, as the financial institution with the obligation to fulfill those obligations in respect of the underlying investor clients.

If Korea were to adopt an interpretation contrary to that encouraged here, it would create a situation that would be contrary to the U.S. Treasury's preferred approach. Such a course would give rise to duplicative due diligence and reporting which would prove very costly and troublesome to all financial institutions and tax authorities involved. It would undermine the clear desire of the U.S. Treasury / IRS to align the FATCA obligations to the greatest extent possible with existing AML / KYC rules and to apply the FATCA regime in such a way as to avoid duplicative due diligence and reporting. It would also diverge from the approach already being followed by other jurisdictions that are in the process of publishing guidance on their IGA implementation.

Overview of global custodian / local sub-custodian arrangements

Global custodians have been operating client accounts in Korea for quite some time. Global custodians are typically large international banks subject to know your customer (KYC) laws and regulations in their home jurisdictions as well as related laws

and regulations in the countries where they conduct business. Pursuant to authority granted to them by their investor clients, global custodians typically appoint one or more local market sub-custodians in Korea, as in other countries, to service their investor client accounts by holding local assets for the benefit of their investor clients. The local-market servicing arrangements operate under an agreement that runs between the global custodian and the local sub-custodian. In that context, a local sub-custodian takes instructions only from the global custodian, and the global custodian in turn takes its instructions from the foreign investor client. The local sub-custodian typically does not have direct contact or direct interaction with the foreign investor. Indeed, the agreement relating to the sub-custody account prohibits the sub-custodian from taking instructions from the investor client.

In most jurisdictions, an account established by a global custodian with a local sub-custodian takes the form of a so-called "omnibus" account, which is a single account in the name of the global custodian in which the assets of multiple investor clients of the global custodian are held. Because Korean domestic law requires accounts to be in the name of the beneficial owner of the assets, the omnibus account structure is not used in Korea. Instead, the global custodian would typically establish a relationship with the local sub-custodian governed by the agreement between those two entities, and it would then open various segregated subaccounts in the names of its various investor clients. The local sub-custodian often issues a single customer information file (CIF) number to the global custodian with respect to the relationship, and that number is shared by all the subaccounts. Thus, even though the subaccounts may be in the name of investor clients, and even though the investor clients may execute a Standing Proxy (also described internationally as a Power of Attorney) in favor of the sub-custodian bank to perform certain acts on its behalf with respect to the assets in those accounts, the subaccounts are in substance operated by the global custodian due to its exclusive right to give instructions to the sub-custodian.

Application of KYC rules to sub-custody accounts

Global custodian banks are fully regulated in their country of domicile, and all national-level banking agencies responsible for supervision of global custodians impose strict accountability for compliance with KYC regulations. Furthermore, all global custodian banks follow KYC-related global procedures that consist of having robust customer identification programs in general, including use of a risk-based approach to customer due diligence under which enhanced due diligence is conducted for customers that fall into high risk categories. Lastly, the global custodian client base is primarily institutional investors who are themselves regulated and therefore generally are low risk in nature as compared to individuals or retail investors.

Furthermore, under internationally agreed FATF anti-money laundering (AML) Customer Due Diligence (CDD) recommendations, a global custodian bank, as an "equivalently regulated financial institution", qualifies for reduced or "simplified due

diligence" (SDD). For more details on the risk-based approach and SDD, see Global Custody Structure Special Factors" in Appendix 1.

FATF recommendations also allow local sub-custodians to rely on the global custodian in order to satisfy the local sub-custodian's KYC duties, usually via the provision of an AML Comfort Letter, or other form of introduction, confirming that the global custodian has performed CDD. This is the practice that is used for Korean sub-custody accounts, and the Comfort Letter provided by the global custodian to the local sub-custodian typically confirms that the global custodian has performed CDD, that any contact information provided for the investor client is accurate and will be updated as needed, that the standing proxy provided by the investor client in favor of the sub-custodian appears to be duly executed, and that the global custodian will provide further information as needed on these points.

