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Office of the Assistant General Counsel (Enforcement)
Attention: Official Comment Record, Room 2000
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Proposal on Counter Money Laundering Requirements - Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks

Ladies and Gentlemen:

The New York Clearing House Association L.L.C. (the "Clearing House"),[1] joined by the Bankers' Association for Finance and Trade[2] and the American Bankers Association (the "ABA"),[3] appreciates the opportunity to comment on the notice of proposed rulemaking (the "Proposal") issued by the Department of the Treasury (the "Department") to implement Sections 313 and 319(b) of Title III of the Uniting and Strengthening America by

[1] The member banks of the Clearing House are: Bank of America, National Association; The Bank of New York; Bank One, National Association; Bankers Trust Company; Citibank, N.A.; First Union National Bank; Fleet National Bank; HSBC Bank USA; JPMorgan Chase Bank; LaSalle Bank National Association; and Wells Fargo Bank, National Association.

[2] The Bankers' Association for Finance and Trade is a financial trade association whose membership represents a broad range of internationally active financial institutions and companies that provide important services to the global financial community.

[3] The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (Pub. L. No. 107-56) (the "Act"). 66 Fed. Reg. at 67460 (December 28, 2001). These Sections (i) prohibit covered financial institutions from providing correspondent accounts to shell banks; (ii) require covered financial institutions to take reasonable steps to ensure that correspondent accounts provided to foreign banks are not being used to provide indirectly banking services to shell banks; (iii) require covered financial institutions that provide correspondent accounts to foreign banks to maintain records of the ownership of such foreign banks and their agents in the United States designated to accept service of legal process for records regarding the correspondent accounts; and (iv) require the termination of correspondent accounts of foreign banks that fail to turn over their account records in response to a lawful request from the Secretary of the Treasury (the "Secretary") or the Attorney General of the United States (the "Attorney General").

The Clearing House strongly endorses the Department's objective, as set forth in the Proposal, to give effect to Congress' intent to enhance the ability of the U.S. government to prevent, detect, and prosecute international money laundering and the financing of terrorism. We are also very appreciative of the Department's efforts to provide timely guidance to covered financial institutions with regard to their compliance obligations under Sections 313 and 319(b) of the Act. We believe that the certification process embodied in the Proposal creates a method that is both effective and feasible for achieving Congress' objectives. By providing this guidance and approach, the Department has enhanced the ability of financial institutions to combat money laundering and terrorist financing.

Our comments will focus on three issues of primary significance, which are identified and addressed in the body of this comment letter. Additional comments and suggested revisions with regard to the Proposal are set forth in Annex A.

Issues of Primary Significance

I. Definition of "Correspondent Account"

A. Introduction

A principal focus of Title III of the Act is "correspondent accounts." The Clearing House believes that the proper definition of this term is the primary regulatory issue in implementing this Title and in the Proposal. Because our member banks are committed to combating money laundering and terrorist financing, we support a definition that is sufficiently broad to capture those accounts that create a meaningful risk of these activities. In such cases, the accounts should be covered irrespective of the regulatory burden. If, however, the risk of money laundering or terrorist financing is not meaningful with respect to a particular type of account, the regulatory burden and other adverse effects described in 31 U.S.C. § 5318A(a)(4)(B) should be important considerations in avoiding an unnecessarily broad definition.

Although the Proposal relates directly to only Sections 313 and 319 of the Act, our comments and recommendations with respect to "correspondent account" also address Section 312.[4] We believe that the Department has the authority to utilize different definitions of "correspondent account" for these provisions (and, indeed, should exercise that authority), but we believe that the definition adopted for Sections 313 and 319 will inevitably inform the definition for Section 312.

The basic structure of Title III of the Act indicates that a universally broad definition of "correspondent account" is not necessary to close all possible loopholes. Title III consists of two previous bills, S. 398, introduced by Senator Kerry, and S. 1371, introduced by Senator Levin. The Levin bill, which is incorporated in Sections 312 and 313 of the Act, establishes specific rules for specific types of accounts. In contrast, the Kerry bill, which is incorporated in Section 311, provides broad flexibility to the Department to identify and deal

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4 We have not addressed the definition of "correspondent account" for purposes of Section 311 because the Department has broad authority to tailor the requirements of that Section to the relevant circumstances.

with accounts and transactions that create a special risk of money laundering or terrorist financing.

Under this structure, the Department can use a traditional, commonly accepted definition of "correspondent account" for purposes of Sections 312 and 319, with the knowledge that any loopholes that may later arise from this approach can be targeted and closed by special regulations under Section 311. This approach is more consistent with the objectives of the Act than a sweeping definition of "correspondent account" that includes numerous accounts with little risk of money laundering or terrorist financing.

B. Description of Clearing House Proposed Definition

In order to accomplish the objectives discussed in the preceding section of this letter, the Clearing House proposes the following definition of "correspondent account":

> The term "correspondent account" means an account established by a foreign bank at a financial institution in which deposits are received or from which payments or other disbursements are made; provided, however, that (a) for purposes of Section 313, "correspondent account" shall also include an account established to handle any financial transaction with a foreign bank; (b) for purposes of Section 312(a)(i)(1), a correspondent account at a depository institution shall include only a deposit account in which deposits of funds from third parties are received or payments or other disbursements of funds to third parties are made; and (c) except for purposes of Section 313, a correspondent account does not include (i) financial transactions conducted by a financial institution in the ordinary course of its business with a foreign bank that is acting as a principal and not on behalf of a third party; (ii) financial transactions conducted by a financial institution with a foreign bank in the ordinary course of the financial institution's business in connection with the following activities: (A) escrow; (B) corporate trust, paying agency, depositary receipt, and similar business activities; (C) letters of credit, lending, and other extensions of credit; (D) custody outside the United States; and (E) securities clearing; and (iii) any account used exclusively to facilitate the transactions and activities listed in clauses (i) and (ii).
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> For purposes of this section, the term "depository institution" means any institution or other entity referred to in clause (A), (B), (C), (D), (E) or (F) of 31 U.S.C. § 5312(a)(2) and an Edge or agreement corporation.

