

**MEMO# 15136**

September 9, 2002

## **INSTITUTE COMMENTS ON THE FATF FORTY RECOMMENDATIONS**

[15136] September 9, 2002 TO: INTERNATIONAL COMMITTEE No. 68-02 INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 41-02 MONEY LAUNDERING RULES WORKING GROUP No. 54-02 RE: INSTITUTE COMMENTS ON THE FATF FORTY RECOMMENDATIONS The Financial Action Task Force on Money Laundering (FATF) recently issued a consultation paper that invited comments on the FATF's "Forty Recommendations."<sup>1</sup> The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering.<sup>2</sup> The Forty Recommendations, which were initially developed in 1990, set out the FATF's basic framework for anti-money laundering efforts. All FATF member countries, including the US, are encouraged to adopt them. In response to the invitation to comment, the Institute submitted a joint comment letter with the Securities Industry Association and the Futures Industry Association. A copy of the letter is attached. The comments and recommendations made in the letter are summarized below.

**General Comments**

- In general, the letter endorses a risk-based approach to anti-money laundering regulation, consistent with the approach taken by US regulators in the various rules proposed under the USA PATRIOT Act.
- The letter is critical of a recommendation in the consultation paper that all or most non-face-to-face scenarios should be treated with heightened due diligence. The letter notes 1 "Review of the Forty Recommendations Consultation Paper" (May 30, 2002), available at [http://www.fatf-gafi.org/pdf/Review40\\_en.pdf](http://www.fatf-gafi.org/pdf/Review40_en.pdf). See also "The FATF Forty Recommendations: A Global Framework for Combating Money Laundering," available at [http://www.fatf-gafi.org/pdf/40Rec\\_en.pdf](http://www.fatf-gafi.org/pdf/40Rec_en.pdf).

2 The FATF is an independent international body and its Secretariat is housed at the OECD. The twenty nine member countries and governments of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; Denmark; Finland; France; Germany; Greece; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; Singapore; Spain; Sweden; Switzerland; Turkey; United Kingdom; and the United States. Two international organizations are also members of the FATF: the European Commission and the Gulf Co-operation Council.

2 that this recommendation, without a recognition of the historic non-face-to-face methods of doing business in the securities-related industries (including the mutual fund industry), is likely to have grave consequences for securities-related firms and their customers. The letter therefore recommends that any measures to address the risks that arise in non-face-to-face contexts should be premised on a risk-based approach and left entirely to the discretion of the member country, which will be familiar with the practices of its financial services industries.

**Identification and Verification**

- The consultation paper includes a provision that would require financial institutions to "[v]erify the customer's identity using reliable, independent source documents, data or information." The letter supports this principle, but seeks a clarification

that reliable third-party identification databases can be used as a means of verification. • The consultation paper invited comment on the point in the customer relationship at which verification must take place. The letter recommends that financial institutions be permitted flexibility with respect to both the means and timing of verification, consistent with a risk-based approach, and supports an option in the consultation paper which provides for a reasonable time period for verification. • The consultation paper sought comment on whether financial institutions should be required to identify all existing customers. The letter recommends that FATF adopt a risk-based prospective approach similar to the one taken in Section 326 of the USA PATRIOT Act, rather than requiring financial institutions to perform identification on all existing customers. • The consultation paper suggested that particular categories of customers that do not pose significant money laundering risks should be subject to a simplified verification regime, and included as examples credit or financial institutions already subject to the FATF standards, large public companies listed on a stock exchange, counter-parties that are publicly known, and regulated entities. The letter strongly endorses this principle, and suggests adding pension funds and other accounts that involve little control by the individual investor as additional examples. • The letter strongly endorses the verification of a customer that itself is a financial institution through review of lists of authorized institutions (such as through the website of the applicable supervisory authority) or by confirming with the relevant supervisory authorities that it is a licensed/registered institution. • The letter expresses support for the position that it would be reasonable for a financial institution such as a mutual fund to rely on an intermediary financial institution to identify and conduct due diligence on its own clients. (The letter goes into significant detail on this point later, as described below.) • The letter commends FATF for recognizing that corporate vehicles such as occupational pension funds, mutual funds and similar types of pooled investments pose a reduced risk of money laundering.

### 3 Intermediaries

• The letter strongly endorses a recommendation in the consultation paper to permit financial institutions, in appropriate circumstances, to rely on intermediaries to perform identification and verification obligations. • The consultation paper presented three options for determining when a financial institution could rely upon an intermediary to perform identification and verification of customers. Instead of endorsing any one of those options, the letter suggests that FATF adopt a broad, flexible framework that sets forth three categories of intermediaries, each requiring its own level of due diligence:

- o The first category would include intermediaries that are financial institutions subject to the full range of AML requirements consistent with the FATF standards. No due diligence, other than confirming that an intermediary is within this category, would be required in order to rely upon it to perform identification and verification with respect to its customers.
- o The second category would include financial institutions that are in an FATF member country (or in a jurisdiction that has procedures consistent with the FATF standards) but are not subject to the full range of AML requirements. The letter recommends that reliance upon second category intermediaries should be permitted after:
  - (i) conducting appropriate due diligence with respect to the intermediary in order to confirm that the intermediary is a legitimate, reputable entity that can be relied on with respect to its identification and verification procedures; and
  - (ii) obtaining a representation from the intermediary that certifies that it has comprehensive and rigorous customer identification and verification procedures.
- o The third category would include all other intermediaries. More detailed due diligence would be required before relying on these intermediaries, including determining whether the intermediary actually has implemented comprehensive and rigorous identification and verification procedures.

• The letter endorses reliance in appropriate circumstances on outsourcing of identification and/or verification to agents that are contractually bound to the same due diligence obligations as the financial institution.

### Correspondent Banking/Payable-Through Accounts

• The letter recommends that the terms

“correspondent accounts” and “payable-through accounts” should be limited to the banking industry, and that the FATF should address any verification issues with respect to collective investment vehicles, such as mutual funds, or other similar arrangements under the letter’s recommended framework for intermediaries. 4 Politically Exposed Persons • The letter strongly recommends that the FATF develop an international, publicly available listing of all politically exposed persons (PEPs), including those who present heightened risks for financial institutions, together with all entities or other investment vehicles known to be associated with such PEPs.3 Suspicious Transaction Reporting • The letter states that, to the extent that a financial institution is subject to an affirmative reporting obligation, it also should be entitled to the benefit of a defense to any criminal money laundering charge. • The letter also recommends that the FATF seek to establish a global safe harbor from civil liability for suspicious transaction reporting. • The consultation paper stated that the FATF is considering requiring financial institutions to obtain customer identification from a customer at the time it files a suspicious transaction report. The letter is strongly opposed to such a requirement, noting that it would “tip off” the subjects of the report and therefore be counter- productive to anti-money laundering goals. Robert C. Grohowski Associate Counsel Attachment (in .pdf format) 3 PEPs include government leaders and public sector officials that might be required to be subject to heightened due diligence for anti-money laundering purposes.