Relevant FATCA Rules

The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 to require foreign financial institutions (FFIs) to provide information to the Internal Revenue Service (IRS) regarding their U.S. accounts. Generally speaking under FATCA, an FFI must either enter into an agreement with the IRS to perform certain obligations (i.e., become a "participating FFI" or "PFFI") or suffer 30 percent U.S. withholding tax on certain payments it receives. The PFFI agreement obligates the FFI to identify its U.S. accounts, comply with verification and due diligence procedures prescribed by the IRS, and annually report certain information to the IRS with respect to each U.S. account.

In order to overcome legal impediments that could prevent certain FFIs from reporting the required information directly to the IRS, the U.S. Treasury Department developed alternative model IGAs that overcome these legal impediments and allow FATCA to be implemented. A partner jurisdiction signing a Model 1 IGA agrees to adopt rules to require its financial institutions to identify and report to it information about U.S. accounts, and further agrees to exchange this information with the IRS on an automatic basis. The Model 1 IGA is designed to ensure "that the IRS will receive the same quality and quantity of information about U.S. accounts from FFIs covered by a Model 1 IGA as it receives from FFIs applying" the final FATCA regulations.[3]

The FATCA regulations, and the corresponding provisions of the Model 1 IGA, lay out the due diligence and reporting procedures an FFI must follow in order to avoid withholding. The FATCA regulations specify that a PFFI must follow certain specified due diligence procedures to identify and document the FATCA status of each "holder" of an account "maintained" by the PFFI to determine if the account is a U.S. account.[4] They further specify that a PFFI must annually report certain specified information with

[3] Preamble to final FATCA regulations, T.D. 9610.
[4] Treas. Reg. §1.1471-4(c)(1).

respect to U.S. accounts "maintained" during the year "for which the PFFI is responsible for reporting".[5] They further specify that the PFFI that "maintains" the account is responsible for reporting the account,[6] and they provide a definition of "maintaining" an account in order to ensure that only one financial institution has reporting requirements:

> A custodial account is maintained by the financial institution that holds custody over the assets in the account (including a financial institution that holds assets in street name for an account holder in such institution). A depository account is maintained by the financial institution that is obligated to make payments with respect to the account (excluding an agent of a financial institution regardless of whether such agent is a financial institution under paragraph (e)(1) of this section).[7]

The IRS added this language to the final regulations issued in January 2013 specifically in order to clarify that when a financial institution (such as a global custodian) holds assets in an account for an investor client, it is that financial institution that is obligated to report with respect to such assets, even if the financial institution engages another financial institution as its agent to service the account (such as happens when the global custodian engages a local sub-custodian to provide local servicing for the account assets). The IRS explained its reason for doing this in the Preamble to the final regulations:

> The Treasury Department and the IRS received comments that the proposed regulations could be read to provide that a single account could be maintained by multiple entities (such as both a collective investment vehicle and its transfer agent), thereby creating multiple documentation, reporting, or withholding obligations for each entity. In response to these comments, the final regulations identify the entity that will be treated as maintaining a financial account in order to avoid requiring multiple entities to document, withhold, and report with respect to a financial account.

This shows the clear desire of Treasury and the IRS to avoid any possibility of duplicative documentation, withholding, and reporting obligations on multiple financial institutions with respect to the same account assets. Briefly stated, the United States does not intend there to be duplicative responsibilities, as duplicative responsibilities would not advance the cause of FATCA.[8] In other words, the FATCA rules are

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[5] Treas. Reg. §1.1471-4(d)(2)(i).
[6] Treas. Reg. §1.1471-4(d)(2)(ii).
[7] Treas. Reg. §1.1471-5(b)(5).
[8] See, for example, U.S. Treasury Decision 9610, February 28, 2013, in relevant parts:

designed to ensure in a situation like the one at hand that it will be the global custodian, who has custody over the assets in the account, and not the sub-custodian who has been engaged by the global custodian as its agent, who should be considered to "maintain" the investor client's account and to have the responsibility to document, withhold, and report with respect to that account, notwithstanding that the sub-custodian is also an FFI and is holding the investor client's assets in a sub-custody account. It is expected that the global custodians who establish sub-custody accounts in Korea on behalf of their investor clients will all be PFFIs, IGA FFIs, or U.S. financial institutions (USFIs), so they will all be treated as maintaining the investor client's account and as having the responsibility to document, withhold, and report with respect to that account, including the part of the account that is represented by the sub-custody account shown on the books of the local sub-custodian in Korea. Even if one were to conclude that the local sub-custodian had direct FATCA obligations in respect of the investor client, the FATCA rules make it clear that the sub-custodian could, absent knowledge or reason to know to the contrary, rely on the global custodian's declaration that the latter had

