

July 1, 2002

Judith R. Starr
Chief Counsel
Financial Crimes Enforcement Network
U.S. Department of the Treasury
Attn: Section 312 Regulations
P.O. Box 39
Vienna, VA 22183
regcomments@fincen.treas.gov

Attention: Section 312 Regulations of the USA PATRIOT Act

Dear Ms. Starr:

On behalf of Arab Banking Corporation ("ABC"), a bank operating under an offshore banking license granted by Bahrain, I am submitting these comments on the Section 312 Regulations of the USA PATRIOT Act (the "Proposed Regulations"), which have been proposed by the Financial Crimes Enforcement Network ("FinCEN").

The focus of this comment is the narrow scope of the exception to the enhanced due diligence requirements for offshore banks. ABC, as a bank with an offshore banking license, but subject to a supervisory and regulatory regime in Bahrain that is equal to that applied to domestic banks and to banks generally in other countries that are not subject to the enhanced due diligence required by Section 312 of the Act and by the proposed Regulations, is very concerned that the Act and the proposed Regulations unnecessarily subject it to the regime of enhanced due diligence by its correspondent banks. The concern is that this situation could seriously affect ABC's ability to do business with them, and thereby adversely affect its ability to serve the legitimate businesses of the Middle East. As a wholesale bank, ABC's correspondent banking relationships are crucial to its ability to carry out its international business activities.

ABC's choice of Bahrain as the banking center in which it is incorporated was not for the purpose of avoiding sound banking supervision and regulation, but is particularly a function of the part of the world in which it is located, the countries of the region that it is in business to serve, and the major governmental shareholders of the bank and their need to find a neutral place to establish a bank to serve the businesses of the region. Because Bahrain itself is a very small banking market, and it seeks to attract banks to Bahrain that will serve a much broader regional market, ABC does not have the choice of being able to serve the particular country in which it is located, but instead serves the wider region in which it is located.

ABC appreciates that the proposed Regulations recognize the problem posed by Section 312 for banks such as ABC. However, the solution proposed in Section 103.176(1)(1)(ii) does not establish a fair and useful standard for determining those banks that are subject to rigorous standards of banking supervision and regulation, particularly for anti-money laundering. This is because it only captures banks from those countries where there has been an application to the Federal Reserve to establish banking activities in the United States that has required the Federal Reserve to make a finding on consolidated home country supervision (“CCS”). We believe that the banking supervisory regimes in other countries, such as Bahrain, where no applications have been made to establish banking activities in the United States, have just as good supervisory regimes as those that have been found by the Federal Reserve to be subject to adequate CCS where such applications have been approved.

This comment explains the limitations of Section 103(c)(1)(ii), proposes possible alternative methods for establishing exemptions from the enhanced due diligence requirements, describes the banking supervisory regime in Bahrain as a country that meets consolidated home country supervision standards but has not been subject to such a determination by the Federal Reserve, and outlines the policies and practices of ABC in compliance with the bank supervisory regime in Bahrain and international banking standards. It concludes with a request that the Proposed Regulations be amended to permit more flexibility for a case-by-case determination of consolidated home country supervision that would allow exemption from the enhanced due diligence requirements of Section 312.

The CCS Exception

Section 103.176(c)(1)(ii) of the Proposed Regulations provides that the enhanced due diligence provisions do not apply if a bank does not fall within paragraph (c)(2) or (3) and if the bank "has been found, or is chartered in a jurisdiction where one or more foreign banks have been found by the Board of Governors of the Federal Reserve System under the Bank Holding Company Act or the International Banking Act, to be subject to comprehensive supervision or regulation on a consolidated basis by the relevant supervisors in that jurisdiction." For the purpose of this letter, the language quoted here is referred to as the "CCS Exception."

First, the CCS Exception is too exclusive a category. Only a narrow class of jurisdictions has been determined by the Federal Reserve to have comprehensive, consolidated supervision ("CCS"). As noted in footnote 9 of the Proposed Regulations, there are only 24 jurisdictions for which the Federal Reserve has made such a finding. Half of the countries on the list are European (Austria, Belgium, France, Germany, Greece, Italy, Ireland, the Netherlands, Portugal, Spain, Switzerland, and the United Kingdom). The remaining jurisdictions are: Canada, Mexico, Argentina, Brazil, Chile, Australia, Hong Kong Special Administrative Region, Israel, Japan, Korea, Taiwan, and Turkey.

Second, this narrow list of jurisdictions for which the Federal Reserve Board has made a CCS determination is randomly driven by an application process and not by consideration of the broader category of internationally active banks that have significant business in the United States and elsewhere and have correspondent accounts with U.S. banks. In fact, the Federal Reserve Board has only made CCS determinations when an application has been submitted to it by a bank in a particular country seeks to establish a branch in the United States or to acquire a

U.S. bank. If no foreign banking organization from a particular jurisdiction has filed an application with the Federal Reserve since 1991, when the CCS criteria was adopted, then the Federal Reserve has had no basis on which to make such a determination. Unless the Proposed Regulations are amended, there are many foreign banks from jurisdictions that could qualify for a CCS determination that will unnecessarily be subject to the enhanced due diligence requirements.

Proposed Options

Based on the foregoing, it is proposed that consideration be given to revising the CCS Exception. Three possible options for revising the CCS Exception are: (1) having the Treasury and/or the Federal Reserve Board make exceptions on an individual bank-by-bank basis using the criteria now employed by the Federal Reserve for making CCS determinations; (2) having the Treasury and/or the Federal Reserve Board make exceptions on a country-by-country basis; and/or (3) incorporating within the current CCS Exception those jurisdictions that are "actively working" to establish CCS. This latter option, taken alone, would only insignificantly expand the current list of countries that would be excepted from the enhanced due diligence program. Therefore, it is primarily proposed as a supplement to the other options.

ABC believes the fairest and most appropriate resolution of the limited scope of the CCS Exception would be to provide that the Treasury and/or the Federal Reserve Board, or one in consultation with the other, would be able to make determinations either on an individual bank basis or on a country-by-country basis that the enhanced due diligence program elements do not apply. If such an approach were adopted, then Arab Banking Corporation could apply to have such a determination made with respect to itself and/or Bahrain.

Moreover, the CCS Exception could be broadened to include those jurisdictions that are "actively working" to establish CCS. The International Banking Act of 1978, as amended, provides for two types of CCS determinations by the Federal Reserve Board.¹ The Proposed Regulation adopt the language of one of them.² However, the Board may also determine that the appropriate authorities are "actively working to establish arrangements for" consolidated supervision.³ In making such determination, the Federal Reserve Board considers the money laundering measures adopted by the country and the foreign bank.

The following countries have been determined by the Federal Reserve Board to be "actively working" to establish CCS: Egypt, Colombia, and Peru.⁴ Previously, Korea had been identified as "actively working" to establish CCS,⁵ but is now listed among those jurisdictions above as having CCS.

¹ 12 U.S.C. § 3105(d)(2) and (6) (2001).

² 12 U.S.C. § 3105(d)(2).

³ 12 U.S.C. § 3105(d)(6).

⁴ National Bank of Egypt, Cairo, Egypt, 87 F.R.B. 344 (2000); Banco de Credito del Peru Lima, Peru, 87 F.R.B. 708 (2001); Banco de Bogota S.A., Santafe de Bogota, D.E. (2001).

⁵ Kookmin Bank, Seoul, Korea, 87 F.R.B. 786 (2001) and 86 F.R.B. 291 (2000); Housing & Commercial Bnak, Seoul Korea, 83 F.R.B. 935 (1997).

Bahrain is one example of a country that has a comprehensive regulatory system for banks and other financial institutions, but for which the Federal Reserve Board has yet to make any analysis of whether the Bahrain Monetary Agency provides CCS or is actively working to establish CCS.⁶ The purpose of the following description of the measure of supervision and regulation of banks in Bahrain is to show that there are jurisdictions other than the short list of 24 that should be given due consideration for inclusion within the CCS Exception.

Supervision and Regulation of Banks by the Bahrain Monetary Agency

Bahrain is widely recognized as a well-regulated international, financial center. There are approximately 180 banks and other financial institutions licensed in Bahrain, which engage in activities ranging from commercial banking, investment banking, Islamic banking and portfolio management to private banking.

The Bahrain Monetary Agency ("BMA") regulates all licensed banks, financial institutions and investment companies. Additionally, these institutions are subject to regulatory requirements of the Ministry of Commerce, the Ministry of Labor and Social Affairs, and the General Organization for Social Insurance. Also, all registered companies are subject to statutory requirements and regulated by the Bahrain Stock Exchange, if they are listed on the exchange. However, the BMA is the principal regulator for the Bahrain banking system.

The BMA is broadly divided into three major directorates: Management Services, Banking Operations, and Banking Control, which is divided into sub-directorates -- Banking Inspection, Banking Supervision, Financial Institutions Supervision, and the Licensing Information Unit.⁷ The Banking Inspection Directorate conducts on-site examinations, while the Supervision Directorate provides overall supervision, including through calculation and analysis of relevant banking ratios such as liquidity, capital adequacy, and profitability, based upon prudential reports, annual audited financial statements, and quarterly financial statements that it receives (discussed below). Additionally, the Supervision Directorate has regular meetings with senior management of the banks and other financial institutions that is supervises to understand, monitor, and control their activities.

The BMA is responsible for ensuring compliance with the banking law and regulations. It issues circulars to provide banks with best practices in international banking and to help ensure that such practices are implemented. For example, a BMA issued circular requires all banks to appoint a senior member of staff to the role of compliance officer. Another circular notified

⁶ In assessing CCS, the Federal Reserve Board typically considers five overlapping factors listed in Regulation K. 12 C.F.R. § 211.24(c). These factors are the extent to which the foreign bank's home country supervisor: (1) ensures that the bank has adequate procedures for monitoring and controlling its activities worldwide; (2) obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise; (3) obtains information on the dealings and relationships between the foreign bank and its affiliates, both foreign and domestic; (4) receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis; and (5) evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

⁷ The Bahrain Monetary Agency Law 23 of 1973 governs the administration and operation of the BMA.

banks that the BMA issued new prudential return forms to aid in its assessment of financial performance. The assessment includes capital adequacy, asset quality, earnings, and liquidity in accordance with international standards. Another circular informed banks that the BMA issued a framework for internal control systems parallel to those issued by the Basle Committee on Banking Supervision. The BMA evaluates each bank through prudential meetings and on-site inspections.⁸

Five key aspects of the regulatory system are: prudential reporting, annual audits, interim financial reporting, bank inspections, and anti-money laundering measures. Each is described in further detail below.

Prudential Reporting. First, banks are required to submit Prudential Reports on a quarterly basis, separately for both the parent company and the group. The report's format is dictated by the BMA and generally requires a balance sheet, profit and loss account, calculation of risk assets ratio,⁹ classification of loans and advances, investment portfolio, movement in provisions and interest in suspense, large exposures, liquidity analysis, maturity profile, and related party transactions. Additionally, the BMA has, on a regular basis, prudential meetings with the bank's senior management to address any issues that have been identified.

Annual Audits. Second, banks are required to conduct an annual audit of their accounts using external auditors, whose appointment must be approved in writing by the BMA. The annual audited financial statements are to be prepared according to International Accounting Standards and filed within three months from the financial year-end.

Interim Financial Reporting. Third, locally incorporated banks must submit interim financial statements on a quarterly basis to the BMA. The statements are to be prepared in accordance with International Accounting Standard 34, and they are required to be examined by external auditors. The interim financial statements include a balance sheet, statement of income, statement of changes in equity, statement of cash flows and selected explanatory notes. The BMA also dictates that banks must publish these statements in local newspapers within two months from the quarter end.

Bank Inspections. Fourth, banks are also subject to on-site examination by the Inspection Directorate of the BMA. The Inspection Directorate receives standard information from the banks prior to the examinations, including minutes of board meetings, minutes of committee meetings, internal auditor's reports, information on internal controls, and risk management reports. The inspection is based on the reports and the books of accounts, and then the inspection report is discussed with senior management and followed up for resolution of the issues. In addition, the BMA conducts on-site examinations of overseas branches of Bahrain based banks and holds discussions with regulatory authorities of these countries to address the required matters.

Anti-Money Laundering Measures. Fifth, Bahrain is represented at the Financial Action Task Force ("FATF") by the Gulf Coordination Council of which it is a member, and Bahrain is

⁸ The framework would be considered in factor five.

⁹ All banks are required to maintain a minimum risk assets ratio of 12%.

a party to the 1988 UN Drug Convention. Banks licensed by the BMA, including offshore banks, and branches and subsidiaries of locally incorporated banks operating in foreign jurisdictions, must comply with the January 2001 Money Laundering Regulation.¹⁰ Among other things, the regulation requires that the identities of all customers must be verified, and before opening an account for any individual, the bank must obtain and record various types of information, such as the individual's full name, address, date of birth, nationality, occupation, employer's name and address, as well as the individual's passport number. The regulation also requires banks to take steps to ensure that staff members report any transaction which may involve money laundering to the Money Laundering Reporting Officer ("MLRO"), who is an individual appointed at the bank to act as the focal point for oversight of all activity relating to anti-money laundering. Additionally, reports made to the MLRO are required, where appropriate, to be made available to the BMA. The BMA has provided a standard form to be completed by the MLRO, which calls for the name of the customer, the individual's date of birth, his occupation and his passport number, among other things.

Furthermore, the BMA has established guidelines for detecting suspicious activity. For instance, they provide that special attention should be given to persons (individuals and companies) from countries that are identified by FATF as being non-cooperative in combating money laundering. The regulation also provides that banks should refuse to enter into or continue a correspondent banking relationship with a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group (i.e., shell banks).

Furthermore, the regulation requires that banks maintain transaction documents for transactions with account holders and non-account holders for five years after the transaction was completed. A licensed bank is additionally required to maintain records that indicate the dates when anti-money laundering training was given and to whom it was given for at least five years.

Additionally, banks are subject to a new (January 2002) BMA regulation that seeks to help track terrorist funds. The regulation should aid banks in monitoring suspicious transactions related to terrorism, wire transfers, and alternative remittance systems.

Overview of Arab Banking Corporation

Arab Banking Corporation was incorporated as a Bahrain joint stock company on January 17, 1980, and the Bahrain Monetary Agency issued it an offshore banking unit license on April 7, 1980. Arab Banking Corporation was established with an authorized capital of \$1,000 million. In 1990, its authorized capital was increased to \$1,500 million pursuant to Amiri Decree No. 3 for 1990 and an amendment of its Memorandum & Articles of Association. Also in 1990, it listed its shares on the Bahrain and Paris stock exchanges.

Arab Banking Corporation has developed into a widespread network ("ABC Group") of branches, representative offices, subsidiaries and affiliates in over thirty countries. Among other places, it has bank offices in New York, Milan, and Singapore. Its branches concentrate

¹⁰ It also applies to moneychangers, mutual funds registered in Bahrain and investment advisers licensed by the Agency.

primarily on wholesale commercial and corporate banking and trade finance services, while the subsidiaries principally focus on the retail and merchant banking sectors. Additionally, its affiliates offer specialized financial services.

Arab Banking Corporation is subject to the regulation and supervision by the Bahrain Monetary Agency, which is described above legal and compliance division of the ABC Group is responsible for the Group's compliance with international regulatory and reporting requirements, while the Chief Internal Auditor is the liaison between ABC and the Bahrain Monetary Agency. The legal and compliance division also works with the in-house legal advisors of other ABC Group subsidiaries. Additionally, the planning and financial controls division ensures that ABC Group fulfills the financial reporting requirements of the Bahrain Monetary Agency, and an Internal Audit Group and external Auditors conduct an independent review of internal and financial controls. Arab Banking Corporation has also appointed a Compliance Officer as required by the Bahrain Monetary Agency to coordinate the Group in respect to matters involving regulations, reports, and other requirements of the Bahrain Monetary Agency.

Arab Banking Corporation strongly supports the efforts of the U.S. Government and other governments to combat money laundering and terrorism. It faithfully complied with an order of the Bahrain Monetary Agency that mandated the freezing of one account with the bank in the aftermath of terrorist attacks on September 11, 2001. The account frozen was one of an Islamic bank. Furthermore, Arab Banking Corporation maintains a comprehensive, up-to-date Money Laundering Manual. The manual includes definitions of money laundering and other related terms, establishes internal control procedures, describes the role of the Compliance Officer and Money Laundering Reporting Officer, sets forth the Know Your Customer policies and procedures (including customer identification requirements), and rules for monitoring suspicious activities. The manual also describes record keeping requirements (including reports submitted to senior management for review) and staff training requirements. New employees are given training on money laundering, and staff attend money-laundering training update sessions regularly. The head office's internal audit of subsidiaries and branches reviews compliance with the anti-money laundering procedures.

Conclusion

The brief overview of Arab Banking Corporation and bank regulation and supervision in Bahrain is intended to assist FinCEN in concluding that the Proposed Regulations under Section 312 of the USA PATRIOT ACT as currently proposed do not provide a sufficient mechanism by which international banks can be excepted from the enhanced due diligence requirements. Therefore, it is respectfully requested that alternatives to the CCS Exception outlined above be given further consideration and the language of Section 103.176(c)(1)(ii) be revised accordingly.

Please do not hesitate to contact me if you have any questions or comments. My direct phone number is (202)879-4697.

Sincerely,

Michael Bradfield