American Bankers Association
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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

By e-mail to baselcommittee@bis.org

Sound Management of Risks Related to Money Laundering and Financing of Terrorism

Dear Sir or Madam:

The American Bankers Association (ABA)[1] appreciates the opportunity to offers comments on aspects of the consultative document, "*Sound Management of Risks Related to Money Laundering and Financing of Terrorism,*"[2] published by the Basel Committee on Banking Supervision (the Committee) earlier this year.

ABA agrees with many of the points raised in the paper, and where ABA agrees with recommendations in the consultative paper, we have not offered specific opinions. Instead, we offer suggestions or recommendations where changes to the paper will help improve the final outcome. We hope that the Committee will take our comments into consideration as it makes adjustments.

Introduction & Background

On February 16, 2012, the Financial Action Task Force (FATF) published updates to the "*International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*" (the FATF Recommendations).[3] In accordance with the work done by FATF, the Committee proposes further guidelines for sound management practices to address potential risks of money laundering and terrorist financing. At the same time, and in drafting these guidelines, the Committee also affirms its support for the March 2013 FATF Financial Inclusion Guidance,[4] which "focuses on ensuring that AML/CFT (Anti-Money Laundering/Combating the Financing of Terrorism) controls do not inhibit access to well regulated financial services for financially

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees,
[2] http://www.bis.org/press/p130627.htm
[3] http://www.fatf-gafi.org/topics/fatfrecommendations/documents/internationalstandardsoncombatingmoneylaunderingandthefinancingofterrorismproliferation-thefatfrecommendations.html
[4] http://www.fatf-gafi.org/documents/guidance/revisedguidanceonamlcftandfinancialinclusion.html

excluded and underserved groups, including low income, rural sector and undocumented groups." While other financial institutions such as broker/dealers are subject to ML/FT risk management requirements, the focus of the consultative paper is commercial banks.

ABA Position

ABA has three primary concerns about the current draft of the consultative paper that we urge the Committee to address:

- In paragraphs 13 & 14, there should be greater recognition of FATF's endorsement to use risk assessment to prioritize an institution's resources to the highest risks while allowing less burdensome and more simplified measures to manage lesser risks. We recommend that the final version of the consultative paper clearly reflect the relationship between resource allocation and risk.

- In paragraphs 32 through 41, the expectation that institutions determine beneficial ownership of legal entities should be explicitly limited to the availability of such information from the governmental authority that creates the legal entity. We recommend that the final consultative paper acknowledge the role government authorities play in maintaining this information while also recognizing that banks should not be responsible for unavailable or unverifiable information.

- In paragraphs 60 through 80, we urge revisions to encourage government agencies to commit affirmatively to respecting cross-border enterprise risk management regimes and the internal data management processes they employ. ABA believes such a change is needed to enable banks to function without artificial barriers to prudent internal handling of enterprise information, including the secure exchange of suspicious activity reports within the enterprise. While banks should be encouraged to manage their records across borders, they should also have the flexibility to adjust their data management processes based on restrictions imposed by individual countries where a bank operates. Equally important, the final version of the consultative paper should emphasize the need for supervisors to observe these limitations.

Risk Management

In the latest update to the FATF recommendations, FATF expressly recognized that "there is more flexibility for simplified measures to be applied in low risk areas. This risk-based approach will allow financial institutions and other designated sectors to apply their resources to higher risk areas." Unfortunately, ABA does not believe that the consultative paper at paragraphs 12-14 captures this important endorsement of risk-based prioritization.

ABA has been a long-time proponent of a priority-focused, risk-based approach to managing AML/CFT obligations. AML/CFT compliance is viewed as an important tool in the international fight against terrorist financing and criminal activities. As law enforcement increasingly relies on

depository institutions to identify illicit activity, policymakers should reform legal and regulatory requirements to support law enforcement while minimizing unnecessary regulatory burdens. To this end, ABA empanelled leading bank experts to take a fresh look at the AML/CFT system to develop recommendations about how to reform practices that impose burden without producing commensurate law enforcement value.

The ABA panel issued its report, *A Framework for a New Partnership: Recommendations for BSA/AML Reform*,[5] which sets forth five key recommendations. Particularly noteworthy in this context is our Recommendation 2: Take a priority-focused approach to compliance. This recommendation incorporated FATF Guidance that stressed applying risk-based compliance to establish priorities for the use of resources and to legitimize the reasonable judgments of financial institutions in implementing efficient programs.[6] The FATF Guidance clearly states that, "[t]he principle is that resources should be directed in accordance with priorities so that the greatest risks receive the highest attention. The alternative approaches…can inadvertently lead to a 'tickbox' approach with the focus on meeting regulatory needs rather than combating money laundering or terrorist financing."[7]

Accordingly, we have been particularly encouraged by the interpretive note to FATF Recommendation One at paragraph 1 that reads: "By adopting a risk-based approach, competent authorities, financial institutions and DNFBPs should be able to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified, and would enable them to make decisions on how to allocate their own resources in the most effective way."[8]

To reflect properly the revised FATF Recommendations, the consultative paper's description of the risk-based process must recognize and affirm that risk assessment provides the foundation for the legitimate purpose of effectively prioritizing risk as well as affirming that risk assessment should apply to the allocation of resources across different levels of risk.