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> "In order to minimize any duplicative responsibilities, the final regulations permit the agent to rely (absent contrary knowledge or reason to know) upon documentation collected by the principal or a certification by the principal that appropriate documentation has been collected."
>
> "The Treasury Department and the IRS are considering ways to eliminate duplicative reporting or effect, as appropriate, uniform reporting under chapters 4 and 61."
>
> "The Treasury Department and the IRS intend: (1) to issue guidance coordinating chapters 3 and 61 with chapter 4, in order to reduce or eliminate duplicative reporting as between chapter 4 (and reporting pursuant to a Model 1 IGA) and chapters 3 and 61; and (2) to conform, as appropriate, the withholding, payee identification, and other due diligence rules of chapters 3 and 61 with rules under chapter 4."

See also T.D. 9658, March 6, 2014:

> "As previewed in Notice 2013-69, in order to further reduce burdens and mitigate instances of duplicative reporting under chapters 4 and 61 and based, in part, on stakeholder comments requesting relief, these temporary regulations provide that non-U.S. payors that are also participating FFIs (including reporting Model 2 FFIs) or registered deemed-compliant FFIs (including reporting Model 1 FFIs) are excepted from the requirement to report on payments made to accounts held by U.S. non-exempt recipients under chapter 61 to the extent the payor reports on the account under chapter 4 or an applicable IGA."
>
> "In addition, these temporary regulations do not require backup withholding under section 3406 for certain payments with respect to which withholding under chapter 4 has been applied, regardless of whether the payee is a known U.S. person to prevent duplicative withholding with respect to the same payment."

The import of the above text (including the quoted text from T.D. 9610) is that a regulatory requirement can be eliminated if another regulatory requirement satisfies the objective of the eliminated requirement. By analogy, a requirement that a Korean local sub-custodian perform the FATCA due diligence and reporting on an investor can be eliminated if the global custodian performs the due diligence and reporting on the investor.

carried out the relevant documentation, withholding, and reporting requirements in respect of the investor client.

Given the above, imposing specific documentation requirements in Korea at the local sub-custodian level would trigger re-documentation across a large client base, which would not be practical and could be infeasible to a large extent. It would not be consistent with the U.S. efforts to promote rules that avoid these types of duplicative obligations with respect to an investor's single pool of assets. Also, as was recognized when the SDD arrangement for local Korean sub-custody accounts was approved, the additional and extensive documentation (or re-documentation) of all sub-custody accounts would likely not mitigate exposure to money laundering and terrorist financing in material ways and would draw resources away from the identification and monitoring of investor-clients who truly pose a higher risk.

These principles are also reflected in the FATCA regulations' definition of an "account holder". Those regulations define an "account holder" as "the person listed or identified as the holder or owner of the account with the FFI that *maintains* the account" (emphasis added).[9] They further specify: "A person, *other than a financial institution*, that holds a financial account for the benefit or account of another person as an agent, custodian, nominee, signatory, investment advisor, or intermediary, is not treated as an account holder with respect to such account for purposes of this section. Instead, such other person is treated as the account holder."[10] (Emphasis added). The implication of this language is that a *financial institution* acting as an intermediary in holding an account for the benefit of another person is to be treated as the account holder of that account by the financial institution with which it is maintained.

The drafting may be somewhat cryptic, in part because the drafters may have assumed that the normal international practice of establishing sub-custody accounts in the name of the global custodian was universal. Nevertheless, the commonly understood intent of this definition is to treat a financial institution, such as a global custodian, that holds a sub-custody account for the benefit of its investor client, as the account holder of the sub-custody account for FATCA purposes. The investor client is, of course, treated as the account holder of the global custody account maintained by the global custodian, and the global custodian's obligations (as a PFFI, IGA FFI, or USFI) with respect to that account extend to the portion of the account which consists of the assets held in the local sub-custody accounts in Korea and elsewhere. But the sub-custodian should treat the global custodian (i.e., a PFFI, IGA FFI, or USFI) as the account holder of the sub-custody account for purposes of determining the sub-custodian's obligations.