Our proposed definition can be divided into two parts. First, the Clearing House proposal begins with a basic definition of "correspondent account" that is based upon the statutory language in 31 U.S.C. § 5318A(e)(1)(B). There are three differences between our basic definition and the statutory language: (i) the Clearing House definition includes "disbursements" as well as "payments"; (ii) payments (and disbursements) are not limited to those "on behalf of the foreign bank"; and (iii) the reference to "handl[ing] other financial transactions" is not included. The first two differences strengthen the statutory definition by closing possible loopholes. The third difference is proposed because the statutory reference to financial transactions is overly broad, extending beyond the commonly understood meaning of not only "correspondent account" but even beyond "account."

We believe that the exclusion of "other financial transactions" from the basic definition of "correspondent account" is consistent with the objectives of the Act, as exemplified by the first two clauses of the statutory definition.[5] These two clauses focus on and capture the movement of funds. This focus is appropriate because there should be no meaningful risk of money laundering or terrorist financing unless funds actually move to or from the foreign bank. In contrast, the third clause of the statutory definition refers generally to "transactions", and would apply even if there were no movement of funds. In addition, as noted above, the Secretary has ample authority under Section 311 to close any loopholes that may be created absent such a broad phrase as "other financial transactions."

The second part of the Clearing House's proposed definition establishes special rules for: (i) Section 313 (shell banks) (clause (a)); (ii) Section 312(a)(i)(1) (general due diligence) (clause (b)); and (iii) provisions other than Section 313 (clause (c)). Such distinctions are consistent with the structure of the Act, which itself distinguishes among types of foreign banks, and the objectives of the particular statutory provisions. Congress dealt separately with shell banks, which were regarded as such a serious problem as to require an absolute ban. Congress also dealt separately with what it regarded as the next most serious problem – offshore banks and banks from non-cooperative jurisdictions. The statute requires "enhanced" due diligence for those banks and requires certain specific information. In contrast, Section

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5 The statutory definition of "correspondent account" is "an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution."

312(a)(i)(1) imposes only a general due diligence requirement, and Section 319(b) is principally an administrative provision.

1. Section 313 definition

Clause (a) of the Clearing House's proposed definition corresponds to Congress' special concerns regarding shell banks by creating a broader definition of "correspondent account" for purposes of Section 313. The Clearing House believes that U.S. banks, and banks throughout the world, should normally refuse to deal with shell banks. Although the concept of a shell bank may not inherently create a money laundering risk, in practice these banks have been particularly susceptible to money laundering, and would be susceptible to terrorist financing, because of the absence of meaningful regulation. Accordingly, for purposes of the Section 313 prohibition on shell banks' usage of the U.S. banking system, the Clearing House's proposed definition of "correspondent account" would include all financial transactions with a shell bank.

2. Section 312(a)(i)(1) definition

Clause (b) of the Clearing House's proposed definition relates to Section 312(a)(i)(1) of the Act, which requires, among other things, U.S. financial institutions to conduct general due diligence on all correspondent accounts with foreign banks. Unlike Sections 312(a)(i)(2) and 313, Section 312(a)(i)(1) is not targeted at specific types of foreign banks where there may be a higher risk of money laundering. Indeed, we are unaware of any evidence that correspondent accounts established by foreign banks generally – as opposed to accounts established by shell banks, offshore banks and banks with weak regulatory regimes -- create any special money laundering risk.

Accordingly, for purposes of Section 312(a)(i)(1), the Clearing House's proposed definition is directed at "traditional" correspondent accounts. The hallmark of a traditional correspondent account is a deposit account used to make payments to or accept payments from third parties.[6] It may be possible to transfer funds through other accounts, but we believe that

[6] For this reason, the application of clause (b) is limited to depository institutions. Only depository institutions have deposit accounts.

due diligence efforts should be focused on those accounts where the overwhelming majority of funds flows occur.

The use of this traditional definition of correspondent account for purposes of Section 312(a)(i)(1) would, of course, reduce regulatory burden.[7] The Clearing House approach is, however, more fundamentally grounded in its objective of eliminating money laundering and terrorist financing. For purposes of the general due diligence requirement in Section 312(a)(i)(1), we believe that the definition of "correspondent account" should be directed at those types of accounts that involve a truly meaningful risk of money laundering and terrorist financing. This enables banks to focus their efforts where they are most likely to be productive. In contrast, a broader definition of "correspondent account" would result in a more diffuse and, we believe, less productive effort.

Indeed, in hearings before the Senate Banking, Housing and Urban Affairs Committee, Deputy Secretary Kenneth W. Dam acknowledged that it will be crucial for the Department to exercise judgment "as to where strict enforcement is going to yield a high return." Deputy Secretary Dam further stated:

> you're never going to have a strong enough law and you're never going to have enough money to proctor each and every account and each and every transaction. So the question is going to be figuring out where you put in your efforts . . . Like duck hunting – you go to the Eastern Shore of Maryland, you don't go to the desert. It's not that there are no ducks in the desert, it's just there are very few of them. Hunting them there is not productive.

Financial War on Terrorism and Implementation of the Money-Laundering Provisions of the USA PATRIOT Act, Hearings before the Senate Banking, Housing and Urban Affairs Comm.

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7 The Department has also described as one of its objectives in defining key terms under the Act, the need to reduce unnecessary regulatory burden. In hearings before the Senate Banking, Housing and Urban Affairs Committee, Deputy Secretary Kenneth W. Dam testified that "[the Department] want[s] to make sure that the definitions are . . . not so broad that they bring in information and impose burdens that are not necessary." See *Financial War on Terrorism and Implementation of the Money-Laundering Provisions of the USA PATRIOT Act*, Hearings before the Senate Banking, Housing and Urban Affairs Comm. (January 29, 2002)(Testimony of Kenneth W. Dam, Deputy Secretary, Department of the Treasury).