Furthermore, we believe that the consultative paper needs to place greater emphasis on risk assessment if the Committee wants to incorporate adequately FATF Interpretive Note to Recommendation One at paragraph 8 which states that,"[t]he nature and extent of any assessment of money laundering and terrorist financing risks should be appropriate to the nature and size of the business. Financial institutions and DNFBPs should always understand their money laundering and terrorist financing risks, but competent authorities or SRBs may determine that individual documented risk assessments are not required, if the specific risks inherent to the sector are clearly identified and understood." ABA also strongly urges including this express recognition that the nature of the assessment process appropriately varies across the nature and size of the institution and that formal documentation is not to be elevated over functional adequacy.

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[5] http://www.aba.com/Compliance/Pages/CCBSA.aspx. See Recommendation 2 at pp. 11-17.

[6] *See*, FATF Guidance on the Risk-Based Approach to Combatting Money Laundering and Terrorist Financing—High Level Principles and Procedures, June 2007, ¶¶ 1.2, 1.3, 1.7, 1.14, 1.21 and 1.22. http://www.fatf-gafi.org/documents/documents/fatfguidanceontherisk-basedapproachtocombatingmoneylaunderingandterroristfinancing-highlevelprinciplesandprocedures.html

[7] Id at ¶ 1.7.

[8] DNFBPs are Designated Non-Financial Businesses and Professions

Where, as here, the governing authorities represented by FATF preserve both supervisory and institutional latitude, it is particularly important for the consultative paper to support the validity of this permissible discretion. Accordingly, ABA requests that paragraphs 12-14 be revised to recognize these important FATF-endorsed elements of the risk-based system.

Beneficial Ownership: Identification, Verification & Risk-Profiling

ABA generally agrees with paragraph 33 that banks should adopt appropriate steps to identify and verify the identity of customers. ABA also agrees with the premises set forth in paragraph 34 on the expectations for documentation and sources used to verify that information. However, it is extremely important to recognize also the additional factors that apply when a customer is a legal entity. When a customer is a legal entity, government authorities have a critical role to play, especially since it is the government which creates these legal entities. Therefore, the consultative paper would be lacking if it did not also recognize that government authorities that create these legal entities have a responsibility to maintain the necessary information about those entities.

ABA believes the revised FATF Recommendations recognize this central role played by governing authorities in identification and verification of beneficial ownership. In paragraph 5 of the Interpretive Note to FATF Recommendation 10, FATF lists public registrars as a reliable source for verifying beneficial ownership. At the same time, the interpretive note acknowledges the role played by national public stock exchanges in ensuring transparency, which in turn eliminates the need for otherwise burdensome identification and verification of corporate beneficial ownership. These underscore the role that government authorities play in the beneficial ownership process.

If governing authorities fail to collect and maintain this information, the burden should not shift to banks. ABA opposes any supervisory expectation that banks identify and verify beneficial ownership information that the government failed to collect or to make available. ABA urges the Committee to revise the consultative paper at paragraph 33 to limit expressly the expectation that financial institutions ascertain beneficial ownership of a legal entity to obtaining the information available from the governing authority that created the entity and makes readily available to financial institutions.

Cross-Border Enterprise Risk Management

ABA agrees with the underlying premise in Section III of the consultative paper (AML/CFT in a group-wide and cross-border context) that banks which operate in multiple jurisdictions should maintain a global process for managing customer risks. As provided in paragraph 61, consolidated risk management means establishing and administering a centralized process around a consistent and comprehensive baseline, and a bank should have robust information sharing among the head office and all of its branches and subsidiaries. It also is important to recognize that this should not artificially restrict sharing information simply because that

information is contained or presented in an official report form, and it should be permissible for banks to share the official copies of reports internally. Unfortunately, it is not clear that the consultative paper adequately acknowledges that restrictions and limitations imposed by individual countries can interfere with efficient risk management processes. Since it is not unusual for local jurisdictions to have laws or regulations which inhibit or serve as a barrier to an effective group-wide enterprise management program, ABA urges the Committee to support steps that will eliminate these barriers.

