THOMAS R. CARPER, DELAWARE, CHAIRMAN

CARL LEVIN, MICHIGAN
MARK L. PRYOR, ARKANSAS
MARY L. LANDRIEU, LOUISIANA
CLAIRE McCASKILL, MISSOURI
JON TESTER, MONTANA
MARK BEGICH, ALASKA
TAMMY BALDWIN, WISCONSIN
HEIDI HEITKAMP, NORTH DAKOTA

TOM COBURN, OKLAHOMA
JOHN McCAIN, ARIZONA
RON JOHNSON, WISCONSIN
ROB PORTMAN, OHIO
RAND PAUL, KENTUCKY
MICHAEL B. ENZI, WYOMING
KELLY AYOTTE, NEW HAMPSHIRE

GABRIELLE A. BATKIN, STAFF DIRECTOR
KEITH B. ASHDOWN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

December 10, 2014

SUBMITTED VIA EMAIL (Patrick.O'Brien@fincen.gov)

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

RE: Docket No. FINCEN-2014-0001; (RIN) 1506-AB25:
Customer Due Diligence Requirements for Financial Institutions

Dear Director Shasky Calvery:

This letter responds to the request for comment on a notice of proposed rulemaking (NPRM) to address customer due diligence requirements for financial institutions, as issued by the Financial Crimes Enforcement Network (FinCEN) with the support of its parent agency, the U.S. Department of the Treasury. I appreciate the opportunity to comment on this important rulemaking.

U.S. law already requires a long list of financial institutions operating in the United States to establish anti-money laundering (AML) programs to combat money laundering, terrorist financing, and foreign corruption.[1] U.S. financial regulators already require those financial institutions, as part of an effective AML program, to conduct customer due diligence and maintain risk-based, know-your-customer (KYC) policies, procedures, and documentation.[2] The proposed rule is, thus, unnecessary unless it clarifies or improves existing AML safeguards. The proposed rule should not be finalized if it would weaken or confuse current due diligence and KYC practices.

---

[1] See Section 352 of the Patriot Act, P.L. 107-56 (October 26, 2001), codified at 31 USC §5318(h). Covered financial institutions are listed in 31 USC §5312(a)(2). While the law requires all of the listed financial institutions to establish AML programs, in 2002, the Treasury Department issued "temporary" exemptions permitting several categories of financial institutions to disregard the statutory requirement. See 31 CFR §103.170, codified by interim final rule published at 67 FR 21110 (April 29, 2002), as amended at 67 FR 67547 (November 6, 2002) and corrected at 67 FR 68935 (November 14, 2002). Treasury also delegated its rulemaking authority in this area to FinCEN. See Treasury Order 180-01 (Sept. 26, 2002). Despite the passage of twelve years, the "temporary" exemptions created by Treasury have yet to be lifted. The proposed customer due diligence rule provides an opportunity to eliminate those exemptions and establish a timetable for all listed financial institutions to establish AML programs and conduct customer due diligence.

[2] See, e.g., Bank Secrecy Act/Anti-Money Laundering Examination Manual, Federal Financial Institutions Examination Council, (2014), at 56-59 (guidance for examining "Customer Due Diligence").

Unfortunately, while the proposed rule would strengthen U.S. due diligence and KYC practices in some ways, in others it would actually weaken current practices by employing an ineffective and unworkable definition of beneficial ownership. Unless the beneficial ownership definition is strengthened as suggested below, the proposed rulemaking would degrade rather than improve existing due diligence and KYC practices, and should not be finalized.

Importance of Customer Due Diligence. Over the last decade, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has worked to strengthen U.S. AML safeguards by conducting investigations to expose how money launderers, terrorists, organized crime, corrupt officials, tax evaders, and others have utilized U.S. financial institutions to conceal, transfer, and spend suspect funds.[3] The Subcommittee's investigations have provided detailed case histories and concrete evidence of the need for greater transparency and due diligence to stop abuses that are fueling crime and undermining tax fairness. Our investigations have shown not only how wrongdoers utilize shell corporations, trusts, foundations, attorneys, corporate service providers, and other means to conceal their identities and gain access to the U.S. financial system; but also how financial institutions can protect themselves and the U.S. financial system from misuse. The Subcommittee's work provides ample support for designing a strong customer due diligence rulemaking that improves the status quo, and this letter hereby incorporates the Subcommittee's hearing records, detailed in footnote 3, as part of the administrative rulemaking record supporting issuance of a strong customer due diligence rule.