(January 29, 2002)(Testimony of Kenneth W. Dam, Deputy Secretary, Department of the Treasury). We believe that funds flows relate to money laundering, as water relates to ducks.

Congress' own deliberations are supportive of this approach. Congress attempted to identify those accounts where the risks are greatest and to require banks to make special efforts with respect to those accounts. The hearings before the Senate Permanent Subcommittee on Investigations contain a number of statements by Senators Levin and Collins that refer explicitly to this focus on high risk accounts. Those hearings did not demonstrate that <u>all</u> correspondent accounts of foreign banks were particularly susceptible to abuse or presented undue risk. *Role of U.S. Correspondent Banking in International Money Laundering, 2001, Hearings before the Permanent Subcomm. on Investigations of the Comm. on Governmental Affairs U.S. Senate*, 107th Cong. 2-3 (statement of Sen. Collins); 5-7 (statement of Sen. Levin).

Accordingly, we have limited clause (b) of our proposed definition so that it does not apply to the correspondent accounts of higher risk banks identified in Section 312(a)(i)(2), which have special due diligence requirements. For purposes of that section, the broader basic definition applies, subject to the exclusions described below.

3. <u>Exclusions for provisions other than Section 313</u>

Clause (c) of the Clearing House's proposed definition excludes, other than for purposes of Section 313, those types of transactions and accounts that we believe do not create a significant risk of money laundering or terrorist financing.[8] The principal reason for this approach is the concern expressed in the immediately preceding section that an effective campaign against money laundering and terrorist financing must be a focused campaign. As discussed, a general, unfocused approach would result in a reduced capacity to identify and prevent these crimes. It would also significantly increase regulatory burden and ultimately create serious competitive issues for U.S. financial institutions and endanger the position of the United States as the world's leading financial center.

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[8] These exclusions are intended to apply to activities of banks, although some of them may apply equally to other covered financial institutions.

The Clearing House has carefully attempted to shape and limit the exclusions in clause (c) so that they do not include transactions and accounts which create a serious risk of money laundering and terrorist financing. The first element of this approach is to require that the account must be established in the ordinary course of the U.S. financial institution's business. The second element is to require that, unless the foreign bank is acting as a principal, there must be a specific, actual activity. This requirement prevents institutions from qualifying for the exclusion simply by describing a certain transaction or account with certain nomenclature. Third, the excluded types of activities are carefully limited. None of these activities is normally used as a method for making or receiving payments (other than for a defined purpose) to or from third parties.

There is an additional reason why the exclusions are appropriate. Unlike a true correspondent account, the identified business relationships and activities are not more susceptible to money laundering or terrorist financing because the counterparty is a bank. For example, acting as escrow agent or paying agent for a foreign bank is no more likely to involve money laundering than a similar transaction with an industrial company.

Our member banks have been active participants with representatives of U.S. regulatory and law enforcement agencies in efforts to develop policies, procedures and controls to detect and prevent terrorist financing. These efforts are ongoing, and the process is evolutionary. Accordingly, in preparing our comments, we have made certain assumptions about the sources of the risks of terrorist financing based on our information to date. As we and the Department gain additional knowledge, changes in the regulatory scheme can be made, whether through additional regulations under Section 311 or otherwise.

a. Principal transactions

One set of excluded activities relates to transactions conducted by a financial institution in the ordinary course of its business with a foreign bank acting as principal and not on behalf of a third party (clause (c)(i)). We believe that there is no need for special regulatory due diligence requirements when the foreign bank is acting in an actual principal capacity. If the U.S. financial institution is dealing with the foreign bank as principal, there are no other parties involved in the transaction. "Know your customer" policies and procedures – the foundation of an effective anti-money laundering program – can then be thoroughly and completely applied. Because the foreign bank is not acting as a conduit, the risk that a third party could somehow use the transaction for money laundering or terrorist financing is minimized. In addition, in many cases extensive due diligence will be conducted because of potential credit exposure.

b. Specific activities

i. Credit transactions

One set of excluded activities consists of the credit transactions which comprise a bank's basic business (clause (c)(ii)(C)). At the outset, we are unaware of any situation in which bank to bank credit transactions have been vehicles for money laundering or terrorist financing. Moreover, it is difficult to see how such a transaction could be readily used for those purposes. In addition, banks already conduct extensive due diligence before entering into such transactions, because the bank is taking a credit risk in respect of the counterparty. As a result, there is no need to apply special regulatory requirements. Our conclusion is supported by the findings of the Permanent Subcommittee, which frequently noted that banks did take sufficient care when credit risk was involved. *Correspondent Banking: A Gateway for Money Laundering*, Report by Minority Staff of U.S. Permanent Subcomm. on Investigations 3 (2001).

ii. Escrow activities

As an escrow agent (see clause (c)(ii)(A)), a U.S. bank acts as a neutral third party in a business transaction that holds, services and disposes of escrowed property pending completion of the transaction. An escrow agent's specific responsibilities may include: (i) holding, exchanging and pricing the assets; (ii) investing cash held in the escrow account as directed by the client; and (iii) distributing the assets at the end of the escrow period in accordance with the agreement of the parties.

Escrow accounts are not transaction accounts. They are accounts established for a specific purpose and activity in the accounts is limited by the terms of the escrow agreement. As a result, they are not particularly susceptible to money laundering. Parties establishing escrow accounts are subject to due diligence, and transactions underlying the escrow relationship, including the source of funds, normally would be scrutinized. We do not believe, therefore, that these activities should be included because they do not create a meaningful risk of money laundering or terrorist financing that requires special regulatory requirements.

There is a theoretical possibility that an escrow account could be used to launder money. The account would be funded with the laundered funds and one of the conspirators would be authorized to receive the funds under certain designated conditions.