ABA welcomes paragraph 63 of the consultative paper since it recognizes "that implementing group-wide AML/CFT procedures is more challenging than many other risk management processes." However, to that end, we question whether the provisions of paragraphs 75 and 77[9]adequately facilitate the steps banks need in order to create efficient and secure cross-border, enterprise-wide AML risk management programs. ABA recommends that the consultative paper be revised to recognize explicitly the obligation imposed by international legal protocols in seeking institutional information.

We also agree that cross-border information sharing is critically important to the risk-management process, and ABA believes that the Committee can play a vital role in facilitating this effort. First, in accordance with the recommendation in paragraph 63 that permits financial institutions to share information internally, it is important that the consultative paper encourage the development of centralized data, as noted in paragraph 71. At the same time, it is equally important to ensure that privacy is properly protected, as specified in paragraph 75. To achieve this goal and balance these recommendations, the consultative paper should clarify that government access to a financial institution's enterprise-wide AML data repository is not available to the country where the database is located solely because that is where the data is housed. Instead, the consultative paper should make clear that individual jurisdictions only have access to information which applies to transactions which occur within that jurisdiction and are subject to its reporting requirements; access to any other information must follow accepted international protocols. Otherwise, the ability of financial institutions to establish centralized information systems is impractical and far too risky, undermining the goal of the consultative paper.

Beyond protecting centralized databases from inappropriate access, the consultative paper also should encourage local jurisdictions to take steps to identify and eliminate unnecessary restrictions that inhibit or needlessly burden information sharing. For example, while paragraphs 63 and 67 support information sharing with the head office, in order to facilitate effective information sharing, the consultative paper also should promote information sharing with other branches and offices within the financial institution, subject to appropriate security measures. This will help ensure a truly robust enterprise-wide risk-management program.

[9]Paragraph 75 addresses the need for a bank's group-wide policies to take into account local data protection and privacy laws and regulations, while paragraph 77 addresses the need for banks to respond to requests from law enforcement, supervisors, and financial intelligence units (FIUs) for information about customers.

Conclusion

ABA appreciates the opportunity to express our views and concerns regarding the consultative paper. As an addendum to these comments, we have provided additional thoughts on other aspects of the paper for the Committee to consider.

Sincerely,

Robert G. Rowe, III
Vice President & Senior Counsel

Addendum – Additional Comments

Three Lines of Defense exist to protect the bank from ML/FT risk

In paragraphs 18 and 19, the consultative paper points to business units and front line personnel, the employees who engage in customer-facing activity, as the first line of defense against ML/FT risk. To that end, the consultative paper recommends that banks have adequate policies and procedures for screening prospective and existing staff to ensure high ethical standards and that all employees should undergo appropriate training.

ABA agrees that individual banks should clearly set expectations for their employees, but it is equally important that regulatory expectations for the industry be clearly stated so that supervisory expectations are fully transparent.

The second line of defense the consultative paper identifies in paragraphs 20 through 23 is the chief AML/CFT officer. The consultative paper creates expectations that the chief AML/CFT officer should be responsible for ongoing monitoring and fulfillment of all AML/CFT duties of the bank, serve as the main point of contact for all AML/CFT issues, be responsible for reporting suspicious transactions and have sufficient resources to carry out the function. ABA agrees with paragraph 20 that the AML/CFT officer should be both the main point of contact and the person who has overall responsibilities for AML/CFT compliance. As expectations expand, though, an institution should not be limited to assigning the entire responsibility to a single individual. For example, the expectations the consultative paper creates for the chief AML/CFT officer place a heavy burden on a single individual. Therefore, the final consultative paper should recognize that a properly structured compliance team is fully appropriate to meet this expectation.

The consultative paper also recommends in paragraph 21 that business units should "in no way be opposed to the effective discharge of the…responsibilities of the chief AML/CFT officer," with procedures to resolve conflicts at the highest level. ABA concurs, and since this is a very important point, it should be retained in the final consultative paper. ABA also recommends that the paragraph acknowledge the role and importance of the corporate culture of compliance.

The third line of defense identified by the consultative paper in paragraph 24 is internal audit. Clearly, internal audit plays an important role, but external auditors should also receive greater acknowledgment in the final consultative paper. The current version does acknowledge that external auditors may play a role, as set forth in paragraph 25. However, as regulatory expectations have increased and the demands for resources needed for AML/CFT compliance have steadily grown, the ability to rely on external experts or auditors is an important option to have available, if desired. Therefore, ABA recommends paragraph 25 be revised to recognize that external auditors are as competent as internal auditors, a step especially important for smaller institutions in the United States that frequently need to rely on outside expertise.