Definition of Beneficial Ownership. Effective risk assessments and risk-based AML safeguards require accurate and meaningful KYC information about persons seeking to open accounts. For information to be useful, it must look beyond the nominal owners of a financial account to ascertain the true beneficial owners, including the beneficial owners of any legal entity listed as an accountholder. Without a list of the beneficial as well as the nominal owners of an account, an institution's assessment of its customers' risk profiles will be incomplete and inadequate, in particular because the highest risk customers are likely to be concealed behind nominees. An effective beneficial ownership definition is, thus, critical to a rulemaking that would improve U.S. customer due diligence and KYC practices.

Using Nominal and Beneficial Owner Terminology. The proposed rule addresses a variety of account and beneficial ownership issues, including accounts opened in the name of legal entities, intermediaries, and agents. To ensure ownership issues are addressed effectively, the proposed rule should make it clear that financial institutions are obligated, for every account, to identify both the nominal and beneficial owners. The nominal owners are the owners of

[3] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History," S.Hrg. 112-597 (July 17, 2012); "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010); "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006); "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act," S.Hrg. 108-633 (July 15, 2004); "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (March 1, 2 and 6, 2001); and "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999). See also U.S. Senate Committee on Homeland Security and Governmental Affairs, "State Business Incorporation – 2009," S.Hrg. 111-953 (June 18 and Nov. 5, 2009).

record; the beneficial owners are the true owners, those standing behind the nominees. To accomplish that task, the proposed rule should be strengthened by ensuring both terms are used consistently throughout the rule. Including the terms "nominal" and "beneficial" owner in the proposed rule would provide, not only concepts that are easy to grasp, but also a construct that makes the meaning of each term clearer by way of contrast. Using those two terms would also help ensure the proposed rule is consistent with the existing due diligence requirements of Section 312 of the Patriot Act, which already incorporates both terms.[4]

Currently, the NPRM proposes to define beneficial ownership of a legal entity by focusing on two independent components, an "ownership prong" and a "control prong." While that dual approach is both workable and in line with international norms, both proposed prongs must be clarified and strengthened to achieve an effective and practical definition that will lead to accurate risk assessments and useful information about account ownership. In particular, revising the control part of the definition to more accurately identify the natural persons who exercise ultimate control over a legal entity is critical to achieving an effective beneficial ownership test.

Ownership Prong. In the first prong, the NPRM proposes that a beneficial owner be defined, in part, as "each individual, if any, who directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of a legal entity customer." Specifying a disclosure threshold is generally an ineffective approach, since it simply invites wrongdoers to arrange their affairs to come in below the specified threshold, particularly since FinCen permits financial institutions "to rely generally on the representations of the customer." Wrongdoers can simply issue more shares of stock or identify more trust beneficiaries, using nominees, to avoid triggering financial institution oversight. Under the proposed rule as currently drafted, a criminal would have to find only five people to agree to serve as "equity" owners of the relevant legal entity in order to avoid having the names of any beneficial owners included in financial institution records.

If the rulemakers insist on specifying a numerical ownership threshold, the 25% level is too high and, at a minimum, should be lowered to 10%. As FinCen notes, many financial institutions already identify beneficial owners using the 10% ownership threshold. In addition, in the Foreign Account Tax Compliance Act (FATCA), Congress has already defined substantial ownership of a corporation, partnership, or trust using the 10% standard.[5] It would be inappropriate and hypocritical for the United States to apply a weaker disclosure standard to legal entities opening accounts in the United States while requiring financial institutions in other countries to meet a tougher disclosure standard. It would also create an unwelcome incentive for wrongdoers to seek to open U.S. versus non-U.S. accounts due to the weaker disclosure requirements. Using the same 10% standard as FATCA uses for non-U.S. accounts held by U.S. persons would also increase consistency and efficiency for financial institutions required to comply with FATCA.

---

[4] See, e.g., 31 USC §5318(i)(3)(A)(requiring financial institutions to "ascertain the identity of the nominal and beneficial owners" of certain private bank accounts).

[5] 26 U.S.C. § 1473(2)(A).