This theoretical possibility, however, does not translate into a meaningful risk. The non-recurring nature of the account would alone make it infeasible for money laundering. Moreover, the basic due diligence as to the transaction underlying the escrow account, as described in the previous paragraph, should prevent this usage. In addition, because of the expense involved, it would be highly unusual to establish an escrow account for the small amounts that have been used to fund terrorists. Indeed, if a foreign bank sought to establish an escrow account for a small sum, that transaction would be intensely scrutinized by the U.S. bank/escrow agent.

iii. Corporate trust activities

Another type of excluded activities is corporate trust activities (clause (c)(ii)(B)), which include acting as trustee; acting as issuing, paying, and transfer agent; and acting as registrar for private and public debt securities. As trustee, a bank acts as liaison between the issuer and the bond holders. The bank's duties and responsibilities are governed by the indenture. Issuances of greater than $10 million are subject to the Trust Indenture Act, which defines the duties of trustees. There is little or no risk of money laundering inherent in these trustee and other administrative functions, which do not involve the transfer of funds or securities. Other administrative functions include acting as stock transfer agent, which involves maintenance of an issuer's stock transfer ledger, exchange and tender agent in mergers and acquisitions, warrant agent, calculation agent, and "Dutch" auction agent.

Paying agency activities do involve the receipt of funds from the issuer to be disbursed to the bond holders in payment of principal and interest, but not in circumstances that are readily susceptible to money laundering. These funds transfers are subject to the terms of the paying agency agreement with the issuer and the requirements of the indenture. Payments are made only in accordance with the instructions from and the official records of the issuer reflecting ownership of the bonds.

Again, it may be helpful to examine the mechanics of these activities in the relevant context. In order for someone to launder money or fund a terrorist, the originator of the scheme would first need to purchase a bond through a broker shortly before the bond's maturity. He would then need to transfer the bond to another party, who would then proceed to collect payment upon the maturity of the bond. Accordingly, both the originator and the recipient would have been subject to the KYC procedures of their brokers.

iv. Custody activities outside the U.S.

The proposed definition also excludes global custody (clause (c)(ii)(D)), which involves providing institutional clients with a single entity or point of contact for securities safekeeping, settlement and servicing in local securities markets worldwide. We are not aware of any suggestion that the custody of securities creates a significant risk of money laundering. Moreover, U.S. banks confront vigorous competition from foreign banks for their services overseas, which tends to be a very low margin, high volume business. Consequently, if additional requirements, of at most marginal utility, are imposed on only U.S. banks, their competitive position will be threatened.

v. Securities clearing activities

These activities (see clause (c)(ii)(E)) consist of clearing and settling a securities purchase and sale. A bank is merely processing a transaction that already should have been subject to due diligence by the parties to the transaction or the broker or dealer executing the transaction. The processing of the transaction does not create any additional risk that requires special regulatory requirements.

C. Legal Analysis

The question arises whether the Department has the authority to use a definition of "correspondent account" that differs from the statutory language. If the Department has that authority, the further question is whether it should be exercised. We submit that the answer to both questions is in the affirmative.

The authority of the Department to interpret the statutory language should be beyond doubt. The Department not only has broad interpretative authority under the general provisions of the Act (see 31 U.S.C. § 5318), but has specific broad authority to "further define" the term "correspondent account" (See 31 U.S.C. § 5318A(e)(4)).[9] Moreover, we respectfully suggest that it is incumbent upon the Department to interpret the statutory language because it is ambiguous and can lead to confusion. As one example, the definition includes an account established "to receive deposits from . . .". There is no indication from whom the deposits are to be received. Presumably, it is from the foreign financial institution opening the account, but that is not what the statute says. Likewise, although there is at least a reference to "a foreign financial institution" in the second part of the definition, it is unclear whether this term refers to the institution opening the account or has broader reach. The courts have consistently held that a governmental agency has broader authority to interpret a statute if the statutory language has apparent flaws or ambiguities. United States v. Mead Corp., 533 U.S. 218 (2001); Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996).

There are a number of other basic rules of statutory construction that support not only Department interpretation, but an interpretation that is consistent with the more focused approach suggested by the Clearing House's proposed definition. One of those basic rules is that terms are to be interpreted in accordance with their commonly understood meanings. F.D.I.C. v. Meyer, 501 U.S. 471 (1994); Woolford Realty Co. v. Rose, 286 U.S. 319 (1931).[10] A correspondent account is generally understood to mean a deposit account that is established by one bank with another bank (normally in a different geographic region) to receive deposits and make payments. For example, the Federal Reserve Board's Regulation O defines "correspondent account" as "an account that is maintained by a bank with another bank for the deposit or

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[9] The Department has stated that it has the requisite authority under the Act to interpret and implement the provisions of the Act. See *Financial War on Terrorism and Implementation of the Money-Laundering Provisions of the USA PATRIOT Act*, Hearings before the Senate Banking, Housing and Urban Affairs Comm. (January 29, 2002)(Testimony of Kenneth W. Dam, Deputy Secretary, Department of the Treasury).

[10] A related doctrine of statutory interpretation recognizes that the practical interpretation of a statute by the public, or a specific profession, constitutes an invaluable aid in determining the meaning of a doubtful statute. People v. Jones, 11 Cal. 4th 118, 44 Cal. Rptr. 2d 164, 899 P.2d 1358 (1995).

placement of funds." 12 C.F.R. § 215.21(c). The dictionary definition of "correspondent" indicates that "[i]n banking there is usually a deposit relationship." Dictionary of Finance and Investment Terms, John Downes and Jordan Elliot Goodman (5th ed. 1998).[11]

A second basic and long-recognized principle of statutory construction is that each word in a statute must be given independent meaning and that no words are superfluous. Duncan v. Walker, 533 U.S. 167 (2001); United States v. Menasche, 348 U.S. 528 (1955); In Re Surface Mining Regulation Litigation, 627 F.2d 1346 (D.C. Cir. 1980). Based on this principle, as well as common sense, when Congress used the term "correspondent account," it must have been referring to a subset of all accounts, i.e., accounts that are correspondent in nature. Otherwise, the word "correspondent" would have no meaning. Accordingly, a definition of "correspondent account" as synonymous with "account" would violate this basic principle of statutory construction.

This basic principle is reinforced because the term "account" is defined in the very same section of the Act. See Section 311(b)(1)(A). If Congress had intended Sections 313 and 319(b) to cover all accounts, it would have just used that defined term.

A third basic rule of statutory construction is that words in a series should be interpreted to achieve comparable or related meanings. Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001); Norfolk & Western Ry. Co. v. Train Dispatchers, 499 U.S. 117 (1991). This rule, which is referred to as ejusdem generis, would require the phrase "handle other financial transactions" to be interpreted by reference to the other terms in the definition of "correspondent account." In other words, financial transactions would be those types of transactions that are similar to receipt of deposits and the making of payments, both of which require a deposit account.

Finally, it is not only a basic principle of statutory construction, but a Constitutional principle, that terms in a statute that could be subject to criminal enforcement be

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[11] Correspondent accounts can be domestic or foreign. The major U.S. banks have long served as correspondent banks for smaller U.S. banks, and, with the emergence of the dollar as the world's principal reserve currency, have served as correspondent banks for banks from around the world.

interpreted narrowly. Busic v. United States, 446 U.S. 398 (1980). This principle is designed to give fair notice and ensure due process. Crandon v. United States, 494 U.S. 152 (1990).

In summary, there is ample legal authority, and seemingly virtual legal compulsion, for the Department to adopt a definition of correspondent account that is consistent with Congress' focus.

II. Application of Sections 313 and 319 to Foreign Branches of U.S. Financial Institutions

The Proposal defines covered financial institution to include "any foreign branch of an insured bank." 66 Fed. Reg. 67465. In addition, the Proposal states that the recordkeeping requirements of proposed Section 104.40(a)(i) and the prohibitions on correspondent accounts for shell banks in proposed Section 104.40(a)(2) apply to "any correspondent account maintained by a foreign branch of a covered financial institution." 66 Fed. Reg. 67466-67. As a result, it appears that the Proposal would require U.S. covered financial institutions to obtain the information contained in the model certification from any foreign bank for which it maintains a correspondent account either in the U.S. or at one of its foreign branches.

The Clearing House banks are committed to closing all correspondent accounts with shell banks, whether held in the U.S. or at any of their foreign branches. We are deeply concerned, however, by the application of the certification requirements to correspondent accounts held by our member banks' foreign branches. By applying the certification requirements to every foreign bank correspondent account held by a U.S. bank wherever located, the Proposal places U.S. banks at a distinct competitive disadvantage vis-à-vis foreign banks in the same foreign market.[12]

U.S. banks operating in overseas markets through foreign branches often hold accounts of foreign banks in local currency. U.S. banks compete with local banks, including those with no U.S. branch or agency, for this business. These accounts generally have no connection with the U.S. Accordingly, if foreign banks opening these accounts are required to (i) appoint an agent for service of process in the U.S., (ii) subject themselves to subpoena by U.S.

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[12] We understand that the Department did not intend to require foreign branches of foreign banks with U.S. branches or agencies to obtain certifications from their foreign bank customers.

authorities, and (iii) make certifications about the use of their accounts, they will more than likely opt to bring their business to a non-U.S. bank.

Moreover, foreign banks that have U.S. branches or agencies can continue to offer these customers even U.S. dollar clearing services through their non-U.S. branches while avoiding the need to obtain certifications from these customers. The foreign bank can accomplish this result by holding its foreign bank customer's account overseas and using its own U.S. dollar account in the U.S. (either with its own U.S. branch or its U.S. correspondent bank) to clear payments for the customer. The overseas account would not be covered by the certification requirement and the foreign bank customer would not be obligated to appoint a U.S. agent for service of process.[13] Thus, U.S. banks are placed at a significant competitive disadvantage.

Moreover, the Clearing House believes that the Act was not intended to apply to accounts held at foreign branches of U.S. covered financial institutions. Title III of the Act incorporates many of the definitions of the Bank Secrecy Act (the "BSA") and amends many provisions of the BSA. Historically, in implementing the BSA, the Department has confined the scope of its coverage to entities and activities "within the United States". See 31 C.F.R. § 103.11(n).

Moreover, the Act itself is frequently limited by its terms to accounts maintained in the United States. For example, the shell bank provisions of Section 313, which are the most restrictive, apply only to correspondent accounts in the United States. Section 313(a) of the Act provides that a covered financial institution shall not "establish, maintain, administer, or manage a correspondent account *in the United States*" for a shell bank. Section 313(b) provides that any covered financial institution that establishes, maintains, administers, or manages a foreign bank's correspondent account that is "*in the United States*" must take reasonable steps to ensure that the correspondent account is not being used to indirectly provide banking services to a shell bank. Furthermore, Section 319, which requires the maintenance of records regarding foreign bank owners, applies to "[a]ny covered financial institution which maintains a correspondent account

[13] The foreign bank could not avoid the shell bank prohibition in this way because it would be prohibited from using its U.S. correspondent account to provide banking services to shell banks.

in the United States for a foreign bank." By repeatedly using the phrase "in the United States," Congress clearly intended to limit the application of these provisions of the Act to correspondent accounts located in the U.S.

III. Termination and Closure of Correspondent Accounts

The Proposal contemplates the termination or closure of correspondent accounts in three circumstances. First, Treasury expects that a covered financial institution, as required by Section 313 of the Act, will immediately terminate all correspondent accounts with any foreign bank that it knows to be a shell bank and that is not a regulated affiliate, and will terminate any correspondent account with a foreign bank that it knows is being used to indirectly provide banking services to a shell bank. 66 Fed. Reg. at 67462. Second, the Proposal provides that a covered financial institution that does not obtain, from a foreign bank or otherwise, the information described in the model certification, must terminate, within the prescribed time periods, all correspondent accounts that it maintains for such foreign bank. 66 Fed. Reg. at 67467. Third, a covered financial institution is required to terminate any "correspondent relationship" with a foreign bank not later than ten business days after receipt of written notice from the Secretary or the Attorney General that the foreign bank has failed either: (1) to comply with a summons or subpoena issued under Section 319 of the Act, or (2) to initiate proceedings in a United States court contesting such summons or subpoena. 66 Fed. Reg. at 67468. The Proposal contains a limitation on a covered financial institution's liability for terminating a correspondent relationship in response to any such notice from the Secretary or the Attorney General. Id.