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[9] Treas. Reg. §1.1471-5(a)(3)(i).
[10] Treas. Reg. §1.1471-5(a)(3)(iii).

Accordingly, the sub-custodian should perform its FATCA due diligence on the global custodian, in general, by collecting a Form W-8IMY (establishing the global custodian as a participating FFI or reporting Model 1 FFI) or a Form W-9 (establishing the global custodian as a USFI). This due diligence would not entail collecting documentation on the underling investors.[11]

Interpretations by Other IGA Jurisdictions

The interpretation we are supporting here is also being adopted by other jurisdictions that are in the process of implementing their IGAs. For example, the following text appears in the UK guidance notes (HR Revenue & Customs, 14 August 2013 Guidance Notes) to the UK-US IGA:

> ***Fully disclosed clearing and settlement (Model B)***
>
> This refers to arrangements designed to facilitate the clearing and settlement of security transactions utilising a third party provider's existing information technology infrastructure 'IT' systems, specifically those that interface with the international securities settlement and clearing systems (clearing firms).
>
> A tri-partite relationship between the underlying customer, the broker and the clearing firm (the 'tripartite relationship') is created, by virtue of the fact that the broker has entered into a fully disclosed clearing relationship with the clearing firm on his own behalf, and, acting as the agent of its underlying client.
>
> For the avoidance of doubt where a broker has opened an account (or sub-accounts) with the clearing firm, in the name of its underlying client and fulfils all verification and due diligence requirements on its underlying clients the Financial Accounts remain those of the broker and not the clearing firm.
>
> Therefore, reporting and classification in respect of the underlying client required under the Agreement and the relevant legislation is the responsibility of the broker.
>
> The clearing firm however will treat the broker as its client and consequently as the person for which it maintains a Financial Account and will undertake reporting and classification with respect to such broker accordingly.

[11] Annex 1 of the Model 1 IGA, which describes the account due diligence requirements of IGA FFIs, only requires looking through account holders when the account holder is a passive nonfinancial foreign entity (NFFE) which has US controlling persons.

> The term broker in respect of fully disclosed clearing and settlement would include any Financial Institution who acts on behalf of the underlying investor in respect of executing, placing or transmitting orders and would therefore include FA's if their business is more than simply advisory.

This text is repeated in substance in the Irish, Jersey, Guernsey, and Isle of Man guidance notes to their respective IGAs with the United States (together, the only IGA Partner Country guidance notes known to us to be issued to date).

Moreover, Section 19.4 of the UK Crown Dependencies 31 January 2014 Draft Guidance Notes quoted below states as follows regarding this type of situation:

> "19.4. Multiple Financial Institutions – duplicate reporting
>
> It is likely that a number of unconnected Financial Institutions could have a reporting obligation in respect of the same account which could result in duplicate reporting. Each Financial Institution has an obligation to report all Reportable Financial Accounts unless it has actual knowledge that the account is being reported by another Financial Institution, whether that Financial Institution is a [CD] Financial Institution or not. For this purpose, the [CD] Financial Institution has actual knowledge where they hold written confirmation from the Reporting Financial Institution in the other jurisdiction that the Financial Account has been reported for FATCA purposes or under an agreement equivalent to the UK Agreement. There is no need for the [CD] Financial Institution in this case to report anything to the [Comptroller/Assessor/Director] in respect of that Financial Account. This does not remove the responsibility for the [CD] Financial Institution to ensure that a report has been made and so should it be determined that no report has been made by any Reporting Financial Institution in respect of a Financial Account that is a Reportable Account, penalties may be imposed by the [Comptroller/Assessor/Director].

These guidance notes are the most recently published guidance notes of any IGA Partner Country and, therefore, they reflect the latest thinking as FATCA implementing guidance continues to evolve.

Appendix 1: Global Custody Structure Special Factors

A. Global Custodians are Regulated Entities

Global custodians are global banking organizations and are required to adhere to stringent Anti Money Laundering (AML) norms laid out by the regulators in their respective jurisdictions, e.g. The Hong Kong Monetary Authority, The Financial Conduct Authority, The Federal Reserve, Office of the Comptroller of the Currency, U.S. Department of Treasury, and Die Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) for German regulated investors.