Finally, the rule as drafted states "if no one individual owns 25 percent or more of the equity interests, then the financial institution may identify no individuals under the ownership prong." This proposal is unprecedented in AML rulemaking and represents a huge step backward from the ownership rules already in place for many financial institutions, from the requirements for foreign banks under FATCA, and from international norms. This proposal opens the door to abuse by criminal elements and should be stricken from the rule altogether. FinCen must not leave open the possibility that a company with as few as 5 beneficial owners will not be required to identify *any* of those owners.

"Equity Interest." The NPRM also seeks comment as to whether the term "equity interests" in the ownership prong of the proposed beneficial ownership definition will be sufficiently understood and clear to financial institutions and customers. "Equity interest" is not defined in the rule, nor is it an accepted term of art in either U.S. or international law. "Equity" usually refers to stock ownership, and it is unclear how the concept is intended to or would apply to entities other than corporations, such as partnerships, trusts, foundations, and associations. More importantly, for decades, criminals and other wrongdoers have established legal entities that they control, but in which they do not have an identifiable ownership interest, either directly or indirectly, thereby limiting the usefulness of the proposed definition.

A 2006 Subcommittee hearing provides an example. That hearing examined a situation in which a Cayman Island bank formed a Cayman charitable trust, called Security Capital Trust. The trust's grantor and trustee were the bank, and its sole beneficiary was "any qualified charity designated by the trustee at the time the trust terminates."[6] In effect, Security Capital Trust was constructed so that no one had an equitable interest in the trust's assets until the trust terminated. The bank, as trustee, then caused the trust to form a Cayman shell corporation called Security Capital Ltd. The trust owned 100% of the corporation's shares. The corporation's directors and officers were split between the Cayman bank's employees and the employees of a corporate service provider in the Isle of Man. The Subcommittee investigation disclosed that the persons behind both the trust and the corporation were U.S. citizens, Sam and Charles Wyly. After the Cayman trust and corporation were formed, the Wylys caused other offshore corporations and trusts they controlled to send, over time, a total of $140 million to Security Capital Ltd. which then wire transferred "loans" to Wyly family members and businesses in the United States. The Wyly brothers controlled and benefited from both the trust and corporation, but at no time did either own, directly or indirectly, any "equity interest" in Security Capital Ltd. or Security Capital Trust.

The NPRM's use of the term "equity interests" is unclear, of limited use, and should be removed from the proposed rule. Alternatively, the term should be defined with respect to corporations, partnerships, trusts, foundations, associations, and other legal entities.

Control Prong. The NPRM defines the control prong as "an individual with significant responsibility to control, manage, or direct a legal entity customer, including (A) An executive officer or senior manager; or (B) Any other individual who regularly performs similar functions." This language essentially permits employees – including executive officers or senior managers – to be treated as the "beneficial owners" of the legal entity they work for, confusing

---

[6] "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006), at 440 et seq.

the concepts of employment and ownership. The provision also requires law enforcement, for the first time, to prove that an individual has "significant responsibility" to control an entity, a requirement that is confusing, difficult to establish, and without precedent in U.S. and international AML law. The language is also inadequate to convey the concept of ultimate or effective "control" over a legal entity as opposed to exercising routine, day-to-day management over its operations.

According to the NPRM, FinCen has endeavored to capture both the concept of ownership and of effective control defined in the Financial Action Task Force (FATF) definition of beneficial ownership. FATF defines a beneficial owner as "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement."[7] FinCen's proposed rule does not use the word "ultimate" or any similar term, despite its prominence in the FATF definition, nor does it include the concept of a person who is a beneficiary of the legal entity. Moreover, the NPRM's insertion of the term "responsibility," which has no FATF parallel, creates a troublesome new evidentiary requirement, since criminals are not usually viewed as having a "responsibility" to control a legal entity.

Subcommittee investigations have exposed multiple examples of individuals who had no legal ownership of or official management role at a legal entity, yet ultimately controlled that entity through extra-legal means. In a 1999 hearing, for example, the Subcommittee highlighted a Cayman Island shell corporation, Trocca Ltd., that had been established by Citibank Private Bank through its Cayman affiliate, Cititrust, for a client, Raul Salinas, then brother of the President of Mexico.[8] Cititrust formed the corporation in such a way that its shareholders, directors, and officers were all offshore shell corporations owned by Cititrust. A year later, Cititrust established a numbered trust and transferred the corporate shares to that trust, so that it held 100% of Trocca's shares. While Mr. Salinas never "owned" any shares in Trocca, he gave Citibank Private Bank a "letter of wishes" about how he'd like the funds in the Trocca accounts to be handled, and both Citibank and Cititrust agreed to follow his wishes.