The Department recognizes in the Proposal that some correspondent accounts may contain, at the time of termination, open securities or futures positions, and states that a covered financial institution may exercise its "commercially reasonable discretion" in liquidating such open positions (including, but not limited to, following its ordinary practices upon the default of a client). 66 Fed. Reg. at 67462. The Department also indicates that a covered financial institution must take reasonable steps to ensure that an account that is in the process of being terminated is not permitted to establish new positions. Id.

The Clearing House has several concerns with regard to the termination provisions of the Proposal. First, the Proposal contains no definition of "correspondent relationship." Second, in most cases, it will be very difficult for banks to terminate their relationships with foreign banks in the short periods of time required by the Proposal. Third, in the capital markets area, it is unclear what the Department means by the exercise of "commercially reasonable discretion" in liquidating open positions and what constitute "reasonable steps" to ensure that new positions are not established. Fourth, the limitation on liability, while helpful, may not be effective when terminating accounts outside the U.S. or accounts governed by the laws of a country other than the U.S.

A. <u>Definition of "correspondent relationship"</u>

As stated above, the Proposal requires a covered financial institution to terminate any "correspondent relationship" with a foreign bank that fails to comply with or contest a summons or subpoena issued under Section 319 of the Act. Failure to terminate the relationship may subject the covered financial institution to civil penalties of up to $10,000 per day until the correspondent relationship is terminated. Given the serious consequences that follow from such a failure to terminate, the Clearing House urges the Department to clarify with precision the types of accounts or other relationships covered by the term "correspondent relationship."

We believe that the Department should define "correspondent relationship" synonymously with "correspondent account." Title III of the Act focuses on correspondent accounts, and we are unaware of any practical or policy reason to use two different terms in this context.

B. <u>Difficulty of closing accounts</u>

The Clearing House banks appreciate the Department's recognition that, in capital markets and derivative transactions, it may be impossible for a covered financial institution to liquidate its positions expeditiously. We are concerned, however, that the Proposal does not appear to recognize that many other relationships with foreign banks can present even more difficult timing issues. Banks usually need at least 30 days when closing demand deposit accounts voluntarily, primarily to account for any returned checks or other deposited items previously credited to the account. Many accounts or relationships, including service agreements for cash management services and the like, require more than 30 days' notice prior to termination. In addition, in securities or custody accounts, the underlying securities cannot simply be returned to the client, and placing a stop on deliveries into the account could cause fails to occur that would have significant ripple effects throughout the securities markets. Arrangements must be made for a substitute depositary or custodian. It may take some time for the foreign bank to make such arrangements (particularly, as is likely to be the case, if no U.S. financial institution is permitted to serve in that capacity).

In addition, requiring termination of accounts could expose covered financial institutions to credit risk where such accounts are held by the institution as collateral for a loan. Also, if the account has been pledged or assigned to a third party, termination could cause economic harm to the third party.

The Clearing House suggests that the Department provide for some flexibility in requiring termination of accounts and other relationships. For instance, the 10-day termination period could be tolled as long as the covered financial institution takes steps prior to the end of the 10-day period to terminate the account by (i) providing formal notice of termination to the foreign bank, (ii) limiting further use of the account, to the extent practicable, and (iii) taking other commercially reasonable steps to terminate the account. An outside limit of 90 days could be required for terminating the account, subject to a special extension granted by the Department.

The Department should also recognize that if correspondent accounts at foreign branches are covered by the termination requirement, a covered financial institution could be compelled by legal process in a foreign jurisdiction to keep the account open. Failure to comply with the local requirements could have serious consequences for the covered financial institution. Our member banks would appreciate any guidance the Department could provide on how it would expect covered financial institutions to resolve such conflicts. The Clearing House suggests that, in such cases, it may be appropriate to allow covered financial institutions to appeal to the Department to keep such accounts open, at least until issues in the foreign jurisdiction can be resolved.

C. Capital markets transactions

As noted above, the Department recognizes, in the capital markets area, that termination of an "account" could have adverse economic consequences for the covered financial institution. In this regard, we respectfully request the Department to clarify that "commercially reasonable discretion in liquidating open positions" would include taking steps to close out positions (including hedges, where necessary) in an orderly manner without unduly penalizing the financial institution. We appreciate that the Department recognizes that "default" procedures will not always be appropriate, because, contractually, default may entail severe adverse economic consequences for both the covered financial institution and its foreign bank counterparty.

The Clearing House banks also believe that these commercially reasonable liquidation provisions made available for closing shell bank accounts should also apply when terminating correspondent accounts pursuant to notice from the Secretary or Attorney General under Section 319 or as a result of failure to obtain the information described in the certification. The issues in those cases, and the need for some relief, are no different.

D. Limitation on liability

Pursuant to the Proposal, the liability of a covered financial institution for terminating a correspondent relationship in accordance with proposed Section 104.40(d) is limited. 66 Fed. Reg. at 67467. The Clearing House notes, however, that many transactions, especially capital markets transactions, are governed by the laws of foreign jurisdictions, most notably those of the United Kingdom. It is not clear whether the protections of the Act extend to judgments rendered against covered financial institutions in proceedings under foreign law. The Clearing House banks request that the Department allow U.S. financial institutions to keep accounts open pending resolution in such cases.

* * *

The Clearing House, joined by the Bankers' Association for Finance and Trade and the ABA, appreciates the opportunity to comment on the Proposal, and would be pleased to discuss any of the points made in this letter in more detail. Should you have any questions, please contact Norman Nelson, General Counsel of the Clearing House, at (212) 612-9205.

Very truly yours,

cc: Bankers' Association for Finance and Trade
(Thomas Farmer)

American Bankers Association
(John J. Byrne)

Annex A

Additional Comments and Suggested Revisions

1. The Model Certification and Model Recertification

At the outset, it should be noted that the Clearing House strongly endorses the certification process, and especially the Department's initiative in granting covered financial institutions a safe harbor if they obtain the information contained in the form of model certification from foreign banks for which they maintain correspondent accounts. The certification process and the safe harbor will indeed promote efficiency and uniformity in compliance.

Set forth below are the Clearing House banks' comments with regard to the model certification and model recertification appended to the Proposal.

a. Electronic Certifications

The Clearing House urges the Department to clarify that the certification and recertification may be distributed, completed, returned and stored in electronic form. The model certification and recertification call for an authorized signature (66 Fed. Reg. at 67471, 67476). In addition, under proposed Section 104.40(e), covered financial institutions must retain the original of any document provided by a foreign bank for purposes of that section for at least five years. (66 Fed. Reg. at 67467)

Under the Electronic Signatures in Global and National Commerce Act (15 U.S.C. § 7001 et seq.) ("E-Sign Act"), a signature, contract or record relating to a transaction in or affecting interstate commerce may not be denied legal effect, validity or enforceability solely because it is in electronic form. 15 U.S.C. § 7001(a). In addition, under the E-Sign Act, if a statute or regulation requires that a contract or other record be retained, this requirement is met by retaining an electronic record, so long as the record meets certain criteria. Id. At 7001(d). The E-Sign Act was adopted to recognize technological developments that have made information flows more efficient and more effective. See 146 Cong. Rec. H4346-47 (2000) (statement of Rep. Sessions).

The terms of the E-Sign Act apply to the certifications because they are provided by the foreign banks in connection with the establishment or maintenance of a correspondent account, which is a relationship governed by an agreement between the covered financial institution and the foreign bank. The Clearing House, therefore, urges the Department to recognize the validity of electronically filed and maintained certifications and recertifications.

We recognize the importance of establishing the authenticity of the certifications. One effective authentication method would be a Department requirement that certifications electronically transmitted by foreign banks to covered financial institutions be authenticated using SWIFT[1] keys. SWIFT keys provide a highly secure method that is commonly used by banks to validate payment instructions for wire transfers in amounts totaling billions of dollars daily.

Application of the E-Sign Act to the model certification and recertification will substantially reduce the burden on covered financial institutions and foreign banks in obtaining, providing and storing these documents.

b. Reliance on certifications obtained by affiliates

The Clearing House requests that the Department clarify whether affiliated covered financial institutions that provide correspondent accounts to a foreign bank may rely on certifications from that foreign bank obtained by one of their affiliates. For example, a registered broker or dealer should be permitted to rely, for purposes of the safe harbor, on a certification obtained by its affiliated bank from a foreign bank that maintains a correspondent account at both the broker or dealer and the affiliated bank, provided that the certification names the broker-dealer affiliate.

Similarly, the Clearing House requests that the Department clarify under what circumstances a foreign bank may execute a certification on behalf of its affiliate. For example, may the head office of a foreign bank that maintains a correspondent account at a covered financial institution, issue a certification on behalf of itself and each of its affiliates that also maintain correspondent accounts at such covered financial institution?

[1] SWIFT (Society for Worldwide Interbank Financial Telecommunication) is a financial industry cooperative that supplies secure messaging services to its members, which consist of some 7,000 financial institutions around the world.

It seems clear that if a foreign bank is authorized, as a corporate governance matter, to make a certification on behalf of its affiliate, and it can identify an authorized agent for service of process for that affiliate, the certification should be acceptable. Recognition by the Department of the acceptability of such certification would substantially reduce the burden of obtaining the certifications.

c. The meaning of the phrase "received, reviewed and accepted"

The Clearing House seeks written clarification from the Department of the meaning of the phrase "received, reviewed and accepted" in the model certification (66 Fed. Reg. at 67471) and the model recertification (66 Fed. Reg. at 67476). With regard to the model certification appended to the Interim Guidance, the Department's staff had verbally indicated that this phrase should be interpreted to mean that the certification had been obtained by the covered financial institution, that it was complete and that it was not prima facie inconsistent or irregular. We believe that this is the correct approach.

d. Minor flaws in certifications

The Clearing House urges the Department to find that a certification would not be rendered incomplete, and that the safe harbor afforded by the certification not be lost, as a result of a minor omission in the certification, such as a failure to include the electronic mail address of the agent designated to accept service of legal process.

e. The meaning of the phrase "this Certification and the Annexes hereto may be transmitted to one or more departments or agencies of the United States"

The Clearing House recommends that the Department clarify the intended purpose of the phrase "this Certification and the Annexes hereto may be transmitted to one or more departments or agencies of the United States of America for purposes of fulfilling such departments or agencies governmental functions." 66 Fed. Reg. at 67471. We understand that the consequences of this language is to render any intentional misstatement made in the certification subject to criminal penalties. Foreign banks should be given clear notice that this is the intent of the language.

f. Verification requirements

According to the Proposal, covered financial institutions must verify the information provided by a foreign bank, or otherwise relied upon for purposes of Sections 313 and 319(b) of the Act, every two years, or at any time the covered financial institution has reason to believe that the previously provided information is no longer accurate. 66 Fed Reg. at 67467.

The Clearing House submits that the biennial verification requirement may be unduly burdensome, especially in light of (i) the sheer volume of correspondent account relationships maintained by covered financial institutions for foreign banks and (ii) the affirmative obligation undertaken by a foreign bank upon execution of a certification, to notify the covered financial institution within 30 calendar days of any change in fact or circumstances as reported in the certification. The Clearing House believes that the verification of previously provided information should be done on a periodic basis, consistent with the institution's own risk assessment, but no less than every three years.

The Clearing House urges the Department to delete the "reason to believe" requirement for verification. This is a highly subjective test, and its "with the benefit of hindsight" application will expose U.S. financial institutions to substantial liability. Moreover, in view of the foreign bank's continuous duty to update, this requirement seems unnecessary.

