

MEMO# 21531

August 27, 2007

FinCEN Issues Final Rule on "Enhanced Due Diligence" Requirements for Accounts of Certain Foreign Banks

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TO: AML COMPLIANCE WORKING GROUP No. 5-07

SEC RULES MEMBERS No. 112-07

TRANSFER AGENT ADVISORY COMMITTEE No. 51-07 RE: FINCEN ISSUES FINAL RULE ON "ENHANCED DUE DILIGENCE" REQUIREMENTS FOR ACCOUNTS OF CERTAIN FOREIGN BANKS

The Financial Crimes Enforcement Network (FinCEN) recently issued a [final rule](#) that implements "enhanced due diligence" requirements to guard against money laundering in accounts of certain foreign banks. [\[1\]](#) Mutual funds will have until February 5, 2008 to adopt and apply the AML procedures contemplated by the rule to accounts established on or after that date, and until May 5, 2008 to apply the new AML procedures to accounts opened before February 5, 2008.

Background

As you know, section 312 of the USA PATRIOT Act requires mutual funds and other 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. Regulations implementing the general due diligence requirement under section 312 were adopted in January 2006 (with compliance required later that year), and enhanced due diligence requirements were proposed at the same time. [\[2\]](#)

Applicability

The new rule requires that mutual funds and other covered institutions apply enhanced due diligence procedures to the accounts of three specific categories of foreign banks, namely those operating (1) under an offshore banking license; [\[3\]](#) (2) under a license issued by a country that has been designated by the Financial Action Task Force (FATF) as non-cooperative with international anti-money laundering principles; [\[4\]](#) or (3) under a license

issued by a country that the U.S. Treasury Secretary has designated as warranting special measures due to money laundering concerns. [\[5\]](#)

Enhanced Due Diligence Requirements

A mutual fund must establish enhanced due diligence procedures for accounts covered by the rule that, at a minimum, include taking reasonable steps to (1) conduct “risk-based enhanced scrutiny” of the account; (2) determine whether the foreign bank itself maintains correspondent accounts for other foreign banks through which those other foreign banks may access the account at the mutual fund; and (3) if the foreign bank’s shares are not publicly traded, identify each owner of the foreign bank and the nature and extent of each ownership interest.

1) Risk-based enhanced scrutiny to guard against money laundering and to identify and report suspicious transactions may involve several steps, depending on a risk assessment of the correspondent account. Actions required, “as appropriate,” by the rule include (i) obtaining information relating to the foreign bank’s anti-money laundering program to assess the risk of money laundering in the account; (ii) monitoring transactions to, from, or through the account “in a manner reasonably designed to detect money laundering and suspicious activity”; and (iii) if the account is a “payable-through account,” obtaining information from the foreign bank about the sources and beneficial owners of account assets and the identity of any person with authority to direct transactions through the account.

1. The release accompanying the rule explains that obtaining information relating to the foreign bank’s anti-money laundering program is not mandatory, but should depend on a risk assessment of the account. For example, the release observes that a U.S. financial institution could determine through experience and due diligence that obtaining additional information relating to the foreign bank’s anti-money laundering program would not be relevant to the risk assessment or monitoring of the correspondent account. This might occur in situations of correspondent accounts for foreign banks with which the U.S. financial institution has a longstanding relationship, accounts used only to conduct proprietary transactions, accounts controlled by a U.S. institution, or accounts for a foreign bank whose licensing or home jurisdiction is known for maintaining a comprehensive anti-money laundering regime. This is contrasted with examples where obtaining additional information may be appropriate, including cases where the foreign bank holding the account permits or conducts transactions on behalf of other foreign banks or operates payable-through accounts.

[\[6\]](#)

In situations where a U.S. financial institution determines that it would be appropriate to obtain information about a foreign bank’s anti-money laundering program, the release makes clear that this does not require conducting an audit of that program. Rather, information may, in appropriate circumstances, be obtained using a questionnaire if the questions and responses enable a risk assessment.

2. The requirement to take reasonable steps to determine whether the foreign bank itself maintains correspondent accounts for other foreign banks is not risk-based, but must be done for each correspondent account. [\[7\]](#) Once that initial determination is made, the rule prescribes a risk-based approach to “take reasonable steps to obtain information relevant to assess and mitigate 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. In the case of a foreign bank with shares that are not publicly traded, the requirement to identify the owners extends to all "persons" who directly or indirectly own, control, or have the power to vote ten percent or more of any class of securities of the foreign bank. The term "person" is defined very broadly and, in the case of individuals, includes members of the same "family" as described in the regulations. [8]

If you would like to discuss the new rule on enhanced due diligence, please contact Glen Guymon (202.326-5837 or gguymon@ici.org) or Susan Olson (202.326.5813 or solson@ici.org).

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endnotes

[1] Special Due Diligence Programs for Certain Foreign Accounts, 72 Fed. Reg. 44,768 (Aug. 9, 2007) (the "Enhanced Due Diligence Release") (to be codified at 31 C.F.R. pt. 103), available at edocket.access.gpo.gov/2007/pdf/E7-15467.pdf or www.fincen.gov/31_CFR_Part_103_312_EDD_Rule.pdf.

[2] See [Memorandum](#) to AML Compliance Working Group No. 1-06, SEC Rules Members No. 1-06, and Transfer Agent Advisory Committee No. 3-06 [19580], dated Jan. 6, 2006 (general due diligence requirements for correspondent accounts); [Memorandum](#) to AML Compliance Working Group No. 7-06 and Transfer Agent Advisory Committee No. 17-06 [19806], dated Mar. 7, 2006 (ICI comments on proposed enhanced due diligence requirements).

[3] "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." 31 CFR § 103.175(k); see also 31 U.S.C. § 5318(i)(4)(A).

[4] No countries are currently designated by FATF as non-cooperative. For a current list, see the Non-Cooperative Countries and Territories ("NCCT") list found on the FATF website at www.fatf-gafi.org.

[5] Relevant designations and rulemakings are on FinCEN's website at www.fincen.gov/reg_section311.html. The only country currently designated as warranting special measures is Nauru. The U.S. Treasury Secretary has also imposed special measures against Burma, making it illegal for a U.S. institution to maintain a correspondent account for a foreign bank from or licensed by that country.

[6] See Enhanced Due Diligence Release at 44,770 fn 20.

[7] See Enhanced Due Diligence Release at 44,772.

[8] See 31 CFR § 103.11(z); 31 CFR § 103.175(l)(2)(ii).

should not be considered a substitute for, legal advice.