From the corporation's inception, then, Mr. Salinas had no direct or indirect ownership of Trocca Ltd., nor was he an officer or manager of the company. Instead, Mr. Salinas had a general understanding with the bank and trust company that they would follow his wishes in managing the accounts opened in the name of the shell corporation. Under the terms of the proposed definition, Mr. Salinas' letter of wishes did not make him a shareholder of the corporation, give him an "equity interest" in the company, make him an executive officer or senior manager, require him to "regularly" perform any management "functions," or assign him "significant responsibility" for controlling the company. The result is that the proposed definition does not clearly resolve Mr. Salinas' status as a beneficial owner of Trocca, even though it should. The

---

[7] "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation—The FATF Recommendations," February 2012, General Glossary, at 109, *available at http://www.fatf-gafi.org/topics/fatf recommendations/documents/internationalstandardsoncombatingmoneylaunderingandthe financingofterrorismproliferation-thefatfrecommendations.html.*

[8] See "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999), at 890 et seq.

definition falters, even though this example provides a fact pattern found in many money laundering and tax cases.

Another example involves two California shell corporations discussed at a Subcommittee hearing in 2010.[9] Both corporations, Beautiful Vision Inc. and Unlimited Horizon Inc., were formed by an attorney at the request of a client, Teodoro Nguema Obiang Mangue, eldest son of the President of Equatorial Guinea. Their incorporation papers did not list their nominal or beneficial owners, and Mr. Obiang's name never appeared in either set of papers. Beautiful Vision listed the attorney as its president; Unlimited Horizon did not identify any director or officer, but listed the attorney as authorized to accept service of process for the company. The documentation obtained by the Subcommittee never specified who technically "owned" the shares in either company; they may have been held by the attorney, Mr. Obiang, a trust, or other parties. The attorney opened several U.S. bank accounts in the name of one or the other corporation. Some of the accounts listed the attorney as the account signatory, the company president, and on one occasion as the company owner; others listed Mr. Obiang as the account signatory without specifying his relationship to the corporation that opened the account. In addition, at one bank, the attorney opened an account in the name of his law firm and used it solely to accept wire transfers from Mr. Obiang and then transferred the funds to the accounts held in the names of the shell corporations.

Like Mr. Salinas, Mr. Obiang was not an "officer" or "manager" of either corporation; he did not "regularly" perform executive or management "functions" at either company; nor is it clear that law enforcement could prove he had a "significant responsibility" to control either entity. It would be easier to establish that his attorney filled each of those roles instead. Under the proposed NPRM definition, then, it is unclear whether Mr. Obiang would qualify as a beneficial owner of either corporation, even though he exercised ultimate control over both entities and is the epitome of the person intended to be captured by the term "beneficial owner." A definition that makes it easier to prove that Mr. Obiang's legal counsel, rather than Mr. Obiang himself, was the beneficial owner of the companies formed for Mr. Obiang's use provides a flawed approach that should be corrected.

Strengthening the Definition. As the Subcommittee investigations demonstrate, merely being an officer or a manager of an entity does not equate to exercising ultimate control over the entity, and or to meeting the FATF goal of "incorporat[ing] those persons who exercise ultimate effective control over a legal person or arrangement." The proposed definition also fails to incorporate any concept of the beneficial owner of a legal entity being the natural person entitled to the economic benefits produced by that entity.[10]

---

[9] "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010), at 155 et seq.

[10] See, e.g., Anderson v. Commissioner, 164 F.2d 870 (7th Cir. 1947), affg. 5 T.C. 443 (1945) ("A taxpayer is the beneficial owner of property if the taxpayer controls the property or has the economic benefit of ownership of the property.").