If, however, the requirement is retained, the standard should be altered so that the bank actually "believes" that the information is no longer accurate. At the very least, the Department should provide clarification with respect to this standard. It is not clear what affirmative obligation the covered financial institution has to ensure that the information it received from a foreign bank continues to be complete and accurate. For example, a financial institution's obligation could be phrased in terms of "reason to believe upon receipt of credible evidence".

g. Safe harbor

The Proposal contemplates that the safe harbor will only be available to covered financial institutions that obtain certifications from foreign banks that are complete and in proper form.

The Clearing House urges the Department to provide that a covered financial institution should not forfeit its safe harbor protection with regard to a certification that contains a minor omission, such as a failure to include the electronic mail address or facsimile number of the agent designated to accept service of legal process.

h. Use of the model certification appended to the Interim Guidance

The Clearing House seeks affirmative confirmation from the Department that a covered financial institution will be deemed to be in compliance with Sections 313 and 319(b) of the Act if it requests a foreign bank to provide the information described in the Interim Guidance, i.e., pursuant to the model certification appended thereto, up to 30 days after publication of the final rule, and the foreign bank provides such information within 90 days after publication of the final rule.

i. The form of the model certification and the model recertification

The Clearing House wishes to point out the following minor issues with regard to the form of the model certification and model recertification:

(i) In paragraph 3 of the model certification, the phrase "voting shares or other voting interests" and the phrase "voting securities and other voting interests" are used inconsistently. 66 Fed. Reg. at 67470.

(ii) The prohibition against the use of a post office box as an address for the owner of a foreign bank in Annex II of the model certification does not take into account the fact that in some jurisdictions there is an absence of formal and even informal street addresses with names and/or numbers, and that post office boxes may be the only method of delivering correspondence.

(iii) With regard to the designation of an agent to accept service of legal process in the model certification, the Clearing House seeks clarification as to whether the designation of an embassy, consulate or consulate general would be acceptable.

(iv) In the model recertification, the statement "I, ________________ (name), certify . . ." should be amended to read "I, ______________(name), certify that I have read and understand this Certification and that the statements made in this Certification are true and correct."

2. Termination of Correspondent Accounts

a. Effective dates

The Clearing House believes that the effective dates set forth in the Proposal with regard to the termination of correspondent accounts should be extended. According to the directive from the Department under the Interim Guidance (66 Fed. Reg. at 59343), covered financial institutions have accorded priority to requesting certifications from foreign banks for which they maintain correspondent deposit accounts or equivalent accounts.

The definition of "correspondent account" will only be finalized upon publication of the final rule and may, depending on the breadth of such definition, require covered financial institutions to obtain certifications from an exceedingly large foreign bank customer base. The effective dates with regard to the closure of correspondent accounts set forth in the Proposal may therefore not afford covered financial institutions enough time to obtain certifications from all foreign banks for which they maintain "correspondent accounts" (as defined in the final rule). This is true, especially with regard to the 90-day period allowed for receiving certifications related to existing correspondent accounts. The Clearing House believes that this period does not allow covered financial institutions sufficient time to review their account records and to identify foreign banks for which they maintain correspondent accounts. The Clearing House respectfully requests that covered financial institutions be allowed 120 days to obtain certifications with regard to existing correspondent accounts. As an alternative to extending the effective dates with regard to the closure of correspondent accounts, the Department may wish to issue guidance, well in advance of publication of the final rule, with regard to the breadth of the definition of "correspondent account."

b. New correspondent accounts

With regard to correspondent accounts established after the date that is 30 days after publication of the final rule, the Clearing House believes that the Department should not shorten the period for obtaining certifications from foreign banks if the correspondent account was established after December 31, 2002 (from 60 days to 30 days).

It is even less clear, with regard to verification of previously provided information, why the Proposal affords covered financial institutions more time to obtain verifications from foreign banks of previously provided information if the correspondent account was established prior to January 1, 2003 (90 days), than if the correspondent account was established after December 31, 2002 (60 days).

c. The meaning of the phrase "the information described in the model certification"

The Proposal provides that a covered financial institution that does not obtain, from a foreign bank or otherwise, the information described in the model certification, must terminate, within the prescribed time periods, all correspondent accounts that it maintains for such foreign bank. 66 Fed. Reg. at 67467. The Clearing House believes, and requests the Department to confirm, that this phrase properly refers to only the substantive portions of the model certification which track the statutory requirements of Sections 313 and 319(b), namely, the actual certifications regarding (i) shell banks and owners of the foreign bank in paragraphs 1, 2 and 3 and (ii) the designation of agent for service of process in paragraph 4. The severe measure of terminating the correspondent account is not warranted if the covered financial institution has obtained all the required substantive information, but omits an administrative or procedural provision, such as the 30 day notification requirement.

3. Definitions

a. The definition of "affiliate"

In the preamble to the Proposal, an "affiliate," for purposes of the definition of a "regulated affiliate," is defined as "a foreign bank that is controlled by or is under common control with a depository institution, credit union, or foreign bank." 66 Fed. Reg. at 67462. In proposed Section 104.10(j)(2)(i), an "affiliate" is defined as "any company that controls, is controlled by, or is under common control with another company." 66 Fed. Reg. at 67466.

The Clearing House believes the definition of "affiliate" contained in the preamble to the Proposal to be the more appropriate definition, as it is identical to the definition of "affiliate" contained in Section 313 of the Act (31 U.S.C. § 5318(j)(4)(A)). We respectfully request that the Department resolve this ambiguity by amending the definition of "affiliate" in proposed Section 104.10(j)(2)(i) to correspond to that contained in the preamble to the Proposal and Section 313 of the Act.

b. The definition of “foreign bank”

The Proposal excludes from the definition of “foreign bank” certain international financial institutions identified by name, and also “similar international financial institutions of which the United States is a member or as otherwise designated by the Secretary of the Treasury.” 66 Fed. Reg. at 67466. The Clearing House urges the Department to set forth a similar procedure for designating other financial institutions that do not fall within the definition of foreign bank.