Customer Acceptance Policy

Paragraphs 30 and 31 of the consultative paper recommend that banks develop and implement clear customer acceptance policies that identify customers likely to pose higher risk, using basic due diligence for all customers but enhanced due diligence as risk increases. However, these policies should not be so restrictive that they deny access, "especially for people who are financially or socially disadvantaged." Finally, the consultative paper recommends that policies also identify when an account will not be opened or an existing account terminated.

ABA agrees but also urges the Committee to acknowledge that individual institutions have the latitude to establish acceptable risks coordinated with the institution's own risk tolerance levels. While risk identification is an important step, it also is important to recognize that part of an effective risk management program is to mitigate risks through proper controls. Ultimately, supervisory authorities should focus on residual risk.

ABA also agrees with paragraph 31 that the level of due diligence should be commensurate with the risk. Periodic revisions to the assessment along with regular monitoring of customer activity should be sufficient to alert an institution to the need to adjust the risk assigned to an individual customer or group of customers. While ABA agrees it is appropriate for financial institutions to have policies for refusing or closing accounts, it is also important to underscore that these decisions should be handled by an individual institution based on its own risk tolerance. Further, when law enforcement asks an institution to maintain an account for investigation, the law enforcement agency should provide appropriate documentation to support that action.

Reliance. Although paragraph 40 of the consultative paper acknowledges that an initial deposit transferred from another bank subject to similar AML requirements may provide some comfort, each individual bank should conduct its own due diligence. While ABA agrees that each bank should be responsible for its own AML/CFT compliance, ABA also recommends that paragraph 40 be revised to encourage opportunities for banks to rely on introductions from other financial institutions to a greater extent, consistent with FATF Recommendation 17. With the constant demands on limited resources, it seems unnecessary to duplicate customer due diligence already conducted by another financial institution, especially where the other financial institution is subject to similar AML/CFT expectations. The real focus for financial institutions should be the point of entry into the financial system. Once a customer has entered the financial system, the focus should shift to appropriate due diligence on the correspondent introducing the customer, with the understanding that all banks still must be sensitive to possible red flags associated with any customer.

Anonymous of Fictitious Names. Similarly, as set forth in paragraph 41, ABA agrees that a bank should not open an account for a customer who insists on anonymity or gives a fictitious name. However ABA urges this paragraph be revised and clarified to explain the precise intent of the Committee. For example, legal entities by their nature have fictitious names as a matter of course. The distinction must be clearly delineated between legitimate fictitious names created to identify a legal entity and those which are created to obscure criminal activity. Similarly, the element of anonymity needs better explanation, since there are times when a customer may have very legitimate reasons for maintaining certain levels of privacy or confidentiality; as long as the

bank has all the appropriate information about the customer, it should be recognized that the bank may keep the information about a customer's true identity confidential.

Reporting of Suspicious Transactions and Asset Freezing

As set forth in paragraph 53, ongoing monitoring and account review help banks identify suspicious activity, eliminate false positives, and promptly report genuinely suspicious transactions, so the process for identifying, investigating and reporting suspicious transactions should be clearly specified in the bank's policies and procedures and communicated to all personnel through regular training.

ABA agrees that banks should strive to identify suspicious transactions as accurately as possible. However, it is an unrealistic goal to expect that banks can eliminate false positives entirely. Total elimination of false positives is far beyond the capability of any reasonable system. The consultative paper should be changed to reflect a more realistic goal of reducing false positives to manageable levels

Similarly, paragraph 47 provides that banks should screen customers against sanctions lists when there are changes to the list. ABA believes this should be revised to recommend screening be conducted *as appropriate*. In the United States, changes to the sanctions lists issued by the federal government are constant – sometimes occurring daily – and the most efficient and effective use of resources is to screen the customer database against the changes and not repeatedly against the entire sanctions list.

Management of Information

ABA agrees with paragraphs 48 through 50 that banks should ensure that information obtained in the context of CDD is recorded and that banks should develop and implement clear rules for records needed to document due diligence on customers and individual transactions. While information should be maintained, the consultative paper also should be revised to clarify that it is unnecessary to retain *all* information on *every* customer, particularly for retail customers that present minimal risk. ABA believes that the expectations for record-keeping requirements should be flexible as long as information needed by supervisors or law enforcement is available. The collection of data also must be balanced against the needs to comply with data security and privacy mandates, as laid forth in paragraph 75.

While the Committee recommends time limits for data retention, as it does in paragraph 49, ABA urges the Committee to revise the consultative paper to acknowledge that setting specific timeframes is the role of individual jurisdictions. For risk management purposes, and to avoid confusion, it also would be helpful for the consultative paper to provide that the term for retention should clearly specify when the term begins. For example, when retaining customer identification information, guidelines or expectations must articulate whether that term begins with the creation of the customer relationship or the termination of the customer relationship, since those are two very distinct and possibly distant points of time.