In contrast, the longstanding Treasury definition of the beneficial owner of an account incorporates both the control and entitlement elements of beneficial ownership:

> "Beneficial owner of an account means an individual who has a level of control over, or entitlement to, the funds or assets in the account that, as a practical matter, enables the individual, directly or indirectly to control, manage or direct the account."[11]

This definition could easily be adapted to the proposed rule by essentially replacing the word "account" with "entity." This definition would not only ensure a coordinated approach between the Treasury definitions of beneficial ownership of accounts and legal entities, but would also get to the heart of beneficial ownership – identifying the natural persons who exert ultimate effective control over an entity or benefit from its assets.[12] Failing to adopt this broader approach would not only produce a poor rule, but also create inconsistencies with a longstanding Treasury position.

A beneficial ownership definition focused on "executive officers" and "managers" may involve employees or arrangements that have little or nothing to do with who ultimately controls or benefits from a legal entity. In fact, in many cases over the years, offshore corporate service

---

[11] 31 CFR §1010.605(a).

[12] Another alternative would be to adopt a definition similar to the beneficial owner definition contained in bipartisan legislation introduced by myself and Senator Grassley, S. 1465, the State Incorporation Transparency and Law Enforcement Assistance Act, which has been endorsed by numerous law enforcement groups. That definition does not contain any of the flaws just identified. It provides as follows:

"(1) **BENEFICIAL OWNER**

(A) **In General.** Except as provided in subparagraph (B), the term 'beneficial owner' means a natural person who, directly or indirectly –

(i) exercises substantial control over a corporation or limited liability company; or

(ii) has a substantial interest in or receives substantial economic benefits from the assets of the corporation or limited liability company.

(B) **Exceptions.** The term 'beneficial owner' does not include –

(i) a minor child;

(ii) a person acting as a nominee, intermediary, custodian, or agent on behalf of another person;

(iii) a person acting solely as an employee of a corporation or limited liability company and whose control over or economic benefits from the corporation or limited liability company derive solely from the employment status of the individual;

(iv) a person whose only interest in the corporation or limited liability company is through a right of inheritance, unless the individual also meets the requirements of subparagraph (A); or

(v) a creditor of a corporation or limited liability company, unless the individual also meets the requirements of subparagraph (A)."

providers have, for a fee, designated their own employees as the executive officers, directors, or managers of shell entities for the express purpose of hiding the identity of the persons actually controlling the entity. To now validate those offshore schemes by allowing legal entities to claim that, under U.S. law, those paid individuals qualify as their "beneficial owners" would be to corrupt the very meaning of the term "beneficial owner." It would also fatally confuse the concepts of nominal and beneficial ownership to the detriment of both. For that reason, unless the definition of beneficial ownership is strengthened as suggested, the proposed rule would weaken current AML practices and put U.S. law out of alignment with international norms; in its current form, the proposed rule should not be finalized.

Agent Accounts. A related issue is that, as currently drafted, the NPRM does not clearly articulate disclosure requirements for agent accounts. Agent accounts are accounts opened by one person on behalf of another. Given the NPRM's "control" prong in the definition of beneficial owner, as well as the exemption proposed for certain public entities, clear rules for agent accounts must be a priority. As part of the account opening documentation, customers should be required to state whether they are acting on behalf of, or under instructions from, another party and, if so, require identification of that other party, including whether that other party is the account's beneficial owner. This mandatory inquiry and documentation of any agency relationship would help ensure financial institutions know who they are dealing with and conduct accurate risk assessments.

Attorney-related accounts, in particular, must specifically be addressed. In 2010, the Subcommittee held a hearing and released a report describing a number of incidents in which an attorney opened a bank account in the name of his law office or designated it as an attorney-client account, used the account to carry out financial transactions on behalf of a specific foreign political figure, and did so without alerting the bank to the foreign official's involvement. As a result of that investigation, I and Senator Coburn, the Subcommittee's Ranking Minority Member, issued the following bipartisan recommendation:

> "Treasury should issue an AML rule requiring U.S. financial institutions to obtain a certification for each attorney-client and law office account that it will not be used to circumvent AML or PEP controls, accept suspect funds involving PEPs, conceal PEP activity, or provide banking services for PEPs previously excluded from the bank; and requiring enhanced monitoring of such accounts to detect and report suspicious transactions."[13]

That type of certification process could be included in the proposed rule and used to obtain commitments from attorneys – as well as other intermediaries such as escrow agents who are acting on behalf of others – that they will not use an account to circumvent a financial institution's AML safeguards.

[13] "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010), at 131. PEP stands for Politically Exposed Person.

Thank you for this opportunity to comment on the proposed rule.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations