



INDEPENDENT COMMUNITY
BANKERS of AMERICA®

JACK A. HARTINGS
Chairman
REBECA ROMERO RAINY
Chairman-Elect
R. SCOTT HEITKAMP
Vice Chairman
PRESTON KENNEDY
Treasurer
J. MICHAEL ELLENBURG
Secretary
JOHN H. BUHRMASTER
Immediate Past Chairman
CAMDEN R. FINE
President and CEO

January 25, 2016

Financial Crimes Enforcement Network
Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183

Re: RIN 1506-AB25 Notice of Availability of Regulatory Impact Assessment and Initial Regulatory Flexibility Analysis Regarding the Customer Due Diligence Requirements for Financial Institutions

Dear Sir or Madam:

The Independent Community Bankers of America¹ (ICBA) appreciates the opportunity to comment on the Financial Crimes Enforcement Network's (FinCEN's) Regulatory Impact Assessment (RIA) and Initial Regulatory Flexibility Analysis regarding the Customer Due Diligence (CDD) Requirements for financial institutions.

Summary of ICBA Position

More information and data is needed to accurately assess the regulatory impact of FinCEN's proposed CDD rule and ICBA urges FinCEN to seek additional comments on the estimated costs and benefits of the proposed rule. ICBA believes that the compliance cost estimates in FinCEN's RIA are significantly understated and additional data needs to be collected and analyzed for a more accurate estimate. FinCEN's compliance cost estimates are based on a very limited industry sampling. Collecting data from a broader sampling of financial institutions would provide FinCEN with a more accurate estimate of compliance costs.

Additionally, several elements required to comply with the CDD rule are not included in the compliance costs. For example, the RIA does not include the

¹ The Independent Community Bankers of America®, the nation's voice for more than 6,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. With 52,000 locations nationwide, community banks employ 700,000 Americans, hold \$3.6 trillion in assets, \$2.9 trillion in deposits, and \$2.4 trillion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

The Nation's Voice for Community Banks.®

WASHINGTON, DC ■ SAUK CENTRE, MN ■ NEWPORT BEACH, CA ■ TAMPA, FL ■ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

costs of verifying the identity of each beneficial owner, assessing the risks associated with each beneficial owner, and conducting ongoing due diligence – all elements necessary for a comprehensive and effective CDD program consistent with a bank’s existing customer identification program (CIP) practices.

ICBA also questions the methodology used in assessing the benefits of the CDD rule and urges FinCEN to conduct a more thorough assessment. As stated in the RIA, FinCEN relies on literature on the economics of crime to estimate benefits since there is insufficient information available to FinCEN for an accurate determination.

As a fundamental premise, FinCEN asserts several benefits to our society and individual fraud victims if crime and terrorist financing are reduced as a result, theoretically, of the proposed CDD rule. However, the benefits provided in the RIA would more appropriately apply to a country whose government uniformly and consistently collects beneficial ownership information to reduce illicit activity – not to the limited collection of beneficial ownership information by one private industry sector, the financial services sector. Such a premise is based on a faulty foundation.

The list of alternatives to the proposed CDD rule discussed in the RIA does not consider all probable options. For instance, a sound alternative that would more effectively achieve the agency’s goals with a less costly impact to financial institutions would be for beneficial ownership information to be collected and verified at the time a legal entity is formed. Collecting and verifying the identity of all natural person owners of each entity by the Internal Revenue Service or other appropriate federal agency and/or state in which the entity is formed would provide uniformity and consistency across the United States. Furthermore, information regarding beneficial owners could be more easily shared between law enforcement and government agencies than between banks and law enforcement.

Background

By way of background, on August 4, 2014, FinCEN published a Notice of Proposed Rulemaking on CDD requirements for financial institutions that would amend its existing rules so that each of the key elements of CDD is explicitly referenced in a corresponding requirement within its program rules.

The proposed rule stated that the core elements of CDD would include:

- identifying and verifying the identity of customers;
- identifying and verifying the identity of beneficial owners of legal entity customers (i.e., the natural persons who own or control legal entities);
- understanding the nature and purpose of customer relationships; and
- conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions.

The Nation’s Voice for Community Banks®

WASHINGTON, DC ■ SAUK CENTRE, MN ■ NEWPORT BEACH, CA ■ TAMPA, FL ■ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

Because the first element is already required under the existing customer identification program (CIP) rule, FinCEN proposed two rule changes that would have explicit requirements with respect to the three remaining elements. As such, FinCEN proposed adding explicit CDD requirements with respect to understanding the nature and purpose of customer relationships and conducting ongoing monitoring as components in each covered financial institution's core AML program requirements. FinCEN also proposed a new separate requirement to identify and verify the beneficial owners of legal entity customers, subject to certain exemptions.

Based on comments and information received on the proposal, FinCEN determined that the implementation and compliance-related costs may exceed \$100 million annually, making this rulemaking an "economically significant regulatory action." As a result, FinCEN must conduct an RIA.

Estimated Costs under the CDD Rule

In its RIA, FinCEN quantifies certain costs to financial institutions and their clients and estimates that first-year compliance costs would range from roughly \$95 million to \$220 million and subsequent years would see training costs falling. ICBA disagrees with this conclusion and believes more time is needed to collect and analyze data.

To begin, FinCEN's compliance cost estimates were based on an extremely limited industry sampling.² To thoroughly and accurately measure compliance costs for such a complex rule, collecting vast amounts of data from many financial institutions of different sizes, organizational structures and business models would be necessary.

There are many elements necessary to accurately measure the cost-benefit analysis of this proposal. For example, and as ICBA stated in our original comments, although FinCEN's proposal enables banks to generally rely on the representations of the customer when answering the financial institution's questions about the natural persons behind a legal entity, the proposal would still require bank employees to have some advanced business acumen in order to understand and determine to whom the definition applies. Such an undertaking would require extensive training for bank employees in front-line positions. Additionally, there is often a higher rate of turnover with these positions, which may not reduce training costs in subsequent years as substantially as the RIA assumes.

The RIA also estimates that the additional time necessary to open each account would take between 15 to 30 minutes. The additional time is used to calculate the additional costs to financial institutions under the proposed CDD rule. ICBA strongly questions this conclusion and suggests that more data is needed to

² Reports indicate FinCEN consulted only three small financial institutions out of the 13,000 affected small entities.

determine the costs of opening accounts under the CDD rule. For example, it appears the RIA does not take into account the additional time it would take to verify the identity of each beneficial owner of each new business account opened.

Comprehensive and effective customer due diligence necessitates that a bank verify a customer's identity; assess the risks associated with that customer; and conduct ongoing due diligence. This standard does not diminish when accounts are opened for legal entity customers. In fact, FinCEN expressly states that financial institutions would be required to verify the identity of beneficial owners consistent with their existing CIP practices.

This would require bank front-line staff to conduct several additional intermediate steps during the account-opening process to ensure they have a reasonable belief they know the true identity of each beneficial owner, which would add significantly more time to each business account being opened.

Additionally, often times all beneficial owners are not present to open an account. Rather, businesses are likely to send a designated representative to complete the account-opening process and consequently, no beneficial owners are present. As such, banks would need to rely on nondocumentary methods to verify each beneficial owner's and executive officer's identity. Nondocumentary methods may include contacting a customer, independently verifying the customer's identity through the comparison of information provided by the designated representative with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; and obtaining a financial statement.³ Such a process would take significantly more time than the RIA concluded.

Furthermore, the RIA does not include the significant costs to financial institutions to maintain and update the equity interests and management team of each legal entity customer on an ongoing basis, which would place a significant burden on community banks and other financial institutions.

While the proposal does not specifically require banks to update or refresh periodically the beneficial ownership information obtained, as a general matter a bank should keep CDD information, including beneficial ownership information, as current as possible and update as appropriate on a risk basis. Moreover, the maintenance of current beneficial ownership information would likely become a requirement imposed by prudential regulators over time.

The CDD proposal adds to the existing core provisions a fifth pillar that included understanding the nature and purpose of customer relationships *and conducting ongoing monitoring*. In this context, conducting ongoing monitoring to maintain and update customer information is included as a key element and must be

³ FIEC BSA/AML Examination Manual, Customer Identification Program, Verification Through Nondocumentary Methods.
Page 55

complied with at a fundamental level. In fact, the requirement to conduct ongoing monitoring to maintain and update customer information expressly imposes a requirement to maintain and update customer information on an ongoing basis.

The costs to financial institutions to conduct ongoing monitoring not only to customer transactions, but more broadly to update investor, indirect equity owners, and the management teams of every business account regardless of how low of a risk it imposes would be extraordinary – yet not even mentioned in the RIA.

Similarly, the RIA neglects to include the additional time it would take bank staff to complete Suspicious Activity Reports (SARs) to include beneficial owner information. In its report, FinCEN concludes that SARs filed by financial institutions would increasingly include beneficial ownership information and that SARs with such information would grow over time as the share of accounts whose beneficial ownership information is disclosed gradually rises. While adding such information to each SAR is not substantial individually, as the beneficial ownership information available to the bank grows, and the number of SARs with such information increases, the time it takes to complete a SAR also increases.

Estimated Benefits with the CDD Rule

As with the analysis of the costs associated with the CDD rule, ICBA questions the methodology used in assessing the benefits of the CDD rule and urges FinCEN to conduct a more thorough assessment. To begin, there is not enough information available to FinCEN for an accurate determination of the benefits of the rule. As described in the RIA, “none of the benefits of the proposed rule, in terms of reducing crime, can be measured with sufficient accuracy at this time to warrant quantitative assessment.” As a result, FinCEN relies on literature on the economics of crime and relies on a body of work pioneered by Gary Becker.⁴

While such reliance may be a useful tool in estimating benefits, it is unclear whether Becker’s model is the appropriate method in this case. We ask that FinCEN seek additional comments and information from its stakeholders in evaluating Becker’s model to determine if such a model is the appropriate mechanism for measuring the benefits of the CDD rule.

ICBA also questions the inclusion of potential benefits to society as a whole to offset the costs to a specific industry. For example, in its assessment, the RIA provided several benefits to our society, including benefits to individual fraud victims by way of reduced stress, anger, pain and suffering. The RIA included the value of harm to victims averted by the reduction in crime and terrorist financing. This premise suggests that there is a causal effect between the CDD rule, as proposed, and the prevention of harm to victims. However, it has not

⁴ Regulatory Impact Assessment for FinCEN Notice of Proposed Rulemaking: “Customer Due Diligence Requirements for Financial Institutions.” Docket No. FinCEN-2014-0001, P16.

been established that implementing the proposed CDD rule would reduce the very crimes and illicit activity that cause the health or emotional suffering the victims report. Such a premise is based on a faulty foundation.

Relying on one private industry sector to collect and maintain beneficial ownership information for all legal entities does not result in the benefits to society as the RIA claims. As technological advances are consistently improving and nonbank industries are developing, legal entities will not necessarily need to rely on the financial services sector to transfer or hold funds – illicit or otherwise. As such, the benefits to society as a result of the CDD rule are incorrectly skewed.

In fact, those benefits would more appropriately apply to a country whose government collected vast beneficial ownership information – not to the limited collection of beneficial ownership information by one private industry sector. Furthermore, those benefits would be more significant since beneficial ownership information would be more uniform and consistent.

Additionally, the RIA assumes that information collected and stored by financial institutions regarding beneficial owners could be easily shared with law enforcement and government agencies, thus providing overreaching societal benefits such as reduced crime and terrorist activity, increased asset recovery, and reduced intangible losses such as pain and suffering of fraud victims. However, privacy laws do not permit banks to share personal information with a government agency absent a subpoena or similar directive. The collection of beneficial ownership information would not provide the societal benefits listed in the RIA but rather from the continuation of existing BSA requirements such as risk-based customer due diligence and enhanced due diligence, suspicious activity reporting and information sharing.

Alternatives to the Proposed CDD Rule

The RIA discusses three alternative rules to the proposed CDD rule. The list of alternatives does not consider alternatives that would more accurately achieve the agency's goals with a less costly impact.

For example, the RIA does not consider collecting and verifying beneficial ownership at the time a legal entity is formed by other governmental agencies. Making the formation of an entity contingent on receiving beneficial owner information would create strong incentives for equity owners and investors to provide such information. Additionally, periodic renewal of an entity's state registration would provide an efficient and effective vehicle for updating beneficial ownership information.

Furthermore, collecting and verifying the identity of all natural person owners of each entity by the Internal Revenue Service or other appropriate federal agency and/or state in which the entity is formed would provide uniformity and

The Nation's Voice for Community Banks.[®]

WASHINGTON, DC ■ SAUK CENTRE, MN ■ NEWPORT BEACH, CA ■ TAMPA, FL ■ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

consistency across the United States. Additionally, beneficial ownership information would not be limited to those entities opening a bank account. As stated previously, with technological advances and non-bank financial industries fast developing, legal entities may not necessarily rely on financial institutions to engage in illegal activities such as money laundering, corruption, fraud, or terrorist financing. Collecting beneficial ownership information from financial institutions alone would not address those entities relying on non-bank services for illicit activity.

ICBA urges FinCEN to analyze and assess additional alternatives that would be less burdensome to financial institutions.

ICBA appreciates the opportunity to comment on FinCEN's Regulatory Impact Assessment for its CDD proposal and urges further assessments and analysis with more collaboration from its stakeholders. If you have any questions, please do not hesitate to contact me at Lilly.Thomas@icba.org or 202.659.8111.

Sincerely,

/s/

Lilly Thomas
Vice President and Senior Regulatory Counsel

The Nation's Voice for Community Banks.[®]

WASHINGTON, DC ■ SAUK CENTRE, MN ■ NEWPORT BEACH, CA ■ TAMPA, FL ■ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

The Nation's Voice for Community Banks.[®]

WASHINGTON, DC ■ SAUK CENTRE, MN ■ NEWPORT BEACH, CA ■ TAMPA, FL ■ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org