Documentary verification of identity is driven by the risk posed by the customer to the global custodian, the custodian's current and past experience with the customer or the sponsor of the account being opened, the source of funds, geographic risk, and planned investment and transaction activity. Further, all the regulators mandate a robust customer identification program that can typically involve following identification measures:

Documentary evidence:

For an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and

For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.

Non-documentary evidence:

When using non-documentary means of verification, the custodian must identify the acceptable method of obtaining the verification. Examples of non-documentary verification include:

- Contacting a customer
- Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source, checking references with other financial institutions.

In addition to setting the standards for the documentary and non-documentary verification of the customer's identity, the custodian has procedures to obtain additional documentation or perform additional due diligence where a customer or a prospective customer is deemed to pose a higher risk for money laundering.

B. Risk-Based Assessment

Most jurisdictions impose a requirement that the custodian assign money laundering risk rating to each customer. This exercise identifies customers that may poses a higher risk and the custodian conducts enhanced due diligence and imposes more extensive monitoring and more frequent risk assessment on these accounts. Furthermore, many of the anti-money laundering laws applicable to the global custodians, including those in the United States, allow for custodian to take a risk-based approach to combatting money laundering. By allowing for a risk-based approach, custodians are able to allocate resources efficiently and direct their efforts to those customers and areas that pose the higher risk.

This risk-based approach is articulated in the 2007 report titled "Guidelines on the Risk-Based Approach to Combatting Money Laundering and Terrorist Financing" issued by the Financial Action Task Force (FATF). In this report, it has been noted that where the same standard is set for all customers and resources are evenly applied to all, there could be the unintended consequence of the customer identification or other program elements becoming simply a tick the box exercise. Most anti-money laundering regimes around the globe allow for some form of risk-based approach to conducting customer due diligence.

Under a risk-based approach it is up to each firm to decide on the specific documents requested, as determined by the client's AML risk. So while some of the listed documents may be obtained using a risk-based approach, the regulations do not prescribe a specific list of universally required documents and, therefore, custodians may not always hold the same documents for all clients.

Most importantly, where a client's risk is assessed as low, Simplified Due Diligence ("SDD") applies. This less burdensome set of KYC requirements is appropriate because the majority of custodian's FII clients are themselves regulated financial institutions or collective investment vehicles, publicly listed companies, regulated employer funds, or government pension funds. As these categories of institutions have qualified for this SDD, there is no requirement to obtain the detailed documentation listed above. However, custodians must obtain suitable evidence to document the categorization of these clients for SDD.

C. Product Risk Assessment by Global Custodians

The custodian conducts a Product Risk Assessment annually that identifies products, customer types, geographies, and transaction types. The results of the risk assessment drive the standards used in the Customer Identification Program. Each customer, no matter what the level of documentation gathered, is risk rated for money laundering purposes.

D. Institutional Customers

The global custodians' client base is primarily institutional customer that are organized as collective investment vehicles – investment trusts, public funds, etc. When an institutional customer is itself regulated, the Custodian may relay upon the fact that the customer is regulated, subject to registration by a competent authority and/or subject itself to similar anti-money laundering regulation as the custodian. Further, in such cases, the custodian will have access to resources such as information and documentation maintained in the United States registers with the Securities and Exchange Commission and is subject to regulation under the USA PATRIOT Act. In this case, documentation would be obtained from the Securities and Exchange Commission database and only if the customer was deemed to pose a higher risk would additional documentation be required.

As noted above, for these institutional customers, many if not all beneficial owners are individuals, holding investment interests in a collective investment fund – the unit holders in an investment trust or the pensioners and their beneficiaries in a pension plan. Unless the custodian is also providing ancillary services such as Transfer Agency, Unit Registrar, or benefit plan recordkeeping, the custodian would not have access to beneficial owner information, nor would it be practical to obtain that information. Even where the custodian acts in another capacity and is privy to beneficial owner information, the Custodian may not be required to obtain the identification documents of those individuals.

When the custodian does not have access to the underlying beneficial owner information, they will – as part of their customer identification program conducted on their customer – identify the regulatory regime applicable to the customer, confirm how customer due diligence is conducted on the beneficial owners and by whom, including in some cases representations and warranties in the contracts identifying who is responsible, and they will employ other means, depending upon the risk, to ensure that proper anti-money laundering procedures have been conducted.