

**MEMO# 19559**

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## **FINCEN ADOPTS FINAL ANTI-MONEY LAUNDERING RULE ON "CORRESPONDENT ACCOUNTS"**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19559] January 3, 2006 TO: OPERATIONS COMMITTEE No. 1-06 SMALL FUNDS COMMITTEE No. 1-06 RE: FINCEN ADOPTS FINAL ANTI-MONEY LAUNDERING RULE ON "CORRESPONDENT ACCOUNTS" The Financial Crimes Enforcement Network ("FinCEN") has issued a final regulation implementing the foreign correspondent account provisions and the private banking provisions of section 312 of the USA PATRIOT Act. Section 312 requires 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. The final regulation has not yet been published; it is expected to appear in the Federal Register shortly after January 1, 2006. FinCEN has published a fact sheet, however, a copy of which is attached. Effective Dates 90 Days for New Accounts. Mutual funds and other financial institutions covered by the final rule will 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. 270 Days for Existing Accounts. For existing accounts and those accounts established before the 90-day time frame described above, the final rule will take effect 270 days from the time the regulation is published in the Federal Register. Background FinCEN issued proposed rules to implement Section 312 in May 2002. In July 2002, FinCEN adopted an interim final rule that adopted parts of the rule for banks and broker-dealers, but temporarily deferred the application of the rule to mutual funds. 2 Substance of the Rule Definition of "Correspondent Account". According to the fact sheet, the final rule will retain 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. The Institute has been highly critical of this proposed definition, arguing that the definition is so broad that it reaches practically every relationship of a mutual fund with a foreign financial institution. General Due Diligence Requirement. Mutual funds and other 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; (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.

**Enhanced Due Diligence Requirement.** 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. Along with the final rule, FinCEN issued a related notice of proposed rulemaking (NPRM) on this particular part of Section 312. According to the fact sheet, the NPRM will clarify that U.S. financial institutions have flexibility to tailor their enhanced due diligence procedures to the risks associated with particular accounts.

**Private Banking Provisions.** According to the fact sheet, the final rule requires mutual funds and other 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. The rule 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 \$3 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. The rule expressly applies to mutual funds, even though the fact sheet notes that FinCEN “understands that mutual funds do not currently offer private banking accounts” as defined in the rule. \* \* \* \* \*

We will circulate the text of the final rule as soon as it is published in the Federal Register.

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